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Tiresome Subsidies – The Nuisance of Subsidies Distorting International Competition

Subsidies are not only a nuisance to the tax payer financing them but in a world economy in the process of integration they are also distorting competitive conditions. Most annoyingly it is not only impossible to abolish subsidies but, what is even worse, they are propagating themselves. Any competitive advantage the economy of a State with a propensity to subsidise obtains, gives the competitors in other countries an appetite for similarly generous support—a demand that in a pluralistic society will easily find a willing ear. In the following contributions our authors will try to give a survey of subsidisation in Federal Germany, France, the United States and Britain, and to answer the question of to what extent the subsidisation of certain economic branches is influencing competitiveness on an international level.

FEDERAL GERMANY: Doubtful Effects of Subsidisation

„In the modern State the whole world is endeavouring to live at the expense of the whole world.“ Frédéric Bastiat

Some time ago, Secretary of State Claussen, of the Federal Ministry of Labour and Social Affairs, proposed that a "Federal Association for the Victims of Subsidies" should be set up. "Victims of subsidies" are, in the first place, all consumers, with the exception of those engaged in agriculture, mining, the film industry and shipping; and, secondly, all those not yet receiving subsidies. However, as a sop, Claussen added that the latter has now become a minority group. Thirdly, recipients of subsidies are themselves victims, for they never receive sufficient and—in addition—their spirit of enterprise, and hence their ability to compete, is systematically destroyed.

It is not possible to describe in clearer terms the ambivalent attitude of far-reaching application, yet general rejection, which is characteristic of the subsidy controversy in the Federal German Republic. Although politicians brand subsidies as a "luxury we cannot afford" and a "cancer of democracy" and entrepreneurs are proudly aware of economic risks, the circles of those receiving subsidies in the Federal German Republic continues to increase and the demand for subsidies becomes more vociferous.

So far, the Federal German Republic has not shown any noteworthy resistance to this growing group demand although, in the preamble to the 1959 budget, it was stated: "In principle, subsidies are to be refused as being contrary to our system . . . Those who request on other than economic grounds should realise that the price which has to be paid for them is many times the actual subsidy requirement and that behind such subsidy measures there always lurks the danger of a progressive destruction of the market economy system."

Were the effects of subsidies felt only internally it would be possible to ignore them in the international dialogue as being a purely national problem. However, in a world economy whose tendency is more markedly towards integration, subsidies have increasingly important effects upon the external economy because they are used to an ever greater extent

as tools of commercial policy. As an economic instrument, "the subsidy", which attempts to boost the practical functions of certain branches and regions via restriction of imports and/or promotion of exports has taken the place of protectionist measures such as tariffs and quantitative import quotas.

An attempt is made below to establish the extent of the subsidies in the Federal German Republic and to examine whether the subsidy policy of the latter is in line with its aims. We consider here only those subsidies for the allocation of which external economic motives, as well as internal economic aspects, have been decisive (i.e. maintenance of international competitiveness, adjustment of capacity due to growing international links, aids to integration). This applies particularly to subsidies for agriculture, industry and, in part, to facilities for transport, although not to subsidies for housing or to financial assistance in the social sphere. Housing premiums, tax concessions for housing and advances for social insurance can therefore be ignored.

Volume of Subsidy Expenditure in the Federal German Republic

There is considerable difficulty in determining the public expenditure on subsidies in the FGR because comprehensive figures are available for the Republic only, but not for the Länder and districts. Hence, this article will consider merely Federal expenditure on subsidies, and financial assistance in the Länder budgets only where relatively reliable estimates are possible. On the other hand, it is not possible to take into account communal expenditure on subsidies because, in the main, these take the form of waiving negative transfers (tax concessions, cheap interest payments) and cannot be estimated by an outsider.

Expenditure on subsidies by the Republic and Länder is allocated in almost equal parts to overt and concealed concessions. In the category of overt concessions, i.e. direct financial aid, tax and customs rebates, claims arising from guarantees and the like, the most important item in the Federal budget for 1965 is agriculture, forestry and fishing, at DM 3,956

million. The figures for industry, at DM 565 million, and for transport (DM 489 million) are also high. All in all, overt financial assistance for agriculture, transport and industry from the Republic and Länder must amount to approx. DM 6,123.3 million. This means that in 1965 5.5% of all expenditure by the Republic and Länder was earmarked for overt subsidies. However, it is probable that the subsidy percentage in the public budget is very much higher because, in the first place, it is not possible to take account of communal subsidies; secondly, financial contributions and loans from special Federal funds (i.e. from ERP funds) are not included; and thirdly, expenditure for the adjustment of price differences on imports of foreign agricultural products is ignored.

It is only possible to determine the full extent to which the public budget is burdened by subsidies if negative transfers (tax concessions and cheap interest rates) are considered alongside overt financial assistance. Concessions on income tax, corporation tax, property tax, insurance, turnover and vehicle tax and for the various excise taxes alone amounted to approx. DM 7,016 million in 1965, i.e. 6.4% of the total expenditure of the Republic and Länder. Industry draws by far the greatest benefit from these tax concessions. DM 5,158 million go to the latter, whereby turnover tax concessions, at DM 3,634 million, make up the greatest part. This is mainly due to turnover tax concessions granted to the oil and metallurgical industries, welfare operations and enterprises in West Berlin. The tax-free allowance of DM 12,000 for taxpayers with a total turnover of up to DM 120,000 is a not inconsiderable item (para. 7a, clause 1, Turnover Tax Law). The Federal Ministry of Finance estimates that turnover tax concessions to medium-sized firms alone occasion a tax loss of about DM 550 million.

In contrast to the tax loss caused by concessions to industry, tax losses from concessions to agriculture, forestry and fishing (DM 1,005 million) and to transport (DM 662 million) are comparatively low.

It must be assumed that concealed subsidies, like overt subsidies, are considerably higher than the amount declared by the Federal Government. It must be realised that no account is taken of tax losses due to turnover tax privileges conceded to the wholesale trade and to exemption provisions for public, non-profit-making, charitable and religious bodies. Tax losses are probably also considerably under-estimated because it was assumed that public claims had earned interest at 6% if invested in long-term securities, whereas the average return on the German market is considerably higher than 6%. For instance, on 6% debentures maturing in 1990 it is 7.7% and on 6% loans 7.9%, on an average. Last, but not least, the communal tax losses due to exemptions, respites and reduction of industrial taxes are not included.

On the basis of the subsidy expenditure declared by the Federal Government, it may be established that the charge upon the public budget of overt and concealed subsidies to agriculture, industry and transport—added together, these amount to only half the expenditure on subsidies declared in the 1966 Financial Report—has grown to a size which, for various reasons, gives cause for alarm. Overt and concealed financial assistance amounted to DM 13,139

million in 1965, i.e. 11.9% of all expenditure by the Republic and Länder, or 3.0% of the GNP.

In future, it is to be expected that expenditure on subsidies will increase yet further and, in certain circumstances, an even greater proportion of state expenditure may be earmarked for subsidy purposes.

Merely in order to obtain the consent of the Farmers' Association to the Common Market grain price reduction required additional subsidies to the extent of DM 5,000 million up to 1969. Additional financial assistance is constantly being announced and more and more branches come to believe that they can remain competitive only with State support. Even the butchers, who should not be badly off in view of the considerable increase in meat consumption in the FGR, think themselves entitled to a subsidy. Because poultry is becoming increasingly competitive with veal and there is no longer sufficient demand for fat pork, the General Manager of the German Butchers' Association—in a "Red Plan"—recently demanded extensive State support.

In view of the growing group demand, it is difficult to believe in the "systematic reduction of subsidies" which was announced by Herr Erhard, the German Chancellor, in his official speech on 25.11.1965. The debate on the Budget Guarantee Law certainly did not translate these words into facts. It is true that Common Market adjustment aid to German agriculture in 1966 and 1967 was reduced by DM 260 million each year to DM 770 million; but these are not true cuts because the amounts saved are to be reallocated at a later date.

Consequences of the Subsidy Policy

In judging the internal and external economic effects of German subsidy policy, the major factor to be considered is that a large part of the expenditure on subsidies to some extent serves the purpose of preventing—or partially preventing—the operation of natural locational advantages of foreign countries. The consequence is that international trade is guided away from the direction and volume it would have assumed in a free market. If foreign countries are unable to react with protectionist measures such as tariffs and import quotas, they are forced, in their turn, to grant subsidies. As can be seen from experience in our main trading partner countries, this leads to an avalanche of subsidies, embracing more and more categories and soaking up an increasingly large proportion of the GNP.

In addition, the development of most of the subsidies granted in the FGR raises doubts as to whether it is possible to achieve the aim of such subsidies—be this aim the equalisation of natural cost disadvantages or competitive manipulations based on economic policy. It is characteristic of subsidy policy in the FGR that a large proportion of subsidy payments passes unnoticed, the subsidies are accepted as a convenient alternative income and are dissipated. In this connection, one must recall the many negligible subsidies and the practice in the FGR to grant subsidies not once, but on a recurring basis. This is true of all concealed subsidies in the form of tax concessions and also for a part of the overt financial assistance, in particular that to agriculture (industrial grants to

reduce the price of diesel fuel, higher payments for good quality milk, etc.). Public subsidy payments become fully incorporated into the industrial process, they become an institution and finally pass unnoticed.

Because subsidies have become so unobtrusive, their recipients do not support the aim for which the subsidies are given and it becomes impossible to achieve the goal of adjusting distortions caused by structural factors.

Failure of Secondary Aims

If subsidies cannot achieve their aim because they pass unnoticed, this means that State resources become immobilised, so that they cannot be used to fulfil public obligations which, for many reasons, are of not inconsiderable importance for the future growth of the economy.

In addition, mention must be made of the inherent danger (more acute on pure income payments) that the principle of choice in competition be inhibited. Productive forces are not released and therefore cannot be directed to more productive uses. This would not be such a problem at a general recession. However, in a full-employment economy such as the FGR subsidies mean that advantage cannot be taken of existing, economically functioning production capacity or of price reductions. There is a deceleration in the growth of the national product because, for this to reach a maximum, it is essential to have the optimum commitment of resources.

Last, but not least, the influence of pure income aid inhibits essential capacity adjustments, i.e. those which become necessary due to growing international links; there is a danger that concerns which have hitherto shown a profit may now run at a loss and, in their turn, request State support. This is how a subsidy avalanche can start; it renders the integration process more difficult because it is becoming increasingly painful for those affected to adjust to structural changes forced upon them by the integration process and, in the end therefore, no adjustments are made.

... and Complication of Business Cycle Policy

It must not be left unsaid that the great mass of subsidies, in particular interest concessions, cause complications in the business cycle policy, first of all because the legal strings on many subsidy payments limit the anticyclical measures at the disposal of public expenditure policy and, secondly, they detract from the effects of credit manipulation measures imposed by the central bank. Since about DM 9,000 million were granted in loans in the FGR at interest rates below market rate, credit restrictions become unmeaningful. The classic example of this is that when the nominal interest rate is raised, those affected automatically apply for an increase in the interest subsidy for an amount equal to that by which the credit cost has risen.

Impossible to Control by Fiscal Measures

Any survey of subsidy policy in the FGR would be incomplete without considering whether the economic instrument "the subsidy" can be controlled by

fiscal means; for the suitability of economic instruments depends, in the main, upon the extent to which they can be guided.

The issue of controlling subsidies within the FGR has come to a head over the problem of their reversal, since any increase in the volume of subsidies would probably fail because of the state of the public exchequer—not because of opposition from the beneficiaries. From this point of view, the controllability of a subsidy depends upon whether it is open to technical and political manipulation. In the FGR there is very little chance of administrative and technical manipulation of subsidies because, as a rule, they do not appear in the budget as a non-recurring payment but are passed on each occasion anew.

It is even more serious that the power to initiate subsidies passes from the State to other State bodies, for example, the central bank, or even to the recipients of subsidies themselves. For example, if the State should subsidise individual branches of the economy by issuing credits at favourable interest rates, the amount of the subsidy depends upon the policy of the central bank alone. Should the central bank raise the bank rate for market reasons, the volume of subsidies will automatically expand.

Finally, this subsidy policy becomes farcical when the recipients themselves can arrange for the volume of subsidies to be increased because the legislator decrees a reduction in the price of certain goods or increases in the prices of products on the basis of a hard and fast absolute or percentual figure. Where there is higher production or higher consumption by the recipients of subsidies, the basis of calculation automatically rises and hence the volume of subsidies increases. Examples of this type of "proportional subsidy" are industrial grants to agriculture to reduce the price of diesel fuel, higher payments for good quality milk or the later cancelled oil fuel concessions to industry. In all these cases, fiscal policy can no longer take the decisions, it can only consent to the increase in expenditure resulting from the changed attitude of subsidy recipients.

It must also be taken into account that coupling a subsidy payment to a varying basis of calculation makes it more difficult to limit expenditure on subsidies. Only when it can be ensured that the amount paid out in subsidies remains constant and the amount allocated to individual subsidies is decreasing can a subsidy be cancelled because there is no longer any, or only minimal, awareness.

Although there is only very slight pecuniary or price awareness of many subsidies to individuals in the FGR, reduction of these is fraught with difficulty because growing "association awareness" is taking the place of decreasing "individual awareness" (Hansmeyer). Associations regularly point out to their members and the public that the branch in question is of great economic importance and that any cuts in subsidies would entail not inconsiderable economic, social and political dangers. This ensures a constantly high level of awareness and frustrates any cancellation which might be possible due to decreasing individual awareness, as well as the elimination of those subsidies which have become meaningless.

Revision of Subsidy Policies

In order to achieve a subsidy policy functioning efficiently in both national and international economic spheres, it is necessary to take the following measures:—

1. Subsidies serving to promote exports or to restrict imports should be granted only when it is necessary to counteract competitive disadvantages arising from economic policy;
2. In drawing up and debating budgets, plans must be made to eliminate those subsidies which entail no budget changes for the subsidy recipient because they are considered as a convenient alternative source of income. In order to do this it is essential to have more information about which of the concessions granted in the FGR are maintenance subsidies;

3. When new subsidies are passed, more attention than hitherto must be paid to restrictions upon duration and the recipients must be made aware that the subsidy payments are only temporary;
4. Subsidies which decrease automatically because of the way in which they develop are to be preferred to those whose volume can be decided by the recipients themselves;
5. When new subsidy measures are introduced, more attention than hitherto must be paid to financial cover. This demands a detailed preliminary survey of the extra charges anticipated upon the public budget;
6. Last, but not least, there is the requirement of monetary stability, because, in general, after currency devaluations, maintenance subsidies are unavoidable or it becomes impossible to eliminate subsidies which have become meaningless.

Jürgen Wolflast, Hamburg

FRANCE: Subsidies a Tool of Economic Policy?

In France the statistical registration of subsidies is rather difficult since many ministries are sharing the responsibility in this field and not all Government grants are reflected in the budget but appear on special accounts controlled by the Treasury. Moreover, it is not easy to distinguish economic from social subsidies, i.e. to assess to what extent special social credits are economic subsidies. And it is even more difficult to ascertain the weight of indirect subsidies if they are given in the form of tax privileges. Hence, before indicating the magnitude of French subsidisation in terms of actual figures, it would be expedient to examine into the given very ramified system and to assess the distortions of competition resulting from it.

Seven Groups of Public Intervention

The national budget contains two titles coming into question for such an investigation, namely the so-called public interventions, and investment subsidies granted by the State. Public interventions comprise seven separate groups. Hereto belong the whole of development aid, the building programme of the Ministry for Education, and State-paid financial aid for social policy measures in favour of agricultural as well as for the health service, and pensions for veterans. Two of these groups implicate economic activities favouring above all agriculture and State-owned enterprises. What is involved is partly credits and partly subsidies for balancing deficits in State-owned enterprises.

The budgetary account of public investment subsidising is subdivided into agriculture, power and mining, transport and telecommunications, enterprises in industry and trade, housebuilding, cultural and social infra-structure, administration and investments outside France. The major part of these subsidisation credits falls to the share of the Atomic-Energy Commissariat as well as to education, social policy and housebuilding. Agriculture, too, receives quite con-

siderable funds from this source, whereas private industry and trade enterprises received only a moderate sum in 1965, namely F. 121.5 million.

Limited Information Value of the Budget

The budget does not contain information on a number of subsidies leading to a decrease of State revenue. In this connection investment credits granted by the Government at a low rate of interest are to be mentioned which might be in favour of publicly assisted housebuilding, nationalised undertakings or private industry. Moreover, it quite frequently happens that credits granted to nationalised enterprises are in part converted into capital and that consequently the burden of interest and amortisation costs will be reduced rather considerably. Besides, 10% of the sum spent on certain specified investments private industry may deduct from the corporation tax. In practice this means that in the form of subsidies the State contributes 10% of all investments made. It is by no means certain whether the tax deficit resulting from this procedure is ever recorded statistically. When this measure was announced the Government was thinking of a sum of F. 400 million annually, but it might double if industry wants so.

Varied Tax Benefits

Tax benefits in their proper meaning are very diversified. Conditions are rather simple as regards measures taken to obtain clearly defined targets and which are supposed to remain valid for a certain period only but frequently become permanent institutions. Hereto belong fiscal promotion of mergers and above all regional policies. However, also whole professions obtain tax privileges, as e.g. the press which does not pay any turnover tax and partly is even exempted from the corporation tax. Moreover this applies to the handicrafts which with regard to taxation are in a considerably better position than industrial small-scale enterprises employing more

than five workers, although an economic justification for this differentiation is not necessarily noticeable. Small-scale retailers are promoted twice by taxation since they are authorised to state their turnover and profits globally in accordance with more or less reliable guide lines and since large-scale trade enterprises have still to shoulder an additional tax burden raising their prices by about 2%. The intentionally inaccurate and under some aspects even unjust assessment in the field of agriculture also corresponds to an indirect subsidisation by means of a lower degree of taxation.

The Role Played by Public Utility Rates

Public utility rates play a major part in policies in the field of indirect subsidies. The granting of so-called special social rates explains part of the railway deficits. As far as large families with many children are favoured, competitive conditions will hardly be distorted. However, it is quite a different situation when social rates—by subsidising suburban traffic of railways and other means of transportation in big cities—become a part of wage policies and the State, as has happened at the beginning of 1966, renounces an economically necessary raising of rates because this might start a general across-the-board wage increase. Since here a deficit of more than F. 1,000 million is involved, the whole issue is not only a problem of economic theory.

Causing even more distortions of competition are special rates granted to some industrial branches for their rail transports and power supply and which are justified more or less objectively. Rather peculiar conditions are prevailing in the French coal market. Prices of French coal are fixed as usual. A monopolistic State-owned enterprise is responsible for imports of additionally required coal. It is authorised to sell the pretty cheaply imported coal at world market or French domestic prices. This company's profits are used for the subsidisation of French mines. Recently and only after much pressure State-owned power plants and the private steel industry obtained the right to buy their imported coal at normal world market prices after hitherto both of them had been at a competitive disadvantage in favour of State-owned coal mines.

Export Subsidies

Finally export subsidies are of major importance, and above all agricultural products are directly and heavily subsidised. Mostly these export bargains are concluded directly by official quarters even though private firms might participate in their realisation. As is well-known, agricultural subsidisation will gradually be transferred to the Common Market. Further direct export subsidies are granted to shipyards and in part also to shipping companies. On principle the shipyards are reimbursed for the difference between international prices and their production cost. This applies to all orders. Indirect subsidies are part of the Government promoted export credits and also the insurance of export risks whose rates do not always correspond to usual insurance regulations. Finally, the very numerous and recently extended services should be mentioned that the French Government places at the disposal of its exporters.

These services do not only comprise permanent Trade Missions and Chambers of Commerce but also financial aids for the participation in international fairs, the organisation of sales weeks in foreign cities, a State-financed deficiency guarantee for exhibitions at trade fairs if expenses are not balanced by orders received, an export consultancy service which is becoming more and more expensive, contributions to the financing of expensive advertising campaigns, e.g. for French cheese in Germany, etc.

To what extent do these State subsidies in France distort international competition? It is very difficult to answer this question. Part of this Government interference is motivated by the fact that different factors influencing competitive conditions to the disadvantage of the French economy had to be made up for somehow. Thus for instance the French steel industry feels discriminated vis-à-vis Italian and also British competition, since in consideration of domestic coal mines it has to pay more for its coal although it would frequently be able to import coal at world market prices. Moreover, the steel industry blames the Government for having been forced—in a boom period—to sell its products at prices lower than would have been possible in the French market and thus also within the European Coal and Steel Community because higher steel prices would have disturbed the French price equilibrium. Now the steel industry in return demands from the Government a loan of F. 3,500 million for a five year term at a favourable interest rate of 4.5%, and a five years period of respite for amortisation.

Competition Distorting Effects?

For part of the French subsidies there are mainly social reasons. This sometimes also applies to regional policies the promotion of which will hardly cause distortions of competition for the simple reason that without certain supporting measures regional economic development would not progress. Social considerations were always decisive also for tax privileges granted to handicrafts and small-scale trade. Besides they were frequently a rather serious burden for French competitiveness in the international markets. Even the subsidisation of shipbuilding is a social measure. It is not so much the Government's intention to maintain a comparatively modest export branch, but it wants to avoid a socially tough readjustment process caused by the closing down of shipyards, or at least to postpone it for several years.

No doubt more or less all export subsidies have competition distorting effects as long as they do not correspond to international habits, as to a large extent is the case with agriculture where they balance each other. A much more delicate subject are the differing rates of public utilities and under global aspects the subsidising of numerous public services. It is, however, difficult to calculate the effects these subsidies have on prices, if we disregard special export rates of traffic enterprises. As regards taxation one has to be even more careful in judging its side-effects on competitiveness. So far nobody knows the actual effects of taxes on prices. Moreover, it would be necessary to make a reliable comparison of depreciation methods on the European level. In the long run, however, we may rely on the intervention of the EEC

Commission. Under the Treaty of Rome this Commission is obliged to abolish—at least within the European Economic Community—the direct and indirect subsidies leading to distortions of competition.

Government Funds Required for Subsidies

Now a few figures to complete this survey of the French subsidy system: According to an official compilation, in 1965 the French Government required F. 26,000 million for its economic activities and F. 15,800 million for its social measures. Economic activities included F. 5,000 million—mainly in the shape of subsidies—for agriculture and F. 3,000 million for the railways. Subsidies given in the shape of investment to the power industry amounted to F. 4,500 million, to road construction 2,300 million, telecommunications 7,200 million. From the social budget most of the F. 4,400 million spent for the social insurance of agriculture can be called subsidies as normally agriculture should be able to finance its social insurance itself. As this is not the case it receives this social aid as a hardly disguised subsidy.

According to another compilation Government subsidies to investments amounted to F. 6,400 million in 1965, this, however, includes education and health service, while the exclusively economic part of public interventions—without the Atomic Energy Commissariat, but including housebuilding—claimed F. 8,300 million. Taking into consideration the numerous side-tracks subsidies may take and tax privileges, one arrives at a necessarily rough calculation of a total of F. 20,000 million. Thus subsidies would correspond to between 4% and 5% of the French gross national product. Of course these figures are only a summary.

General Disapproval of Subsidies?

In conclusion the attitude towards the subsidy system of Government, economy and experts should be described. On principle, subsidisation is generally disapproved. The Government of course regards them as a disagreeable burden on its finance and a doubtful source of structural shortcomings as well as a drag on reforms which particularly in France are very urgent indeed. The economy does not fail to recognise the dangers resulting from subsidies for a more or less liberal order nor does it overlook the fact that it itself is limiting its independence if asking for subsidies. Moreover, in the next years the Government hopes to sharply cut down the two most expensive items of its subsidisation budget, namely subsidies to agriculture and public undertakings. Higher prices conceded to the French farmers through European agricultural policies should enable agriculture to finance its social insurance system to a large extent by itself. Credits for an improvement of structural conditions in agriculture are considered a temporary solution only. The costs of export subsidisation are shifting to the European level while at the same time the French Government is making serious efforts to create healthy market conditions through international agreements on products and thus to eliminate the export subsidy system. Public undertakings, on the other hand, shall be enabled to carry through a rational rates policy without endangering French price stability. This is supposed to

be achieved on the basis of a general structural improvement of French conditions, although this is to be considered a wish rather than certainty.

The abolishing of a number of indirect tax subsidies is another aim of the Government and particularly a more normal assessment of agriculture and small-scale trade is supposed to obtain it, whilst it is obviously intended to continue the promotion of handicrafts. Paris is also not unhappy about the Common Market's guide lines opposing subsidies because they support the Government against the urging claims of one or the other pressure group.

The Attitude of Economy and Science

Nevertheless it would be an exaggeration to suspect French government quarters of hostility against subsidies. It must not be ignored that any subsidy, be it direct or indirect, may be regarded as an efficient tool of economic policy. It is easier for the French Government to realise its long-term economic plans by means of a number of direct or indirect subsidies than with a completely neutral financial policy. Therefore time and again new subsidies are being invented and comfort is taken from the thought that these measures would be temporary only although anybody knows very well how difficult it is to abolish subsidies once they have been introduced.

The economy itself assumes a quite ambiguous attitude, to put it mildly. It must not be forgotten that any time the economy believes its interests to be endangered it asks the State for subsidies. The steel industry is the most recent example. Of course one is taking shelter behind the argument that former distortions of competitive conditions are justifying these demands. Behind the scene, however, subsidisation policies have led to a strange struggle between State and private economy. The enterprises prefer indirect subsidies to be granted under general terms which do not give the State the right to interfere with the economy, whereas the State would like to use its means most efficiently and therefore likes to give direct subsidies since it considers them a tool for its economic policy of more or less dirigism.

French economic experts who are working for, or co-operating with, the planning authority quite definitely reject the whole of the subsidy system. They are convinced that under all circumstances it is doing more damage than good and is impairing the economy's efficiency by creating unhealthy conditions or supporting enterprises not fit to live. At the same time, however, they realise the political obstructions for an attitude opposing subsidies and know that it is particularly difficult to oppose indirect subsidies. For some time already they have been endeavouring to work out a theory that will enable them to inform the Government about the admissible extent of subsidisation. So far these studies did not lead to any tangible results. The only thing that is certain so far is the fact that French economic experts believe the Government's present tendency of mixing economic policy with social considerations to be rather precarious and they would like to prevent the Government from giving large-scale economic subsidies for mainly social reasons, particularly for the promotion of regional development.

Alfred Frisch, Paris

UNITED STATES: *The Role of Subsidies*

The American government has subsidized private enterprise throughout history. As a rule, monetary grants were avoided but other equally important benefits were offered such as public land grants, services without charge, tax exemptions and many others. In most cases, direct or indirect subsidy devices helped to avoid true competition or created monopoly-like privileges. Whatever the benefits of the subsidy of any kind, its cost frequently has been concealed though ultimately it must be borne by the consumer in the form of higher prices or heavier taxes.

Even in the definition of the subsidy concept according to a recent government study on "Subsidy and Subsidy-effect Programs"¹ obscurities were indicated in describing subsidies as an "aid or expenditure necessary in the national interest" instead of as a benefit to specific individuals or groups at the expense of all. According to Kaysen, a subsidy is a device by which the demand for an output is increased, or costs of production outside of market forces, are decreased.² Frequently, the effect of the subsidy is expected to be both economic and political in nature. In this discussion, a subsidy is dealing either with a payment, or a remission of charges, or the supply of commodities at less than cost or the market price. This definition separates subsidies from aids to business or foreign governments leaving it to the free choice for the latter how to use them (while the subsidy prescribes what is to be done). Not included in our subsidy definition are government purchases not designed to assist any particular segment of the economy, nor are grants in aid to states and local units. Likewise, we should exclude subsidy-elements in taxation though a case for such concealed subsidies can be made.³

The Scope of Subsidies

While the discussion will be focussed only on the most significant types of subsidies including those affecting exports, a brief survey of general American subsidies shows their tremendous scope, significance and costs. In the wider sense, we can group subsidies in the following 5 categories of current importance:

1. Grants to Business to Achieve Specific Objectives such as
 - a) Shipbuilding through the Maritime Administration for fishing vessels—Interior Department
 - b) Ship-operating differential subsidy
 - c) Subsidies for carrying mail—ship and aircraft

¹ Subsidy and Subsidy-effect Programs of the US Government, materials prepared for the JOINT ECONOMIC COMMITTEE, 89th Congress of the US, 1st session, 1965.

² Carl Kaysen, Harvard economist, and president of the Princeton Institute of Advanced Study.

³ R. L. Hubbell "Concealed Subsidies in the Federal Budget", National Tax Journal, Vol. 10, Sept. 1957. For example, the big tax fight of 1966 is going to be over the 7% investment credit to stimulate the purchase of capital goods. Annual tax savings to corporations, from this title alone, are estimated at \$ 2,000 million annually, since its introduction in 1962.

- d) Financing of plants to generate electricity from atomic fuels.
2. Farm Subsidy Programs
 - a) Commodity Price Support Program—Commodity Credit Corporation
 - b) Surplus disposal program—domestic and foreign
 - c) International Wheat Agreement
 - d) Sugar Act subsidy to domestic producers.
3. Tax Benefits to Specific Groups
 - a) Depletion allowances to mineral and oil producers
 - b) Liberalized depreciation
 - c) Tax credits to modernize plants.
4. Indirect Assistance to Assist Specific Economic Groups
 - a) Financing of highways
 - b) Improvement to harbors, air navigation, etc.
 - c) Protective Tariffs
 - d) Buy American Act
 - e) Cargo preference.
5. Lending and Loan Guarantee Programs of Federal Agencies
 - a) Agriculture—rural electrification, housing Commodity Credit Corporation
 - b) Area Redevelopment Loans
 - c) Export-Import Bank Loans
 - d) Loans to small business
 - e) Loan Guarantee and Insurance Programs—housing — veterans — commodity loans — vessel construction loans — Small Business Administration.

While there exist many other subsidy-like devices, this study emphasizes only those that predominantly serve the stimulation and competitiveness of American exports and, hence, affect the international realm.

How Expensive Are Subsidies?

Net expenditures on subsidies and similar programs of the Federal government showed the following trend in recent years⁴:

	1955	1960	1965	estimate 1966
	(in millions of \$)			
Total	1,979	5,090	7,516	6,723
Agriculture	1,074	3,458	5,621	4,713
Business	741	1,278	1,418	1,375
Labor	269	324	595	620

In further detail, net current expenses of the Federal Government on subsidy programs rose from a total of \$ 2,000 million in 1955 to \$ 7,500 million in 1965. According to sub-groups, the share of agriculture rose from one-half to three-quarters of the total

⁴ Joint Economic Committee, op. cit. p. 22. The lower estimate for 1966 is due to a reduction of price supports. These figures exclude purchases of commodity inventories. Otherwise, subsidies would have amounted to \$ 4,700 million in 1955 and \$ 8,100 million in 1965.

during the same period. Structurally, agricultural, business and labor subsidies went as follows⁵:

	1955	1965
	(in millions of \$)	
Agricultural subsidies, total	1,100	5,600
major items:		
sales for foreign currencies	0,100	1,200
price supports & related items	0,500	3,400
sugar act	0,100	0,100
Business subsidies, total	0,700	1,400
ship operating	0,100	0,200
federal aviation	0,100	0,500
navigation aids	0,100	0,300
Labor subsidies, total	0,300	0,500
(unemployment trust funds)		
Gains in commodity inventories	2,400	-0,300

Additional subsidy-like assistance to the economy was rendered by US Government loans outstanding to the amount of \$ 41,600 million by the end of 1964. The trend of these loans was as follows:⁶

	1955	1964
	(in millions of \$)	
Loan aid to agriculture	6,400	11,700
Loan aid home owners	3,100	6,700
Loan aid industry	0,400	1,000
Loan aid mortgage loan comp.	1,000	4,800
Loan aid education	0,000	0,600
Loan aid states	0,300	0,600
Loan aid foreign countries	8,000	14,300

When we study subsidies in general, we usually don't take this broad view but deal with the \$ 3,000 million annual subsidies regularly given to agriculture and some smaller traditional allowances for the operation and building of ships.

The Government View on Subsidies

The appraisal of direct subsidies and subsidy-like assistance over the years is a subject of public record. In thousands and thousands of pages of Congressional debate and hearing of witnesses, every argument and counter-argument has been used in favor of or against these actions and they frequently are the result of modification, change and compromise. In every case, though, subsidies aim at alleviating economic distress, the creation of income, the strengthening of the domestic economy by larger consumption and investment, the creation of employment and the facilitating of food exports to competitive markets.

All subsidy programs, however, according to the Joint Economic Committee, are subject to the following provisions: "Federal programs aimed at supporting the economic position of particular groups or industries should be constantly reevaluated in the light of changing circumstances, whatever their initial justification, subsidy programs should be contrived so as to eliminate the necessity for their continuation. Without steady adjustment, the most efficient use of resources in the subsidized activities will fail and real costs will be imposed on the economy".

Aids, grants or subsidies are part of the "plans, functions and resources" of government which contribute to the promotion of maximum income and employment. They supplement in a specific way the general objectives of the Employment Act of 1946. The growth of subsidies in our society has been very gradual, piecemeal and elusive but always in accord-

⁵ Joint Economic Committee, op. cit. p. 23.

⁶ Joint Economic Committee, op. cit. p. 29.

ance with democratic political processes as part of justifiable public policies. For this reason, no political label can be attached to subsidies, claiming that they are "typical" of either a Democratic or Republican Administration. Considerations to get the farm vote, however, or to achieve national defense, frequently have been an important factor. While the direction of subsidies has greatly varied in history (think of our land subsidies to the railroad builders), their overall objective—the promotion of particular interests on the assumption that this will contribute to general welfare—has been constant.⁷ Republican party members favored direct cash subsidies as early as 1898 but did not succeed. Already at the earliest stage of the depression in 1929, various aids to agriculture were enacted. Subsidies for the construction and operation of vessels are designed to maintain US shipping though it may not be competitive by international standards. As a rule, subsidies were only devised as aid to a deeply depressed sector of the economy, such as agriculture, during bad times. It should be emphasized, however, that such aids never had a social-political character of the European type such as the encouragement of a demographic balance between land and city or being paid as compensation for the hard life of those who feed the nation.

Subsidies in the United States were never conceived as a permanent institution but only as an instrument for readjustment to economic changes. In the "Trade Expansion Act of 1962", for example, the lowering and elimination of some tariffs was expected to close down non-competitive business here. In this case, employers and their workers become eligible for various kinds of adjustment aid—technical, financial and tax-wise, supplemented by relocation allowances, training etc.⁸ Whenever political pressures against subsidies arise—not so much because of their costs but the senselessness of some acts in face of rapidly changing conditions (partly applicable to the farm support act)—reform plans are swiftly conceived. The National Advisory Commission on Food and Fiber, for example, appointed by the President last November, will review and appraise the entire farm program and related foreign trade policies. The report and its recommendations providing the basis for new farm legislation, are expected by 1967.

Public Views on Subsidies

The monetary burden of farm subsidies, for example, is of little concern to the taxpayer who is willing to see his tax bill increased by 3% or 4% to finance a good law. However, he resents costly programs that pay the farmer for non-producing or provide subsidized food aid abroad contrary to his wishes (to a non-democratic country, or without crediting locally America for this aid, etc.). Arguments have arisen, particularly in 1965, about government aid payments at a rate of \$ 2,450 million annually, when the farmer has been doing so well and received \$ 40,000 million gross income. In other words, about 7% have been added to this prosperous income as direct hand-outs or to put it differently, for every \$ 16 from the sale of produce, the government adds \$ 1. When a news-

⁷ President Washington, for example, favored assistance to the defense industries, while subsidies to shipping have been justified as contributing to both employment and national defense as well as foreign trade (Merchant Marine Act of 1936).

⁸ Trade Expansion Act of 1962, H. R. 11970, Title III.

paper recently discussed the opulence of farmers to whose net income of \$ 14,000 million the government adds \$ 3,000 million, it was attacked in various ways: that labor or investors have increased their incomes at faster rates, or that the government is holding down farm prices, or that the farmers themselves are victims of a bungled and expensive subsidy program.⁹

The business community has not exerted significant pressures to eliminate subsidies or shown a desire to demand assistance on its part, nor have exporters protested against the excessive preoccupation of the Kennedy-Round negotiators to secure favors for agricultural exports while neglecting to press for improved export opportunities for capital and consumer goods. Labor, too, ignores subsidy benefits to agriculture though in this process food prices and the cost of living, are being increased.

The Cotton Subsidy devised to assist small inefficient farmers, soon worked out as a subsidy to foreign textile mills. However, this situation in which we subsidized foreign textile competition, was remedied.¹⁰ As another example of reaction of the business community, a \$ 47 million research grant of the Atomic Energy Commission for construction of a privately-owned power plant of advanced nuclear design, was approved as example of a "good subsidy". Similar assistance to public power plants including the TVA might have been viewed critically as a "bad subsidy".

The International Chamber of Commerce has gone on record in favor of free markets in agricultural products to achieve more productive results in the present GATT negotiations. It rejects, furthermore, restrictions on free trading in primary products and pleads for a reduction and ultimate elimination of all supports in every country.¹¹

The Agricultural Subsidy Program

Farm programs widely interpreted as subsidies, have received much attention in recent years due to their costs and far-reaching scope. They deal with production control, surplus removal, "floor" commodity price support, parity payments, soil conservation, etc.

The realized cost of agricultural and related subsidy programs amounted to \$ 5,400 million in 1965.¹² The most expensive items in this program are:

price support, supply and purchase programs amounting to	\$ 2,600 million
removal of surplus commodities	\$ 0,300 million
conservation, cropland conversion	\$ 0,300 million
various credits	\$ 1,600 million

In the Food and Agriculture Act of 1965, emphasis was shifted from support prices and loans to direct payments to farmers to maintain farm income. In spite

⁹ Responses to an editorial in the Wall Street Journal "Holding the Line down on the Farm", February 15, 1966.

¹⁰ Differential payments between free market prices and "fair prices" for cotton amounted to \$ 750 million for the 1964/65 season. The Agriculture Act of 1965 reduced the support price of cotton from 29 cents to 21 cents per pound. In consequence, cotton can be marketed abroad competitively without any subsidy while domestic mills can buy cotton at lower prices.

¹¹ In accordance with this philosophy, the Chamber rejected the ICC Document No 221/144 of 1964 that recommended to GATT the adoption of special rules of negotiation for temperate zone agricultural products.

¹² Data based on the Federal Budget for fiscal 1967, of January 24, 1966.

of lowering of price supports, expenditures for farm income stabilization are estimated at \$ 3,000 million for 1966.

In international affairs, the Food for Peace Program is being continued at an annual rate of \$ 1,700 million.¹³ About two-thirds of these allocations consist of sales of agricultural commodities to foreign nations for their own currencies. A certain amount of grants will continue while sales for long-term dollar repayable credits will be emphasized.

The system of domestic price support has led to the accumulation of high-priced surplus commodities which require the use of export subsidies to become saleable abroad. In recent years, up to three-fifths of all our agricultural exports benefited from some kind of export stimulation or subsidy. In the case of cotton and wheat sold under the International Wheat Agreement, these subsidies were direct; other assistance was provided indirectly under Public Law 480. In our total export trade of \$ 26,600 million in 1965, agricultural shipments were valued at \$ 6,000 million representing almost one-quarter of the total.¹⁴ US Government-financed agricultural exports amounted to \$ 2,500 million while commercial exports amounted to \$ 3,500 million.¹⁵ Exports of wheat and flour as well as of cotton declined either because of non-competitive prices or of the expected new cotton legislation.

In spite of the apparent need of export subsidies, it should not be assumed that agricultural commodities could not have been marketed otherwise. To note, such exports without assistance more than doubled during the last decade and still continue to rise (projection for 1966: to \$ 4,600 million). American agriculture is strong and extremely productive¹⁶ and there exists little evidence if any that farmers have achieved significant real gains—in higher wages or incomes—as result of all price supports, trade restrictions and export subsidies. On the contrary, many of these programs, by keeping the inefficient farmer in business have created a vicious spiral of making substandard farmers produce for the domestic and international markets.¹⁷ Consequently, this expensive output can only be marketed with the aid of supports and large-scale subsidies. Internationally, some of our foreign sales under Law 480 are causing embarrassment to other countries which protest against our invasion of their traditional export markets.¹⁸ Apart from this undesirable impact, the cost of foreign aid to needy countries which should be a common pro-

¹³ This program is based on the Agricultural Trade Development and Assistance Act of 1954 (Public Law 480).

¹⁴ This amounts to one-seventh of all gross cash income from farming.

¹⁵ AGENCY FOR INTERNATIONAL DEVELOPMENT shipments amounted to \$ 1,100 million and Public Law 480 exports to \$ 1,400 million. The latter alone comprised 27% of all US farm exports in recent years.

¹⁶ According to The Economic Report of The President, January 1966, agriculture is one of the most progressive segments of the American economy with productivity gains exceeding those of any other major sector, p. 131.

¹⁷ The income of two-thirds of all farmers falls below the national average and many qualify for the Poverty Program Assistance, in fact it was partly designed for them though the entire farm population accounts for only 6.3% of the US population.

¹⁸ However, Public Law 480 requires assurance from the participating governments that such sales will not displace normal patterns of commercial trade with friendly countries, 87th Congress, House Document, No. 223, 1957.

ject of the wealthy and mature nations, is shifted exclusively to the American taxpayer.¹⁹

Conclusion

American subsidies in the narrower sense providing cash payments to special groups are concentrated in the field of agriculture. Farm income stabilization in various ways requires about \$ 3,000 million annually or 3% of budget outlays. Additional \$ 300 million are disbursed annually by the Department of Commerce for assistance to ocean shipping for construction of new vessels and operating subsidies. Expenditures on airways services, the use of atomic power for energy production and various forms of research dealing with technical problems such as the building of supersonic transport aircraft, etc., should not be included under "typical" subsidies.

The American taxpayer does not complain that subsidy programs unnecessarily increase the tax burden or are responsible for deficits. He does resent, however, the continuous experimentation and muddle in agriculture soon encouraging excess production and soon paying premiums for non-producing in a hungry world. The use of food surpluses for aid abroad is in line with traditional humanitarian American concepts, namely to feed the hungry in the world and to share our bounty with others. This American devotion to assist others, one should not forget, is at the root of

¹⁹ According to Th. Schultz, the costs of P.L. 480 products have been twice their value had they been sold freely in world markets. On the other hand, to the receiving countries the value has been perhaps 37 cents for each dollar spent by the Commodity Credit Corporation. See *Journal of Farm Economics*, December 1960.

the Food for Peace Program while the subsidization of agricultural exports is only one and incidental facet of US farm policies. Considering domestic and international inequities of the subsidy programs, we can rest assured that the NATIONAL ADVISORY COMMISSION ON FOOD AND FIBER will soon recommend legislation to achieve a better domestic program and more effective international cooperation. The Anti-Poverty Program, too, will take off considerable pressure from the need for farm subsidies to low-income-farmers as other ways must be found to increase the incomes of the two million close-to-subsistence farmers.

In general terms, the concept of subsidies is quite alien to the modern American producer, consumer or taxpayer. Self-reliance, improvement of efficiency in the open market and steady economic growth already are minimizing the significance and real importance of subsidies as well as the dependence on them by large segments of the economy.²⁰ The strong and prosperous American economy of 1966 can easily afford both: payments of specific but time-limited subsidies (in essence, this is the direction of the new support program), and the competitive pressures of an efficient economy. The latter do not encourage the inefficient producer to take shelter behind artificial protection of one kind or another but put him to test to employ freely his skills and resources in a creative market.

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²⁰ American subsidies are a survival of the Great Depression when the Agricultural Marketing Act of 1929 made the futile attempt to stop agricultural price declines by buying commodities for removal from the market.

GREAT BRITAIN: A Temporary Remedy Has Become a Permanent Institution

Among the multitude of grants, rebates, allowances, price guarantees, deficiency and relief payments, incentives, preferences, options and other forms of financial support with which the State tries to temper the wind to the overtaxed citizen it is difficult to select those which deserve to be regarded as subsidies pure and proper. It is even more difficult to define what makes them subsidies as distinct from welfare benefits or normal expenditure on public services. Common to them is that they are paid out of public funds, and in consideration of the public interest, in order to correct the effect of ordinary market forces, to offset a handicap to a section of the community or economy for which the State on behalf of the nation accepts responsibility, or to make a sectional sacrifice in the common interest bearable. Sometimes however subsidies are merely conscience money for past errors and omissions, a book-keeping transaction to dispose of irredeemable losses, or part of a bargain to assuage an aggrieved lobby. Public opinion in Great Britain has never concerned itself with the principles of subsidization but only with the pro and con of specific cases.

Housing Subsidies a Source of Irritation

None of the gratuitous payments were originally conceived as permanent. They were, and are, intended as a remedy for a temporary malady but a lasting

cure is rare. The British housing subsidies were introduced after the first world war to facilitate the building of houses for letting at moderate rents. After the second world war subsidies at a higher standard rate were granted for all new publicly-provided housing accommodation—private building for letting was uneconomical and impracticable—in addition to certain special subsidies. Later variations made for a more flexible subsidy system: Local authorities with inadequate resources were given up to five times the basic annual subsidy so as to ensure that help went where it was needed most. At the same time the local authorities, which were chiefly concerned with house-building, were given access to the Public Works Loan Board and thus to credit on the favourable terms available to the central Government. They in turn fixed rents at the lower rates made possible by subsidies and cheap loan charges and also offered favourable mortgage rates to owner-occupiers. Soon however it became clear that the subsidies did not always go to those in greatest need. Newly-built houses were allocated to the families in most urgent need of accommodation, and these automatically benefited from artificially low rents because all new houses were subsidized and let at fixed rents irrespective of the tenant's income. This did not seem to matter much while all rents were controlled at their pre-war level, just as the continuation of the wartime food subsidies, though increasingly ex-

pensive, created no social tension after the war whilst wages and salaries remained frozen. The subsidized tenant of a post-war house had no material advantage over the inhabitants of rent-controlled pre-war dwellings.

But when rent control was eased in Britain and earnings became more fluid, "council tenants" became a privileged group and source of irritation to others. Various attempts have since been made, on the whole with indifferent success, to extract rent in accordance with the tenants' means, usually through rent rebates for poorer and larger families, and the central Government now intends to replace the basic subsidy by a contribution to the loan charges on the capital cost of houses, related to variations in interest rates paid by local authorities. While the housing subsidies after the war were designed to enable new dwellings to be let, despite higher building costs, at similar rents as rent-controlled houses, they are thus now intended to offset the high interest level in the capital market. Although their effect has not changed, their motive has in one important respect: The intention is to make house-building independent of interest rate movements while continuing to keep rents low. Private house-owners will be able to claim a similar rebate which effectively reduces the net cost of mortgage interest to 4%, both for local authorities and private mortgagors, for "council tenants" and private owner-occupiers. The cost of housing subsidies in 1964/65 totalled £ 150 million; by 1969/70 they were, before the latest changes, expected to rise to over £ 250 million. Under the new system their cost to the State will of course depend on the interest rates at which it borrows, and among its indirect beneficiaries will be those lenders who as a result of the Exchequer help will receive the full market rate whereas local authorities and private borrowers, if left to their own resources, might not have felt able to bear such high loan charges.

The Changed Character of Farming Subsidies

That the immediate recipient is not necessarily the sole of chief beneficiary is also shown by the British agricultural subsidies which have been one cause of the sharp rise in land prices. They have grown out of the wartime food subsidies which served to keep the cost of essential foodstuffs steady. In the first few years after the war the aim changed to a maximum increase in home food production, and this was achieved by a system of guaranteed prices and assured markets, supplemented by direct grants and specific subsidies, chiefly to encourage more efficient production and speedy expansion. Once this aim had been secured, more flexible arrangements were introduced: The fixed prices gave way to market receipts supplemented by "deficiency payments" which were based, commodity by commodity, on the difference between calculated fair prices and average market proceeds. As it was the farmer who decided how much food to grow and market prices fluctuated sharply and unexpectedly, the burden on the Exchequer however rose intolerably. By 1961/62 price guarantees cost £ 225 million, in addition to over £ 100 million of direct grants and subsidies to agriculture. A further rise in home production no longer being considered desirable, it was therefore decided to relate the guarantee payments to specific quan-

ties of output and arrange minimum import prices with foreign as well as British farmers so as to obviate heavy deficiency payments. At the same time price guarantees and direct subsidies were aimed more directly at raising efficiency, cutting costs and promoting a more competitive structure and better use of land and labour in agriculture.

As in housing, so in farming subsidies have become a permanent institution, but their character and purpose has changed. No longer is it the aim to keep food prices steady or help the British farmer against more favourably placed foreign suppliers. Both these objectives can be achieved more effectively by minimum import prices, albeit at some expense to the British consumer. The major consideration now is to maintain maximum levels of home production at the lowest possible cost so as to relieve the balance of payments and to improve the structure of British agriculture with this long-term aim in view. Farming is turning into a business offering as great advantages to the highly capitalised, mechanised and specialised enterprise as other industries, and the case of subsidies to agriculture will in future have to be judged on the same grounds as that of other basic industries—its strategic value, the social significance of a thriving farming community, its inability to put its house in order without support from the Exchequer, the effect on trade with Commonwealth and other foreign suppliers, and Britain's balance of payments.

Deficits An Accepted Exchequer Liability in Nationalised Undertakings

The financial payments by the State to the nationalised undertakings, notably the collieries and railways, differ from those for housing and farming in that they were not conceived as contributions to the running costs but were a belated recognition of the fact that these undertakings did not cover their expenses out of revenue. The nationalised enterprises, though managed by independent boards, require Government permission for price advances. For political as well as economic reasons this has not been readily forthcoming, with the result that collieries and railways, like the British Overseas Airways Corporation which of course is exposed to heavy international competition, ran up considerable deficits financed by public money and carried forward with the approval of the Government or cancelled by ad-hoc grants. All the nationalised enterprises were, at least from 1951 when a Conservative Government took office, encouraged to adopt normal business standards and to cover their outgoings, taking one year with another, by their current revenue. A complication was introduced at once by the need for above-average expenditure on modernisation and rationalisation, and for these special Exchequer grants were given, at first with the idea that they should be repaid when the desired benefits had been obtained. Later however all revenue deficits were accepted as an Exchequer liability, subject only to certain quantitative limitations.

That the coal mining industry and the railways, unlike the expanding electricity generating and gas industries, have failed to balance their accounts is of course due to contracting demand for their services and inroads by their competitors, petroleum and road and air transport. Both could be made to operate

efficiently and profitably within a smaller compass if they concentrated on the outlets for which they are best suited. They—and the Government—have however been reluctant to do so, with the result that the railways still needed Exchequer grants of well over £ 100 million annually in recent years. The railways' financial problem however has at least been properly understood, and public opinion is inclined to accept the experts' distinction between economically justified services which can pay for themselves and those others which are socially desirable but need subsidizing. The Government grants are still related to the railways' operating deficits and capital requirements without regard to their origin. Subsidies proper are meanwhile being paid to bus operators providing alternative road services as a substitute for closed railway lines. The National Coal Board has also run into financial difficulties through reluctance to cut down operations as quickly as called for by contracting consumption. It has now been helped by a capital reconstruction which involved writing off £ 415 million owed to the Exchequer and closing many unprofitable pits no longer required.

Development Programme for Old Industrial Areas

Yet another sector of the British economy in which Government assistance of various kinds has been given over several decades is that of the old industrial areas in which the decline of the coal, shipbuilding and cotton industries and the population drift to the Midlands and South-east made official action imperative. At first this took the form of encouragement for privately-sponsored trading estates and loans for firms erecting factories on them. Rent, rate and tax concessions followed soon, and after the second world war annual grants and loans were given on a substantial scale to firms in these regions which had no other access to finance on reasonable terms and towards the cost of removal to development areas, housing accommodation and other services. From 1960 grants and cheap loans were made available for "general purposes" such as the cost of machinery, equipment and working capital, and factories were built on public account to be sold or let at rates well below those in other parts of the country. In 1963 the Government undertook to bear a quarter of the cost of new factories, shops, offices and hotels providing additional employment and one-tenth of the cost of new plant and machinery. Finally, in addition to preferential treatment as regards tax-free depreciation, all enterprises in development areas from this year qualify for a cash grant of 40% in respect of their expenditure on new plant and machinery (Firms in other regions only receive 20% which in fact barely makes up for the simultaneous withdrawal of previous depreciation allowances).

Insofar as these various concessions involve spending of public money for the benefit of individual firms, they must, unlike other inducements offered to business enterprises in the development regions, be regarded as subsidies because they relieve the recipients of part of the expenditure which they, in common with firms operating elsewhere, have to shoulder. The very fact that further incentives have

had to be added at frequent intervals however suggests that these subsidies—and other concessions—barely offset geographical and other drawbacks inherent in factory location in the development regions.

Subsidies Tend to Perpetuate Themselves

The four sections of the British economy covered here—housing, farming, nationalised railways and coal mines, and the development regions—not only absorb the bulk of Government assistance to be defined as subsidies but have done so for a long time. It is one of the main characteristics of these payments that, though methods and aims have changed in the course of time, they have been made over a long time in all these fields, and their overall cost does not diminish. Subsidies tend to perpetuate themselves, as experience proves. Given different circumstances there might no longer be a need for such support by the State. A lower interest level in the capital market would obviate housing subsidies in their new form of reduced interest rates. Dearer imported food would minimise deficiency payments to British farmers. Concentration on self-supporting services would restore the railways' profitability. Closure of worn-out pits, it is to be hoped, will do the same for the coal mining industry. Attraction of suitable, efficient industries to the development regions should eventually allow the State to withdraw special incentives, as has indeed happened in some smaller areas already. And yet, although the need for economy in public expenditure remains as great as ever, grants and subsidies show no sign of diminishing. "Purposive financial assistance", promised for key industries in the Labour Party's election manifesto, continues to be essential for the well-being of heretofore subsidized sectors of the economy, and the Conservatives' promise to ensure continued support for farmers, lower the interest burden on housing, stop transport costs rising so fast, and develop fully the resources of each region likewise involves a heavy financial outlay.

In addition, both parties promise to shift part of the local rates burden to the State—in other words, from the shoulders of the rate-payer to those of the taxpayer. That these two are in fact identical illustrates vividly the dubious value of subsidies as a means of lightening or shifting financial burdens. The mortgagor who pays the full rate of interest and thereby qualifies for an income tax refund pays the same net interest as his neighbour who opts for the lower rate which does not offer tax relief. The consumer who as tax-payer contributes to deficiency payments for the home farmer would pay more for his food if they were replaced by higher import prices but less in taxes. Why then choose subsidies rather than some other form of assistance or protection which a Government can grant if required? In fact subsidies have usually been selected as a method of support when an especially big rise in the cost of a particular commodity or service was to be avoided. This happened with housing, farm produce, coal and the railways and is the reason for the local rate subsidies now hastily promised. When a substantial rise in the cost of living threatens, it is tempting to absorb the shock by subsidies so as to avoid consequent cost and wage increases setting up an inflationary spiral. The price

paid in the form of heavier public spending, accompanied either by heavier taxation or an unbalanced budget, however, certainly does not improve the competitive strength of manufacturing industries.

The effect of subsidies on foreign trade and payments has lately received more attention in Great Britain, but for curbing imports other methods have been preferred. The rebates given to British exporters are not, strictly speaking, subsidies as they merely offset costs incurred in the production of the export goods, but they certainly make the export business more attractive for British manufacturers in comparison with the home market. Most British exporters however value other incentives, in particular the officially sponsored export insurance, more highly. The indirect effect of subsidized coal, rail transport and regional development on export performance is too remote to be noticeable or measurable. Exporters generally do not feel that these subsidies are helping them but are only too well aware of the handicap of heavier general taxation which is the concomitant of selective assistance.

Different considerations apply if a clearly temporary strain has to be absorbed. Quite substantial State contributions to redundancy and rehabilitation schemes in particular British industries have proved well worth-while in the long run. Such financial payments were often successfully combined with and made conditional upon the adoption of concentration and modernisation plans for entire industries, and these have succeeded in greatly improving the competitive position of, e.g., the British textile industry in the world market. Being non-recurrent ad-hoc contributions in return for definite sacrifices and efforts on the part of the recipients, they can however hardly be grouped together with the subsidies which in fact if not in intent have become a permanent tribute payable by the community to a particular sector of the economy. Their relative success certainly does not lessen the dislike and distrust felt by most British economists for subsidies as a means of treating economic ills.

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World Business Trends

Weakness of Reserve Currencies

Last year official currency reserves in the shape of gold holdings, convertible foreign exchange and reserve positions in the International Monetary Fund have on the whole increased but comparatively slowly in the western countries. According to data so far available the increase by barely 2% has been only half as much as that in 1964. The central banks' gold holdings should have grown somewhat more rapidly in 1965 than in the previous year and the reserve positions in the International Monetary Fund have shown a much quicker increase even. It was alone the reduction of official foreign exchange holdings that has been decisive for the overall change.

But the development of world currency reserves gives a wrong picture of the world economy's liquidity supply since outside the United States—the most important currency reserve country—they were obviously growing as quickly as in the previous year. The considerable slowing down of international creation of liquidity was but a result of the fact that outside the United States the accrual

of reserves occurred mainly in the shape of gold, after in 1964 its share was a bare third only. Thus the gold demands surpassed by far the increase of monetary gold (approximately three quarters of the supply from current production and Soviet sales have been absorbed by industrial demand, private hoarding, and purchases by East-bloc countries), so that the United States had been forced to reduce its reserves considerably.

The US gold reserves decreased by \$ 1,700 million to \$ 13,800 million—including gold deposited by the International Monetary Fund. This was the most pronounced reduction since 1960. At the same time, however, the American banking system's short-term dollar liabilities vis-à-vis the foreign central banks and governments which in the preceding years had kept rising have slightly decreased according to data covering the period up to November. For in 1965 the United States' balance of payments deficit with \$ 1,300 million had been extraordinarily low (1964: \$ 2,800 million). However, this improvement together with an even declining surplus in the bal-

ance on goods and services was mainly due to the fact that under Government pressure the short-term private capital flow produced a surplus, i.e. a permanent solution of the balance of payments troubles is not yet in sight.

The second reserve currency country within the valid gold exchange standard, Great Britain, is not able anymore to contribute to the world economy's supply of additional liquidity as long as other countries are not prepared to increase their sterling holdings. Therefore the balance of payments deficit of almost \$ 1,000 million in the last year (after more than \$ 2,000 million in 1964) would have caused a considerable shrinking of the country's central currency reserves if Britain had not borrowed once more \$ 1,400 million from the International Monetary Fund (1964: \$ 1,000 million). Even after that, at the end of 1965, with \$ 3,000 million they were lower than in many non-reserve countries, as e.g. in Federal Germany, France, Italy and Switzerland.

Above all the balance of payments difficulties of the two reserve currency countries have led to another activation of the International Monetary Fund. In 1965 members' drawings with \$ 2,400