

Edited by Lord Roll of Ipsden

# **THE MIXED ECONOMY**

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Brian Hindley · David Howell

Robert Millward · Maurice Peston

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# THE MIXED ECONOMY

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Edited by  
Lord Roll of Ipsden



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## THE MIXED ECONOMY

It is well known that all Western economies are now mixed economies. What is less well known is why they have opted for a system of mixed ownership, partly State, partly private. This book seeks to provide theoretical justification for that system and to illustrate it with examples drawn from a wide range of areas of economic life and policy. Thus Aubrey Silberston discusses the role of the British Steel Corporation in a mixed economy, Robert Millward seeks to compare the performance of public and private enterprise, and Charles Rowley looks at industrial policy in the mixed economy.

Anthony Culyer considers health services and George Psacharopoulos examines education; David Howell looks at energy and Andrew Bain at finance; Roy Hattersley seeks to situate the mixed economy in its political context, Brian Hindley and Derek Ezra to situate it in its world context, and Maurice Peston to construct a theoretical case for an inescapable condition. In his introduction and in his own contribution Lord Roll of Ipsden ties the threads, analytical and descriptive, together, and indicates important guidelines for future thinking and research.

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POLICY

# Notes on the Contributors

**Lord Roll of Ipsden** is a merchant banker and Chairman of S.G. Warburg and Co. Ltd and its holding company, Mercury Securities Ltd, a director of Times Newspapers Ltd and of other companies. He has been a Civil Servant, retiring in 1966 from the post of Permanent Under-Secretary, Department of Economic Affairs, as well as having been an academic – he was a Professor in Economics at Hull University. Among his books are *A History of Economic Thought* and *Uses and Abuses of Economics*.

**Maurice Peston** is Professor of Economics at Queen Mary College, University of London. He is the author of *Theory of Macroeconomic Policy* (1974) and *Whatever happened to Macroeconomics* (1980). He has been a special adviser to the Secretaries of State for Education and Science and Prices and Consumer Protection.

**Charles Rowley**, B.A., Ph.D., graduated from the University of Nottingham with first class honours in 1960 and a Ph.D. in 1964. He has been a lecturer at Nottingham and Kent and a senior lecturer at Kent. He has also been a reader at the University of York. Since 1972 he has been David Dale Professor of Economics at the University of Newcastle upon Tyne. He has published in the fields of welfare economics, public economics and industrial economics.

**Robert Millward** is Professor of Economics and Chairman of the Department of Economics at the University of Salford, Lancashire. He is the author of *Public Expenditure Economics* (1970) and of several articles in the field of public finance. His recent interests have extended to problems of economic organisation, including the economics of long-run institutional change in European economic history. He also recently served as a member of the Severn Barrage Committee of the Department of Energy.

**Aubrey Silberston** is Professor of Economics at Imperial College, London. He is co-author of books on the motor industry, the patent

system and the steel industry, and has published a number of articles on the economics of industry. He was a member of the Monopolies Commission 1965-8, of the Royal Commission on the Press 1974-7, and a part-time board member of the British Steel Corporation 1967-76.

**Roy Hattersley** is the Deputy Leader of the Labour Party and Member of Parliament for the Sparkbrook division of Birmingham. He has been Labour Party spokesman on Defence and on Education and Science and was Secretary of State for Prices and Consumer Protection from 1976-1979. He was a Visiting Fellow at the Institute of Politics at Harvard University in 1971 to 72.

**Anthony Culyer** is Professor of Economics and Deputy Director of the Institute of Social and Economic Research at the University of York. He has contributed many articles to economics and other journals and his recent books include *Need and the National Health Service* (1976), *Measuring Health: Lessons for Ontario* (1978) and *The Political Economy of Social Policy* (1980). He is co-editor of the new *Journal of Health Economics*, and is an economic adviser to several government and international agencies.

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**David Howell**, Conservative Member of Parliament for Guildford, was Secretary of State for Energy and a member of the Cabinet until June 1983. He served previously as Secretary of State for Transport. He is the author of many articles and pamphlets, was formerly on the editorial staff of the *Daily Telegraph* and before that in the economic section of the Treasury.

**Andrew Bain** is Walton Professor of Monetary and Financial Economics at the University of Strathclyde. He was a member of the Committee to Review the Functioning of Financial Institutions, and is the author of *The Control of the Money Supply* (3rd edn, 1980) and *The Growth of Television Ownership in the United Kingdom* (1964), and joint author of *Company Financing in the United Kingdom* (1976).

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**Lord Ezra** is a former Chairman of the National Coal Board. In May 1978 he published a book entitled *Coal and Energy*. He has also written numerous articles and broadcasts on subjects associated with energy, economic and industrial affairs, overseas trade and the problems of management.



# Introduction

All Western industrial nations have had mixed economies for many years. What is new is an acute debate concerning that mix and the breakdown of consensus with respect to the precise balance between the public and private sectors – in the limit between the command state and the night watchman state. When Section F of the British Association met in Salford in September 1980 to discuss the size, performance, composition and future of the mixed economy, it was doing so at a time of an apparent polarisation of attitudes as between left-wing collectivists and right-wing free marketeers. In that sense Section F was discussing not only the mixed economy but the compromise on which British economic policy had been based throughout the post-war period.

In the circumstances, it would be surprising if all the contributors to the discussions were in agreement on all the issues. Nor were they expected to be, for the purpose of an academic gathering such as the annual meeting of Section F is rather to air ideas than to arrive at decisive solutions. Nonetheless, the papers brought together in this volume do draw our attention to certain key topics in which the interest of all the contributors is engaged. Chief among these are the following:

*Firstly, efficiency.* Professor Millward makes clear how difficult it is to compare the performance of enterprises publicly-owned with that of enterprises in the public sector. In his paper, eschewing comparisons based on profitability (since governments have used public enterprises as instruments for the attainment of other policy objectives than profit maximisation alone, notably price stability), he opts instead for comparisons based on the relative cost-efficiency of public and private firms which supply the same product. Cases in point are not often found in the UK and the bulk of the evidence which he cites is drawn from the USA, Canada, Australia and Switzerland. His conclusion is that management in private enterprise would appear to be *less* cost-efficient than it is in the public sector (the exception seems to be refuse collection). A comparison based on relative profitability might, of

course, yield different results, although the studies on the US electric power industry to which Professor Millward refers illustrate a case where the average rate of return in the state sector does not in practice differ widely from that in private enterprises. Professor Culyer, looking at the health services, returns a verdict similar in its positive attitude towards social provision: he argues that a national health service – contrary to much traditional economic analysis – is actually a more rational mode of organising health care services than would be a private system.

It would be wrong to discuss managerial efficiency in the mixed economy without considering that of politicians and bureaucrats as well. This topic is taken up by Professor Rowley. He draws attention to recent developments in political economy which call into question the omniscience and neutrality of governments and reminds the reader that government failure (a phenomenon less frequently discussed in the literature than is market failure) might result from the distortion of information flows on the part of self-seeking pressure groups and growth-conscious bureaucracies. He shows how state regulation (in the form of, say, tariffs or employment protection laws) may have the effect of ensuring rents to producers at the cost of consumers compelled as a result of the measures to pay supercompetitive prices; and he describes how vote-seeking politicians may have a perhaps unwelcome bias towards deficit finance and excessive expansion of the money supply. He also argues (in contrast to behavioural theorists who deny that market forces adequately discipline organisation men) that, in the perspective of agency theory, the market value of the manager himself is derivative from the performance of the firm he manages.

Professor Silberston, in his paper on the British Steel Corporation (of which he himself was a part-time board member from 1967 to 1976) takes up the theme of performance and politics. He acknowledges that the BSC has in the past failed on occasion to satisfy an unexpectedly high level of demand for steel and that it did not in its early years lay sufficient stress upon initiative and productivity. He blames politicians in part for these shortcomings – for intervening in investment and pricing policies, for example; for retarding closures which were in actual fact inevitable (notably those of works which were sub-optimal in scale and employed obsolete technology); for placing excessive demands upon the valuable time of top management. He points out in addition that the very fact that the BSC was nationalised enabled trade unions to impose overmanning and high pay on the or-

ganisation in the knowledge that it – unlike its competitors in the private sector – was unlikely to be allowed to go bankrupt. At the same time, he also emphasises BSC's successes in the R and D field and its demonstrated ability to exploit economies of large scale.

The BSC faces competition from abroad: even if there were not significant private sector production, it is no more a natural monopoly than the National Coal Board, British Airways, British Shipbuilders, or British Leyland. The deleterious effects of privately-owned natural monopolies have often supplied an easy explanation of *why* industries are nationalised; and its unavailability in the case of industries producing internationally traded goods raises the issue of what policy goals, and what interests, nationalisation of such industries is intended to serve. Dr Hindley notes that nationalisation and nationalised industries have been used as means of protecting domestic industries against foreign competition; but he also argues that policy produces rough counterparts of these protective practices when privately-owned industries are pressed by imports. He therefore views these policies of nationalised industries as part of a wider problem, which is the unwillingness of many industrialised countries to adjust to changes in comparative costs. He suggests that protective policies in either the public or private sectors are designed to maintain or increase real wage rates in industries subject to international competition, and he concludes that the very extent of these policies (which some advocate should be further extended) makes it most unlikely that that aim can be achieved.

No one, as it happens, would say that public enterprise is unaware of the international dimension; and in his paper the Chairman of the National Coal Board, Sir Derek Ezra, draws attention to a little-noted contribution made by the nationalised industries – one independent of export performance and import substitution – to the balance of payments. This contribution is the sale of British technical expertise through consultancy and project-management schemes abroad; through the training of overseas personnel in the use of British equipment; and through the pooling and sharing of information with other nationalised industries at home.

*Secondly, equity.* A democratic society does not wish merely to attain its chosen economic objectives with no more than the minimal expenditure of scarce resources, it wishes also to do so in a manner fully consistent with generally accepted notions of fairness and social justice.

Justice is the theme of Dr Psacharopoulos' paper on education. He

notes the high private rate of return to investment in human capital in all countries and, rejecting the market segmentation hypothesis, presents statistical evidence in support of the thesis that the provision of education to an otherwise poorer man will enable him in practice to receive greater lifetime earnings, even if he is in the short run subject to some graduate unemployment while waiting for a job. He notes that differentials for skill appear to be constant over long periods, suggesting that demand rises at the same time and rate as the supply of educated manpower. Every additional year of schooling brings with it incremental earnings; and, while the benefit is particularly great for the child schooled in the private sector of education, in all cases the provision of education contributes more to life chances than does family background.

Fairness extends beyond the scarce resource of money to spend on goods and refers as well to the whole institutional environment within which that money is earned. This is the essence of Roy Hattersley's contribution. Mr Hattersley calls for an increase in the number of autonomous, socially-owned companies, giving workers via collective ownership a vested interest in the economic success of their organisation; and argues that employee involvement, not state direction, is the way to harness enthusiasm and *morale* and thus to improve the performance of British industry. Mr Hattersley's paper – which seeks to show that self-interest and democratic socialism are not incompatible – was written at the very time that workers at Gdansk and Stettin were demonstrating their conviction that central ownership and bureaucratic control are not always and everywhere perceived to guarantee personal liberty and social equality.

Mr Hattersley is evidently convinced that competition is an important part of the just economy, and he joins his voice to several others in this volume in advocating effective restrictive practices legislation aimed at preventing undesirable concentration of economic power. He in addition proposes interventionist measures of a positive nature – measures such as regional policy or the provision of funds for industry. Clearly, he would be in agreement with Professor Peston's point that private economic transactions have public consequences; that property is to some extent held in trust; and that responsibility to the community cannot be neglected in any discussion of economic arrangements and regulations.

*Thirdly, flexibility.* An economic process is a dynamic, not a static thing. It is in good measure to be judged by how well it adjusts to unforeseen shocks. One of the most challenging tests in recent years has

been the situation in the energy field since 1973, and the paper by the Secretary of State for Energy, Mr David Howell, is particularly illuminating in its attempt to present a Conservative case for rationing via the price mechanism. The market, he argues, encourages energy conservation, say, via home insulation, or via the substitution of the fuel-efficient vehicle for the huge 'gas guzzler', and the search for new sources of power. He adds, however, that a policy of market-determined energy prices must be accompanied by a degree of compassion towards those individuals and groups poorly placed to adapt quickly, together with government support to research and development schemes in areas as yet too risky to make them commercially viable. Mr Howell does not say that market signals are perfect guidelines along the road to change, but he is convinced that central planning would lead to worse errors.

Another illustration of flexibility is macroeconomic flexibility, the theme of Professor Bain's paper. He points out that, while publicly-owned financial intermediaries are in the UK the exception rather than the rule, they are nonetheless key participants in the mixed economy by virtue of their role in the process of credit creation. Although there is some uncertainty as to the sensitivity of private-sector investment to small changes in rates of interest, there can be no doubt that the public sector is significantly less sensitive than is the private to the cost factor in the short run. Professor Bain's general opposition to narrowly-defined monetary targets on the grounds that they impede capital market flexibility is likely to prove particularly controversial.

Policies to foster macroeconomic flexibility have in recent decades become an important part of social regulation; and it is interesting that several papers in this volume favour incomes policy as opposed to the invisible hand when dealing with cost inflation and highly imperfect labour markets.

The mixed economy was not built to the specification of an architect; and its justification must be sought not in any fundamentalist doctrine, but in its responsiveness to the highly complex variety of objectives of man in society. This book does not seek to advocate any particular pattern of a mixed economy, but simply to say what it is and does and what it might in the future become.

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# 1 The Mixed Economy

## LORD ROLL OF IPSDEN

For its annual meeting in 1980, Section F of the British Association chose 'The Mixed Economy' as its theme, and during the course of the session a number of specific topics relating to the mixed economy were treated not only by academic economists, but also by business men and politicians.

In this introductory paper I want to touch upon a few general problems relating to the mixed economy. The first of these that deserves attention is the question why the mixed economy should currently be a matter of interest, indeed, debate, in our country as if it were something new. In fact, we have for about two hundred years had nothing but a mixed economy. That it has not and is not viewed with favour by what I might call the Left in politics and the social sciences, that is to say, by the advocates of the collective management of all our economic affairs, is nothing new. What is particularly striking today is that the mixed economy is under vigorous attack by what I might broadly call the Right of the politico/economic spectrum. The attack is inspired by a revival of extreme individualism in political philosophy with its concomitants of minimal government and a reliance on the 'invisible hand', working through free markets, to achieve an economically most efficient result.

Examples are numerous. In a recent booklet by one of the most consistent advocates of a completely free economy, is the statement that

the mixed economy would be the desired objective if it combined state economy in public goods that yield collective benefits (defence, law and order, local roads, public health, some scientific research, etc.) with market economy in the mass of economic activity that yields personal benefits . . . But in practice the mixed economy has been used to enable the State to regulate, control, direct and run industry in ways that have distorted private initiative and prevented its prodigious productivity.

Here is another, more moderate, statement by the political commentator of a leading daily newspaper. 'The mixed capitalist economy brought so much prosperity to the nation in the 'fifties that socialism was a non-starter.' He goes on to say 'We are now in a very different scene. The mixed economy, as at present composed and arranged, has passed through a period of substantial failure.' To show that even on the political Right other views may be held, here is another example, coming from a practising politician. In a recent lecture, the Lord Privy Seal said:

The extent to which help [that is to say help of a social character] is provided by way of subsidy, by insurance, or by voluntary bodies, or by self-help as a result of lower taxation and a more successful economy, and the extent to which social services are financed by taxation or charges, do not seem to me to be matters of fundamental principle.

And a little further on he speaks of a 'mixed or free economy as a necessary condition of freedom'.

There is much in these quotations that would deserve detailed analysis. For example, the parenthesis in my first quotation speaks of *local* roads, *some* scientific research, and ends with undefined etcetera. The second quotation makes the rather extraordinary statement that the mixed economy brought a great deal of prosperity in the 'fifties but for some reason has now passed through a period of substantial failure because it is 'as at present composed and arranged'. In Sir Ian Gilmour's quotation there is the equation or at least jointure of a 'mixed' with a 'free' economy. I do not propose to deal with these quotations any further. They are not only very puzzling in themselves, but show clearly the difficulties of the subject and the hazards to which one exposes oneself once one leaves the secure shelter of doctrinaire belief, be it in the 'night-watchman' state or in the 'command' economy.

Fortunately, or unfortunately, most of us, economists and businessmen and, as a rule, politicians, cannot take refuge in this shelter. We have to venture out. For my part, I do not propose to spend much time in debating the more doctrinaire attitudes; though in rejecting them, I do not propose to advocate any specific pattern for the mixed economy. My purpose is twofold: first to defend the principle and concept of the mixed economy as such; and second, to point out some of the problems for economics and for the relation between economics



and politics which the maintenance of a mixed economy raises.

I suppose that I should have begun with a definition. But debates about definition are always dreary and rarely fruitful. A rough and ready distinction between two types must suffice. One relates to ownership and to the management of the economic activity of a society; the other is concerned with the instruments of economic policy, that is the means used by the State to influence a generally privately owned and managed economy. The limits of the first of these are set on one side by collective ownership of what are traditionally called the means of production, distribution and exchange, and the management of their use by central government or its agents; on the other side, by the institution of private property in the means of production, distribution and exchange, by the exclusive reliance on individual interest and private enterprise as the motive force in putting these to use. In most Western economies, and certainly in our own country, when we speak of a mixed economy, we mean that the structure of the economic activities of our society lies well within these two limits. It is unlikely that anyone today would wish to question Adam Smith's acceptance that defence (which, you will recall, came before opulence) was a proper field of state activity. (And when the replacement of *Polaris* by *Trident* is to cost £5000 million, one can hardly call it a non-economic activity.) But, defence apart, it is only extreme dogmatists who would wish to 'roll back' the frontiers of state activity until they are virtually coterminous with total inactivity.

We know that the decision where the frontiers of a mixed economy, within the broader limits I have indicated, are to lie raises not only philosophical problems and beliefs which divide people politically; it also raises practical problems which have troubled economists for a long time. The issue was succinctly put by Burke, when he spoke of it as 'one of the finest problems in legislation, namely to determine what the State ought to take upon itself to direct by the public wisdom and what it ought to leave with as little interference as possible to individual exertion'. I cannot dwell on the purely philosophic aspects of this issue, except to say that even among the most libertarian of modern social philosophers very important differences can be discerned. As Professor Partha Dasgupta has shown in a remarkable inaugural lecture, the ideas of, for example, John Rawls in his *Theory of Justice* are very different from those of Nozick or from those of Hayek. I believe that for my present purposes, and perhaps to a large extent for the theme that runs through many of the contributions to this session, the practical problem of the drawing of specific frontiers