JIA 72 (1946) 0364-0376

FULL EMPLOYMENT—THE IMPLICATIONS FOR INSURANCE FINANCE

BY invitation of the Council, Mr G. L. Schwartz, B.A., B.Sc., Economic Adviser to the Kemsley Press and former Lecturer in Economics at the University of London, opened a discussion which took place on 23 February 1945. The following is an abstract of the discussion.

Mr G. L. Schwartz said that on the subject of the relation between a full employment policy and insurance finance problems, he would first diagnose the social temper of the times and indicate, without subscribing to them, the policies which were in favour and which were likely to emerge as a result of that temper.

Governments everywhere in the world were terrified of unemployment, and not only Governments but business, industrial and financial leaders as well. There was a feeling that capitalist enterprise was on trial, and that another great depression would bring it down. There was even a feeling that democratic government was on trial, and that unemployment would bring that down too. There was no doubt that Governments were prepared to, and would, take drastic action to avert any large-scale unemployment.

No Government had ever been in favour of unemployment or lack of prosperity, though, to judge by some of the views expressed, it might be thought that some Governments in the past had liked a good deal of unemployment. Every Government would like to be able to boast that under its regime universal prosperity had prevailed. Certain inhibitions in the past had, however, limited the nature and the scale of Government intervention. Those inhibitions had been removed, at least temporarily, and that reflected the current temper of the age. The British Government had categorically announced that it accepted as one of its primary aims and responsibilities 'the maintenance of a high and stable level of employment after the war'.

The prime instrument of that policy was the maintenance of total expenditure. In the words of the White Paper on employment policy, 'The Government are prepared to accept in future the responsibility for taking action at the earliest possible stage to arrest a threatened slump. This involves a new approach and a new responsibility for the State.' It could be assumed that public expenditure would be used to make up any shortfall in total national outlay. Thus, the first of the old inhibitions, that against Government spending (and deficit spending at that), had disappeared. Budget deficits and their corollary, Government borrowing, were no longer a bogy, and the growth of the national debt was no longer a matter for apprehension; on the contrary, it was almost a matter for congratulation.

What form would Government borrowing take? Once again, another inhibition had been lifted, that which viewed with disfavour a large volume of floating debt. In the past that had always been regarded as a financial menace, to be removed as early as possible by funding into long-term debt; in recent times, fortunately for the cheap-money policy, or perhaps as a development of it, short-term Government borrowing had come into favour. It was necessary to remember that an integral part of the policy of full employment would be cheap money. The method of ensuring cheap money would be the issue of bills and bonds 'on tap', and on terms that would be increasingly less favourable to the lender. The arguments would be found in Sir William Beveridge's book, *Full Employment*, Appendix B, from which it would be learned that it was only as an act of grace to institutions such as insurance companies that any further supply of gilt-edged securities need be issued at all. The position could be met by Ways and Means advances at a zero rate of interest; but, mercifully, Sir William proposed that the long-term rate should be reduced from 3% to 2% only gradually, over the space of, say, twenty years. Thereafter, the rate could be brought down to zero.

The third feature of the policy to which he wished to draw attention was the maintenance of the commodity price-level. That did not involve the removal but the creation of an inhibition, an inhibition against deflation. The generation which came to maturity in the 1920's and 1930's regarded deflation as the source of most of the troubles since

the last war—deliberate deflation in the 1920's and a sort of unmanaged deflation in the 1930's. It was necessary to remember that the last experience of inflation in Great Britain occurred over a quarter of a century ago, and there were many people who did not know what it was like. It was not the bogy that it had been, and remained, to people of his own age. Anything which smacked of deflation was anathema under the new policy, which explained the opposition of some people to the Bretton Woods proposals. They wanted to be free to devalue the pound, not to appreciate it. They did not want to be tied to the gold standard, because the gold standard might involve falling prices. Prices, therefore, would be kept up, and when they thought of the post-war price-level they would have to think in terms not of 25 % but of 33 % or even 50 % above the pre-war level. A higher price-level disposed of many difficulties. It carried a higher wage-level and thus avoided all the trouble of bringing down money wages. It carried a larger debt burden; and if Government debt were going to increase—and the advocates of the policy were quite prepared to see a very large increase in Government debt—it was necessary that it should not loom too large in relation to the national income.

Not only was there to be no money deflation but there was to be no productivity deflation. If the community became more productive—and all would hope that it would become increasingly more productive—the increased output was not to express itself in lower prices but in larger money incomes. As an illustration, if 100 units were produced and were sold for £100, and then, as a result of invention or changes in organization, it became possible to produce 110 units, that would not mean that the price would come down; they would be sold for £110, and the participants in production would receive a correspondingly larger income.

Those were the features of the full employment policy. He did not say that he subscribed to it, but it was the policy which was in the air, and those were the features which he wished to emphasize. Expenditure was the key to the policy—outlay on consumption, outlay on capital goods. Savings as savings would earn no praise. It should be noticed that the tax concessions in the latest Budget were for active investment. Money spent on new machinery or new industrial buildings would qualify for tax allowance; money put to reserve would not qualify. What would be the consequences of such a policy? First, what would be the effect on the prices and yields of gilt-edged stocks? There was already talk of the price of 2½ % Consols rising to par. If Government credit were to be put on a 2 % basis (and it should be remembered that it had even been suggested that there was no need to issue any more Government stock), then the only outlet for investment in the gilt-edged market would be a succession of bonds at par, on terms progressively less favourable to lenders. He had noticed that Mr Bevin had said recently: 'Samuel Smiles may not be read very widely in future.' He did not know whether he was referring to the Samuel Smiles of *Self-Help* or to the Samuel Smiles who wrote *Thrift*; but he did know that the Victorian praise of thrift had changed into complacent speculation about the 'euthanasia of the *rentier*'.

What would be the effect on ordinary shares? Maintenance of the price-level meant that the national income after the war would in money terms be from 30% to 50 % larger in total. If the national income was £5000 millions before the war, after the war it would be £7000 millions or even £8000 millions as a result of the change in the price-level alone. Out of that larger total national income, the part represented by profits would be a much larger actual amount than the pre-war figure. That was why it was being argued by young pundits on the Left that ordinary shares were grossly undervalued. If a revaluation of ordinary shares took place and if it were in fact justified, it would be a once-for-all adjustment. What would happen after that? A national money income which was progressively rising with increasing productivity would furnish a correspondingly rising amount of profits. Those larger profits might have to be spread over a larger amount of capital, because, of course, new investment would have taken place, and in fact would be a prerequisite of increased productivity; nevertheless, the outlook for equity earnings was bright on the basis of that diagnosis. Moreover, if the full employment policy were successful, there would be none of those major setbacks which had rendered equities unstable and risky in the past. There would not be any more of those big depressions, so that a great deal of the instability and risk attached to equity investment would be removed. Finally, with a lower basis of interest—a 2 % or 2½ % basis—equity earnings would be capitalized at a much higher figure.

He would like to quote some calculations which had been made of the future national

income and the part represented by profits. Taking the actual national income in 1938 as about £4600 millions, it had been argued that it would have been about £5200 millions if there had been full employment at the time. In 1948, with a larger working population and increasing productivity, that figure would be about £5600 millions, even if prices had not risen. With a 33⅓% increase in prices, the national income would be about £7500 millions in the year 1948. Profits and interest in 1938 were about £1400 millions, but in 1948, out of that larger national money income, they would be £2400 millions.

Another estimate concluded that the national income would be over £6000 millions in 1951 at 1938 prices, but with a 33⅓% increase in prices it would be over £8000 millions, and with a 40% increase in prices it would approach £9000 millions. On yet another estimate, the national income would jump from £4600 millions before the war to about £7000 millions, even with 10% unemployment, while with 3% unemployment it would be £9000 millions. The calculator in that case went on to dissect the amount accruing to profits and to make a further sub-analysis to determine the amount going to company profits. They should increase from £675 millions before the war to about £1600 millions. Going still further and taking the part accruing to ordinary shares, the income of ordinary shares should rise from £500 millions to over £1200 millions. On that basis, ordinary shares should rise by at least 100% and even more, because a lower interest basis for capitalization would add about one-eighth to share prices. Even allowing for a continuance of Excess Profits Tax for two years, there would be justification for a 100% rise in equity prices.

Such was the comparison between the outlook for fixed interest stocks and that for ordinary shares or equity stocks. What of the repercussions on insurance finance? He would be brief and put what he had to say in the form of a few questions. What could insurance offer on the basis of a 2% gilt-edged yield, with income tax at, say, 5*s.* 6*d.*? Would mortgage, debenture and preference yields decline similarly? If the yield on Government stocks came down to 2½% or 2%, what would be the yield on mortgages, debentures and preference shares? Could endowment assurances be recommended as a form of saving on that basis? What attraction could be offered in annuities on a 2% interest basis? He would put it in the form of a challenge: what sort of disinterested advice should people such as himself give to the saver? If a man said to him 'I am saving a little money; how shall I invest it?', would he be justified in saying 'Take out a very good assurance policy and put it all into that', or should he say 'Take pure life cover and nothing else, and invest the balance in profit-earning channels, or even in real goods'? Should he say 'You will do better to buy furniture and household equipment and leave that as a more valuable legacy to your descendants, but do not put your savings into fixed money claims'?

How would the enhanced prospects for equities affect their qualifications for the investment of insurance funds? Mr Raynes had dealt with the equity *versus* bond question in two papers before the Institute. Mr Raynes had argued—he did not know how far he had convinced his audience—that even in a period of severe strain the advantage was with equities. But in any case, if some offices were to bank on the success of the new economic policy and switch over to equities, or largely to equities, in their investments, how would their terms compare with the terms of the offices which carried on the traditional, orthodox investment policy?

He wished to utter a few caveats. He had begun by diagnosing the temper of the times. They should not be swept off their feet by the new theories. They should look at them and study them, and do so critically, because the temper changed with the times, and some of the features which he had noted might not appear so attractive in five years' time, let alone in ten years' time. First, was the policy likely to succeed? Were depressions things of the past? Was it safe to assume that the clue to the trade cycle or to economic fluctuations had been found, and was it certain that they could be averted in future? After all, the spending policy had been tried in the United States after 1932 and had been continued until war broke out, and up to that time it had not wiped out unemployment. The answer to that might be that it was not on a large enough scale, as the war had shown.

Secondly, could cheap money be maintained? Was 2% really tenable in perpetuity? For some reason 3% had been a pivotal rate for centuries. Had it been left for their generation to discover a new method of managing the monetary system which would ensure permanently low rates of interest? Moreover, could it be held in one

country alone? Suppose it could be done in Britain, but only in isolation. Were they prepared to envisage the situation, in which, in order to maintain low interest rates in Britain, they would have to isolate themselves from outside influences? With higher rates abroad there would have to be exchange control in Britain to prevent advantage being taken of the bigger possibilities abroad. Did that mean ruling out foreign investment?

His third caveat was, could Budget deficits persist? The Government had not accepted that as a permanent feature. They were prepared to see Budget deficits for two or three years, but only if such deficits were made up later by surpluses. Some of the advocates of extreme policies, however, were quite complacent about continuing Budget deficits; so, indeed, was public opinion, but it might change at any time.

Fourthly, would the objection to lower prices persist? As he had said earlier, it was a long time since they had had any experience of inflation, but, if it should come, he was almost certain that there would be a rapid change in public opinion.

Next, if the policy succeeded and they had a much larger national income with a very great increase in profits, what guarantee was there that there would not be special taxation of business profits which would wipe out a large part of the gains—in particular, a special tax on company profits? That possibility would have to be borne in mind.

Lastly, even if equities did present such attractions, there was the problem of the choice of equities. In the case of Government securities, all stocks fell into line in the matter of safety and yield, but, in the case of equities, it was not possible to buy a general prospect or even an index of ordinary shares; the shares of individual companies had to be purchased. The risks could be spread, but there was the danger that a few large capital losses would gravely reduce the net earnings.

Mr D. G. S. Cutler said that the need for a policy of full employment was so generally recognized, and the whole subject was receiving so much thoughtful study, that it was particularly appropriate that the Institute should discuss its implications from the point of view of insurance finance—indeed, it might almost be said, from the point of view of the investor, because pension funds, trust companies and even the smallest investor would be affected in varying degree.

The investment manager, unlike many economists, had to concern himself not only with theories but with the much more difficult question whether any particular conclusion was sufficiently well-founded to justify a definite line of action. From his point of view, the principal implications of a full employment policy were those relating to the level of interest rates and the future of equities, the latter, of course, being to some extent affected by the former. The level of interest rates was closely bound up with the nature and extent of financial controls, both national and international, and there was general agreement that those controls would be the last to be lifted, or even materially eased. It was almost undisputed, therefore, that no rise in interest rates could be visualized in the next few years, but what of the longer view? On the one hand, there was a substantial body of opinion which anticipated that some rise might eventually be unavoidable, and indeed desirable, in the process of levelling the peaks and troughs of industrial activity. Sir William Beveridge, on the other hand, maintained that a policy of cheap money should be regarded as an integral part of a plan for full employment, and that inflationary tendencies should be fought by direct controls rather than by a rise in the rate of interest. Indeed, as the opener had pointed out, in Appendix B of Sir William Beveridge's book it was argued that there should be no difficulty in securing a further gradual reduction in the rate of interest, and Mr E. V. Morgan, writing recently in the *Economic Journal*, visualized a narrowing of the gap between the long- and the short-term rates. If he were asked to subscribe to one or other of the opposing views he would be inclined, on balance, to support the prophets of cheaper rather than of dearer money, but in practice he would endeavour to steer a middle course until the future trend of events was more clearly discernible. While, therefore, he would not invest new money in short-dated stocks, particularly in view of the exiguous yields on them, he would not yet go to the length of making exchanges on a large scale from shorter to longer maturities in the existing portfolio.

Turning to the future of equities, the widest possible diversity of opinion was found, and they had the somewhat ludicrous spectacle of two leading chart-readers in the columns of the financial Press taking diametrically opposite views of the outlook.

Apart, however, from those whom he might call the pure chartists, there were two main schools of thought, their difference being chiefly one of emphasis on the immediate or the less immediate future. On the one hand, there were those whose views were principally coloured by the difficulties and uncertainties of the immediate post-war period, and by the high (relative to past experience) and consequently vulnerable price-level at which equities stood. On the other hand, there were those who were influenced mainly by the implications of a full employment policy and by the increased national income resulting therefrom. The opener had referred to various calculations on the subject and in particular to the recent article in *The Banker* by Dr T. Barna, who reached the arresting conclusion that the present prices of equities should be raised by anything from 75% to 125%.

Before considering whether that tempting prospect was sufficiently well-founded to justify immediate practical action, he would like to review a few general points bearing on the question of investment in equities. He believed that the paper by H. E. Raynes in 1928 (*J.I.A.* Vol. LIX, p. 21) was the first occasion on which ordinary shares were seriously suggested as suitable investments for life offices. Much had happened since that time, and in few quarters would any opposition be found to the general principle. Furthermore, it was becoming daily a more urgent matter to find some means of stemming the continually falling yield on the invested funds of life offices. To the extent that it was due to the investment of all their new money in the Government's 'tap' loans, the fall was unavoidable, but it was being seriously aggravated by the repayments and conversions of high-yielding securities. During the current year alone, for example, more than £100 millions of Australian Commonwealth and State Government securities carrying 5% interest might be called for repayment, and they would doubtless be replaced on a 3–3¼% basis. To mitigate the effect of factors of that sort, how many types of 'yield sweetener' were available? Very few; for that reason, apart from any other, he felt that substantial investment would readily be attracted to equities if sufficient confidence could be felt in the increased dividends which Dr Barna expected them to produce. It would be of interest, therefore, to consider for a few moments some of the more important assumptions upon which Dr Barna based his case.

The first point to notice was that he started with an estimate of the post-war wages bill, and arrived at a figure for the national income by assuming, on the grounds of past experience, that the share of wages in the home-produced national income, excluding the pay of H.M. Forces, would be 39½% after the war, as before. He then estimated figures for various constituent items of the national income, and finally arrived at a figure for company profits as a residue. There was obviously scope for error at each stage of that process, and clearly the aggregate effect on the final residual figure might be considerable. The second point to notice was that, quite apart from the purely statistical aspect, there were two extremely important assumptions of a general character. The first was that there would be no price-fixing by the Government which would reduce the profitability of capital, and the second was that the rate of National Defence Contribution would not be increased and that there would be no other tax on company profits. He thought that both those assumptions were far too optimistic, and he also took the view that the experience after the last war (which Dr Barna adduced in support of his conclusions) was a very uncertain guide to the future, mainly because there was in existence a much more efficient and comprehensive system of controls. Moreover, it would not be wise to overlook a marked growth of the attitude of mind which regarded the profit motive as almost indecent, and dividends as a 'dissipation', to use the words of a former Chancellor of the Exchequer. Furthermore, Dr Barna's conclusions suffered in practical value from the fact that he dealt with the share index as a whole, merely remarking that it could be modified for particular industries. He (the speaker) had always regarded it as somewhat unrealistic to treat equities as though they formed a homogeneous group. There were certain fundamental similarities, but they were quite outweighed by the variation in characteristics of the different types of industry. A glance at the *Actuaries' Investment Index*, for example, showed that, whereas for industrials as a whole the price index at the end of the previous month had been 86·4 and the average yield 4·16%, in the case of the individual groups comprising the total the corresponding figures varied between 27·4 and 173·6 for the price index and between 2·94% and 7·90% for the average yield. That emphasized the substantial difference in the extent to which present prices already discounted future prospects and the very diverse experiences

which might be concealed in any aggregate figures relating to ordinary shares. To sum up, he submitted that the implications of a full employment policy were as yet too uncertain to justify a substantial advance in equity values as a whole. In practice, therefore, he would restrict purchases of equities for the time being to those which could be justified individually on their own merits, having regard to the future prospects of the particular industry, but without budgeting for any (as it might be termed) 'semi-automatic' rise in profits due to the increase in the national income.

He was conscious that his attitude might appear to be somewhat negative in character, but he made no apology for that; indeed, he doubted whether any more positive line was justified until it was possible to feel rather more confident that a full employment policy could in fact be implemented and to form a clearer view of its financial implications for the investor. Any broad, general movement in share prices usually developed relatively slowly, and was very often characterized by one or more temporary reversals of the general trend; consequently, it was usually possible to wait until some of the major uncertainties had resolved themselves and yet to be in time to secure at any rate a substantial portion of the maximum benefit with only a small fraction of the risk which would have been incurred by acting earlier.

Mr F. W. Bacon said that the opener had described the features of the full employment policy, and with gentle irony had attempted to laugh them out of court. For his own part, he did not feel that that attempt had succeeded, and he would like to know what alternative proposals would be put forward to obtain full employment, or whether it was suggested that full employment was not a thing to be desired. He had not really gathered the grounds of the opener's objections to the features of the full employment policy that he had outlined. To take only one, the question of the maintenance of the commodity price-level; was it suggested that prices should be reduced after the war to the pre-war level, or possibly even to the level obtaining before the 1914–1918 war? If so, was it possible to do that without running into the consequences which attended a similar attempt after the earlier war? There was, of course, a distinction between pursuing a deflationary policy to reduce prices quite drastically and pursuing a policy of allowing prices to fall to reflect increased productivity, and he was not clear which of the two courses the opener had in mind when he objected to the 'inhibition against deflation'. Again the opener had referred to the policy of spending to maintain effective demand, but did he suggest that effective demand should not be maintained, and, if so, did not that mean that unemployment was bound to result?

Turning to the effect on insurance finance of full employment, assuming that the policy was implemented, it seemed to him that the insurance companies were deeply interested in the maintenance of full employment. In the first place, savings tended to increase as the national income increased, and it was therefore reasonable to suppose that the volume of new insurance business would also increase. It was certainly likely to be more stable, in that with full employment there would be a smaller volume of lapses. On the investment side, unemployment and depression generally brought in their train depreciation of securities, because equities were depressed and there were defaults on preference shares and sometimes even on debentures. He felt that insurance companies in some degree had a responsibility to support measures for the prevention of unemployment, since they were one of the channels for stimulating and collecting savings. In so far as the diagnosis was accepted that unemployment was the result of intended savings exceeding investment, it was to the advantage of insurance companies to see that savings did not go to waste but were turned into real investment; otherwise a part of the social justification for insurance activities tended to disappear.

In order to maintain full employment, it would probably be necessary to control and to expand the volume of real investment; and that might mean, and in fact in the period immediately after the war probably would mean, that insurance companies would not have such complete freedom with regard to the investment of their funds as they had had in pre-war days. Precisely what the implications of that were it was perhaps too early to say, but it might be surmised that, to the extent to which the Government attempted to maintain effective demand by borrowing, the insurance companies would be asked to support Government loans to the maximum extent possible, in the same way that they had been asked to support Government loans during the war. The same remarks would apply, presumably, to any new institutions set up under Government

auspices or with Government blessing, such as the new Finance Corporation for Industry or, to quote a pre-war example, the Special Areas Reconstruction Association. He thought, too, that it was to be expected that the control of the new issue market would be likely to remain, at any rate for some years.

Then there was the question of the rate of interest. Modern economic theory seemed to support the view that the Government could control the rate of interest, and he had been hoping to hear whether the opener agreed with that. He rather gathered that he did agree with it but did not like it. It meant that the Government could control the long-term rate of interest by appropriate borrowing policy, and, furthermore, could reduce it. The theory would at least appear to be true so long as potential savings were greater than investment, i.e. so long as the Government were borrowing to maintain full employment, because the whole object of the borrowing was to utilize the excess savings which were not being absorbed by private borrowers. If that theory were justified by experience, then it seemed to him that, when it was generally realized that the Government could and would keep down the long-term rate of interest, the difference between the long- and short-term rates was likely to diminish. The current structure of interest rates in the market was logical only on the assumption that interest rates were going to rise in the future to, say, something like $3\frac{1}{2}\%$. If it were realized that that was not going to happen, the margin between short- and long-term rates would be likely to be reduced. The situation might then arise that insurance companies would be expected to support Government loans at a time when the rate of interest was falling. To some extent it might be possible to offset the effect of that by increasing the holdings of equities, since, without agreeing with Dr Barna's detailed calculations, he thought it was possible to agree that full employment was likely to help equities and to increase the income obtained from them. Such a policy would, however, involve taking more risk.

The conclusion to which they seemed to come was that the trend in the future would be towards investment income representing a reward for risk-taking rather than interest pure and simple. That in turn would seem to lend support to the suggestion, put forward in 1937 (on different grounds) by E. H. Lever (*J.I.A.* Vol. LXIX, p. 10), that premiums should be calculated at a zero rate of interest, and that investment income should be distributed in the form of bonus.

So far he had been dealing with the situation after the transition period. During the transition period the danger would be rather the reverse one, the danger of inflation, of too much spending because of the pent-up demand for consumption goods. The question arose whether the rate of interest should be allowed to rise in order to stop inflation. He was very doubtful whether, in fact, any practicable increase in the rate of interest would stop inflation arising from such a cause; it might make it worse or at any rate prolong the period of inflation, by impeding the re-equipment and reconstruction of industry and hence industry's capacity to increase the supply of goods. It seemed to him that during the transition period the only remedy was to maintain direct controls, such as rationing and the allocation of scarce resources, so long as the danger of inflation remained.

Mr Hargreaves Parkinson (a visitor) thought that, though the opener was clear in his own mind about the questions which were really under discussion, others might not be. There seemed to be a danger of confusing two separate questions. The first question was full employment and whether such a policy was likely to be put into force after the war and, if so, what its consequences would be; the second question was whether a larger proportion of the funds of insurance companies should be invested in equities in the future. Those were really two separate questions, because the case for equities did not turn on whether there was a policy of full employment or otherwise; that was only one constituent in it. Moreover, it seemed probable that within the next ten years they would learn what Britain had done in the matter of full employment, whereas the other question was one which depended on much longer-term trends.

With regard to full employment, it seemed to him that the great difficulty was that the question of putting such a policy into force would turn largely not on economic, but on political, considerations. As the opener had said at the beginning of his remarks, many people, including many people at Westminster, were terrified of unemployment; that phrase exactly described the position. If a policy of full employment were imposed, certain definite consequences followed. One was that economically the position would

be far more unstable. A number of economic checks and controls which had existed before would be removed. For example, when there was a state of less than full employment any increase in demand, any increased spending, tended not to raise prices but to raise the volume of employment; but when there was a state of full employment, any added increase in demand would, unless steps were taken, have inflationary consequences. Again, Sir William Beveridge had defined a state of full employment as being one in which there was a 'seller's market' for labour, where at any moment there would always be rather more jobs than there were employees available for them. There went another safety check. If labour in such conditions pressed for higher wages, again certain inflationary consequences would ensue. Sir William himself said that labour would be reasonable; although the whole history and tradition of the trade union movement was in the other direction, it would, when such a state was reached, undergo a complete mental transformation and would not press for higher money wages. If, however, instinct were too strong, if Sir William in fact were wrong, then the consequences would be troublesome. He thought that, given such a condition, it would be necessary for safety's sake to have some kind of outside control, which meant Government control. The policy of full employment would, therefore, inevitably lead to much more Government control, much more outside control, much more control by 'the Old Lady of Threadneedle Street' than there had hitherto been in peace-time or than many of them would willingly contemplate—and, of course, controls imposed in peace-time normally remained.

But what of the policy of full employment itself? It arose, he thought, out of conditions which were not long-term conditions. They came about between the two wars, and, in fact, mainly in the 1930's. There was a great fear on everybody's part of unemployment, as a result mainly of events after 1930. There was a great fear among politicians. Some of them genuinely hated the thought of the misery that unemployment caused; others recognized that those who wanted a full employment policy formed a numerical majority of the voters. There was a general fear of insecurity. It seemed to him that security and not full employment was the real objective of most people; they wanted security, and it so happened that full employment was the panacea offered to them as affording that security. But that again was a complex; it was not a long-term force. It was a complex which would probably pass if they had ten years of prosperity after the war. But if it did pass, that did not mean that the controls which had been imposed and the system which had grown up during that period would pass.

As for the second question, investment in equities, he wished to emphasize that the supposition that equity prices would be higher after the war did not depend necessarily on any assumption with regard to full employment. That was only one constituent in the calculations to which the opener had referred. There was first of all the rise in general prices, which he (the speaker) thought would be at least 50 %, and very probably more. There was the increase in productivity which arose from the development of scientific processes. That was a regular, constant factor, and had been maintained at a steady rate for a very long period. Those were the two main constituents in the figures given for increased national income after the war. Whether there was full employment (meaning unemployment of only 3 %) or whether there was less than full employment (meaning unemployment of 10 %) was in a sense a marginal adjustment to those calculations, but the case for a higher national money income after the war did not basically depend on any assumption as to full employment.

So far as equities and gilt-edged securities were concerned, his recent researches had been concerned with the price of equities during the last seventy years. For his purpose he considered that to be a long period, long enough for long-term trends to be visible. The conclusion seemed clear that the long-term trend of ordinary share values was in essence the long-term trend of the national income. It followed the line of national prosperity. Speaking very broadly, there had been no marked trend, upward or downward, in interest rates over the same period, a period which included times such as that of the last war and the years immediately afterwards, when there were abnormal fluctuations in interest rates. He thought that if the inquiry had been carried further back it would merely have reinforced that conclusion. The opener mentioned that over a very long period of some hundreds of years there was a tendency for interest rates to fluctuate around 3 %. The long-term trend of equities would be an ascending trend, provided it was assumed that the nation would continue to progress.

He thought that if insurance companies bought equities at all, they had better do so on the long-term argument; there was no other argument for them from the insurance point of view. But they had one great disadvantage from the insurance point of view, and that was that they were subject to very violent short-term swings, and it did not seem to be possible to avoid those swings. A representative holding of equities which was worth £100,000 at the beginning of 1929 was worth rather less than £50,000 two years later. On the other hand, an investment in equities in 1931 and 1932 would have doubled in value by 1936. There were swings such as that to contend with, cyclical swings, swings within periods of eight to ten years. If an office had to make a valuation which fell in an awkward cyclical period, and had invested heavily in equities, the figures would make a very poor showing. With present insurance technique, equities had that great disadvantage, and it might be that some modification of actuarial methods of valuation was necessary.

Mr W. H. Clough said the consensus of opinion so far was that the country would adopt a policy of full employment. The opener seemed anxious to dissociate himself from those who regarded that policy as desirable, and he was inclined to quote the old pundits as against the young ones. He (the speaker) well remembered how wrong the former had been in talking about a 'natural' rate of interest of 4 %, about the inability of the Government to control interest rates, and about an inevitable rise in interest rates at the beginning of the war and again at the end, but it seemed to have come to be generally accepted that interest rates would not rise.

Mr Hargreaves Parkinson had suggested that the country might have a policy of full employment as a matter of politics and not of economics, but he would suggest that it would come not only for political reasons but because economically it was desirable that the people of the country should be fully employed producing real wealth and thereby securing the maximum national income.

One bright prospect for life assurance companies was indicated by the opener in the direction of equities, but most of the reasons put forward seemed to have been countered quite adequately by Mr Cutler. In a world of full employment it would be very difficult to keep up the price-level. There was no danger of inflation because, unless there were control of the price-level, prices would tend to fall because of the mass of goods produced, despite the increased demand for those goods. With the increased share of wages, Government control and the possibility of special taxation, he could not feel that the prospects for equities were very good.

A life assurance company was, therefore, left with a problem which it passed to its investment department. It was true that the problem, so far as it entailed the investment of renewal premiums, belonged to that department, but what was the position with regard to premiums in respect of new business? The fact had to be faced that it was time that they put their house in order, not merely with respect to non-profit rates but also with respect to with-profit rates. For the latter class he would suggest a rate of interest of zero, any interest earned being distributed as bonus.

He would like to suggest that investment, which he had been taught to regard as a certain source of profit, had turned out badly, whereas mortality, which he had been taught to fear, had produced a steady profit. The weakness of the position of life assurance companies was that they had persuaded the policyholder to enter into life assurance as an investment. The policyholder should be persuaded to enter for the purpose of mortality cover, which implied whole-life rather than endowment assurance, and it should be realized that there was a possible source of weakness in accepting cash, converting it into investments, and reconverting to cash, with the underlying assumption of a rate of interest which might not be earned.

Mr H. W. Haycocks said that Mr Parkinson, in his very interesting book, devoted a section to a comparison of the yields, as shown by the *Actuaries' Investment Index*, on ordinary shares, preference shares and debentures over a lengthy period. With regard to ordinary shares, the yield was a relation between past dividends and current market price, and very often those dividends related to earnings over a period which had ended several months earlier. Investors, however, when purchasing shares, would try to estimate future earnings and the market price would reflect those estimates. During an upswing of trade it might be expected, therefore, that the yield shown by the *Index* would be

lower than the yield expected by investors, and that partly explained why the current 'ordinary' yield was below the debenture and preference yields. If that point were remembered, some of the conclusions and arguments which had been based on that difference would be modified.

On the question of a low rate of interest, Mr Bacon had referred to the paper by E. H. Lever, but in that paper he thought that the author had ridiculed the idea of the Government's being able to stabilize the rate of interest at a low level. However, they had had 'a 3 % war'. It was also worth mentioning that Lever had based his idea of a zero rate of interest for premiums on the uncertainty of long-term investments and the rather arbitrary way in which they were frequently revised in favour of the debtor; it was not that he had thought that there would be a very low rate of interest on gilt-edged securities.

It was well known that there was a complex of interest rates ranging from the very short loan rate upwards. He understood that at the beginning of the war the very short loan rate had been raised from about ½ % to about 1 % at the instigation of the banks, with a view possibly to assisting the discount market. He thought that that gave some idea of the part played by convention in the determination of a suitable rate of interest. Then there were the conventional rates on deposits of various kinds, which were payments very often out of the taxpayers' money and not in any way out of the proceeds of investments which had reduced costs. There was also the long-term rate, and finally the profit rate, which incorporated, as had been said, a margin for a risk premium. The differences between those rates were functions of the quantities of the different types of assets or securities in existence and the preferences of the investors for those various types, and it was knowledge of those facts which formed the basis of the Government's control of interest rates.

There were several ways in which the Government could regulate those rates. It could be done by changing the stocks of various kinds of assets available to private investors, which, when the Government was not borrowing, depended on open-market operations. The Bank of England could take up long-term securities in exchange for deposits, and in that way suit the preferences of investors who wanted more liquid securities. Again, the various Government Departments could vary their operations in the gilt-edged market, and finally the Government, when it was borrowing, could add to the different types of assets. The last method had been reduced to a very fine art during the war, and the essence of that art was to give the public a free choice between that very liquid asset, the bank deposit, and a variety of other types of more or less liquid securities. It was that method which had maintained interest rates at a low level, and, as long as the Government continued to borrow after the war, he saw no reason why it should not be continued. Another method of regulation, which the opener had touched on, was by a taxation policy which included not only variations in taxes on dividends and undistributed profits but also in the allowances which were made to industry and to investment institutions. The difficulties which arose in that connexion in regard to life assurance were well known. Finally, the Government could take more or less direct action against profit margins, and that was a point which threw doubt on the advantages of certain types of equities after the war.

It was possible to look at the matter in a very different light. The text-books laid it down that investment either reduced costs or was applied to satisfying new wants of consumers, and that was why business men could afford to pay interest. In that way the rate of interest was regarded as a sort of selector of the most profitable types of investment. In his paper in 1937, Lever actually implied that unless interest was paid in that way it was not really justified. Probably the author was referring to contracts between private individuals only, but it was worth remembering that a great deal of interest was nothing but a redistribution of the national income. The supreme example was the national debt, and after the war the national debt would probably be something like 50 % of the total value of all securities and assets. It was also seen in monopoly revenue, when a small group of individuals engineered additional profit by control of market prices and output. If, in future, industry continued to finance itself out of undistributed profits, institutional investors would be left with a choice of new assets on which interest might amount to little more than the redistribution of national income. In so far as some of those securities represented Government investment which had raised the efficiency of the workers, it might be said that the interest was justifiable

because the investment had reduced costs; but if, say, it was interest payable on account of borrowing to meet full employment, he thought that it would then fall into a much more doubtful category.

The main object of his remarks was to bring out the fact that interest was to a large extent a social phenomenon, something which was in many ways decided by the community itself, particularly when related to collective investment, and he saw no reason why the rate should not be driven to any level that the community desired.

Mr R. J. Kirton, in closing the discussion, remarked that Mr Hargreaves Parkinson had, he thought rightly, said that the discussion was concerned with two things: the full employment policy and the question of ordinary shares. He proposed to divide his remarks into three broad sections; first of all he would consider what might be called the peculiarities of life assurance finance, secondly he would try to assess the White Paper and the probabilities and possibilities of its being implemented, and thirdly he would try to see the effect on investment.

It was important to keep in mind that the discussion was concerned with life assurance investment. There was a general principle that assets should be of a similar nature to liabilities, and everybody was familiar with the dangers of lending 'long' and borrowing 'short' and with the dangers of a country where the assets were commodities and the liabilities were sterling or dollars. A life assurance office had liabilities which, generally speaking, were sterling, and which had a certain definite term. They could ignore the nature of those liabilities if they did so on the basis of their judgment, and they might even depart from principle by investing in ordinary shares, but it was important to remember that they were departing from principle. There was another matter which he did not propose to elaborate, but it could be argued that the pound sterling had always depreciated in purchasing power over a long period of years; so far, therefore, as their liabilities were in respect of with-profit policies, or of the bonus content of those policies, there was some reason for investing in ordinary shares.

Turning to the White Paper, he thought that it was a sound and realistic document. He liked the phrase 'a high and stable level of employment'; he was more inclined to quarrel with the term 'full employment'. He liked the White Paper for something which he feared did not commend itself to Sir William Beveridge, namely that the Government visualized dealing with industry as a sovereign power. There was one point about the White Paper which had been little touched on in the discussion, and that was the interesting voice from another world which crept into the section dealing with central finance.

He wanted to deal with three points in the White Paper: foreign trade, timing, and what he might call 'fluidity'. On foreign trade the White Paper said in the Foreword: 'If by these means [collaboration between Governments to secure favourable conditions of international trade] the necessary expansion of our external trade can be assured, the Government believe that widespread unemployment in this country can be prevented by a policy for maintaining total internal expenditure.' With regard to timing, the White Paper said: '...the crucial moment for intervention is at the first onset of the depression', and again: 'Questions of timing will be equally delicate; it is no easy matter to judge when a period of growing prosperity has reached its climax, is in process of turning into an inflation and requires corrective action.' It was interesting to see how the White Paper concerned itself on nearly every occasion with conditions where the onset of a slump required action, and not with a period of prosperity which was turning into a boom. There was, however, on one occasion a reference to that phase: '...but the restraining measures appropriate to a boom may meet with opposition unless they are seen and understood as part of a continuing policy for maintaining employment, and accepted as the price that must be paid for the success of that policy over the long period.' It might be an unkind thing to say, but it was doubtful whether the machinery of government in its current state of development was ideal for taking the necessary swift and far-reaching decisions ahead of events.

On the question of 'fluidity' or balance, he would give another quotation: 'an increase in one part of total expenditure can only within limits offset a decrease in another.' He could illustrate that by the suggestion that the National Insurance contributions should fluctuate with fluctuations in the state of prosperity of the country. It might be that the man who was out of employment would have to give up buying boots, but that

did not mean that the man in employment and receiving a larger net income would necessarily spend the increase on boots.

He would make one last quotation: '...the Government recognize that they are entering a field where theory can be applied to practical issues with confidence and certainty only as experience accumulates and experiment extends over untried ground.' He was not attacking the White Paper; he had said earlier that it was in his view a sound and realistic document. He did not think that the opener intended to attack it; but inevitably there were doubts about it. It represented a vast step forward, in keeping, as the opener had said, with the temper of the age. It represented a decision to expand, rather than to contract, on the onset of a slump. It should be remembered, however, that there was a world of difference between aim and achievement. It was not possible to make a revolutionary change in human nature overnight, and he thought that human nature would always tend to be too optimistic when things looked good and too pessimistic when things looked bad. He suggested, therefore, that if the policy were successful they could look forward to a flattening of booms and slumps, but not to their disappearance.

He did not propose to follow that very interesting line of thought which was concerned with the rate of interest on gilt-edged securities, but he would like to turn his attention to the question of ordinary shares. Pro tanto as prices rose and pro tanto as the Government were successful in their employment policy, the national income would rise. The gross earnings of companies would increase, but those earnings would suffer if wages and salaries rose, and Mr Hargreaves Parkinson seemed to have doubts about the instinct of labour on that point. They would suffer also if taxation rose. The opener had spoken of a possible special tax on company profits; there were already National Defence Contribution and Excess Profits Tax, and there was also the general political trend.

It should be remembered that within the realm of industry there were varying trends in different industries, and that within any given industry there were companies of varying degrees of efficiency and progressive ability. Moreover, as a friend of his had said, 'The blue chips of the present are never the blue chips of the past'. In their business of life assurance the assets had to be chosen to meet liabilities that were given. It was necessary to remember the difference between aim and achievement, and the doubts which had been expressed about achieving the policy of a high and stable level of employment. It was necessary to remember the economic pains suffered in the transition from peace to war, and to consider the transition from war to peace. Remembering all those things, it would be necessary to choose ordinary shares with more than usual care as to price, as to yield and as to prospects, as to the short- and long-term outlook for the industry concerned, and as to political risks. It was possible to be perfectly correct about the general outlook and yet to lose heavily because of a mistake in 'timing', or in the choice of industry, or in the choice of company to implement the general policy.

The President (Mr R. C. Simmonds), in proposing a vote of thanks to Mr Schwartz for his kindness in coming to speak to the members, said that the manner in which he had opened the discussion would confirm their strong sense of indebtedness to him. Even if some members disagreed with certain of the views that Mr Schwartz had expressed, the unanimity of appreciation was in no way diminished.

Mr G. L. Schwartz, in reply, said that he knew he would be criticized by the young men, but he hoped he had not given the impression that he was trying to laugh the proposals for full employment out of court, or that he thought unemployment was a laughing matter. He was seeking to determine the implications of the proposals as they affected insurance business and insurance finance. If interest rates could be anything that the Government liked to make them, so that they could be brought down to a very low level, what would be the result on insurance business and insurance finance? What could be offered through insurance if the business had to be conducted on those terms?

He would like to add a word to the younger members. He was reaching a period of life when he could say, with Falstaff, 'I begin to remember mine end', and at such a juncture he was bound to ask himself, 'What has happened to my savings?' Large numbers of the older people were beginning to be worried about the whole matter. He had been a teacher for most of his life. He had started paying for superannuation in

1912, and he wondered what he would receive in return. What was the current value of the premiums he had invested in 1912? Over the whole range he had lost half the real value of his savings.

There had been a great expansion of assurance business in the past two or three decades because people had used assurance institutions as a medium of saving, and in many cases the whole of their savings had been accumulated in that way. What could an assurance company offer them under a regime where the rate of interest was 2 % or less and where there was a deliberate policy of keeping up prices? Apart from what the assurance companies could offer them, what sort of advice could those not engaged in the business give to them? Was it reasonable to say, 'Put your money into endowment assurance'? If any business came along, the companies would deal with it efficiently and economically, but would any come along in those circumstances?

A great part of the world was beginning again to appreciate the dangers of inflation. Complacency about the progressive depreciation of the currency as time went on remained a sophisticated outlook; when ordinary people thought of those things, they began to ask whether investment in Government securities, either directly or indirectly, was worth while. The day might come when it would be necessary to advise against investment in Government bonds.

Mr A. S. Holness has subsequently written as follows:

Certain of the younger members who joined in the discussion appeared to think that speakers generally were not convinced of the need for full employment, or even doubted whether full employment was economically advisable. I do not think the discussion warranted such an interpretation, and it would be unfortunate if such an impression were allowed to pass unchallenged. I have no doubt that members of the Institute are fully alive to the need for giving the opportunity of employment to every man who is able and willing to do an honest day's work, and this on grounds both of humanity and economy. What was called in question was whether the methods which have been put before the public and which were discussed at the meeting would be effective, and whether their other consequences would be dangerous.

We are first and foremost citizens, but as actuaries we are expected to apply a critical faculty and a scientific method to financial and economic propositions. The main method of controlling employment put forward in the Government White Paper appears to be the incurring of Budget deficits or, what is a very similar proposal, the resort to Government borrowing for the provision of public works of a non-productive character. It seems reasonable to question whether a course of action, spending more than is earned, which in the case of individuals is known to lead to disaster, can result in the case of the State (in other words a combination of all individuals) in producing prosperity. The expedient of Budget deficits has been a commonplace of the South American republics all my life, it was adopted and has persisted as a policy of the United States since the inauguration of the 'New Deal', and Alberta and many similar examples can be recalled; but there is surely no convincing evidence that the results have been effective. The disadvantages in the destruction of credit, the confusion of foreign exchanges and the dislocation of foreign trade are well known. Above all it results in a breach of contract with every person who holds a Government Note or who has contributed savings to Government Loans, and works injury to all who hold assets in the form of promises to pay money.