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No It Did Not: A Reply to Crafts

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THE rewards of the scholarly life are usually like the rewards of abstention in Victorian Britain—small and tardy. Still, like the Victorians themselves (and unlike their critics), one must accept the vengeful god who arranges for 5 per cent over twenty years to be a good return. At least in its size I have no cause for complaint in Mr Crafts's comment on my article published, it seems to me, so long ago. It is a comment on one paragraph.[1] Thus is my 300-word *torah* followed, after a suitable stay in oral tradition, by a 2,200-word *mishnah*. Moses himself did little better, and I accept with gratitude the implied compliment.

Two roads lie open in reply. The low road is through the brambles of Crafts's mismeasurement of British net domestic savings or of the share of income earned by capitalists, a sentence-by-sentence struggle over Errour. The reader will be relieved that I propose instead to take the high road, stopping briefly at the sights along the way worthy of note by other students of British history—even though the road not taken also held a few delights (for example, using the correct share of capital—defined conventionally, though as we shall see misleadingly, as the residual from the share of labour—rather than the "stylized fact" reduces the fresh consumption from higher savings in Crafts's calculation by about 40 per cent).

Before turning up the high road, however, I am compelled to mention a third, the Steady-state Turnpike, if only because Crafts spends most of his comment speeding along it. In fact, his discussion seems to me most bizarre. One might as well take the road to Scotland by way of Katmandu and Milwaukee with a stop in Wagga Wagga. I did not "rely on" a steady-state model in my article, nor even did I use it. Indeed I have long maintained that such models are worthless for historical purposes, and have said so in print and correspondence. Our models are identical—namely, the idiot's friend, a production function with an identity about capital accumulation. Ruminations about the steady state keep mathematical economists off the street, but two economic historians can agree to stick to honest work.

All right, then: after getting down to business in the ante-penultimate paragraph, what has Crafts tried to show? He has tried to show that had Britain invested at home as America did, Britain would have done much better. In particular, had Britain after 1871 matched American standards of 12 per cent of domestic income invested at home it would have enjoyed consumption in 1911 a quarter higher than actual. Although he obscures the point in various ways, it must be made clear at once that he is not coming to a different answer to the question I posed in 1970: "Whether the late Victorians were profligate in con-

[1] 'Did Victorian Britain Fail?', *Economic History Review*, 2nd ser. XXIII (1970), 450–1.

sumption compared with foreigners at the time or Englishmen before." When investment abroad is added to investment at home and compared with income—that is, when all abstention from consumption is included—the British were only a little more profligate in consumption. This, then, is not the issue. Crafts means exactly *domestic* investment. He does not mean that in late-Victorian Britain savings were very low in total, but that they were misdirected to Canadian railways and Italian mines. If Crafts had asked the British to emulate the standards of an industrializing country in domestic investment in addition to those of a mature economy in foreign investment he would be asking it to perform precisely the miracles of thrift I rejected in my article as unreasonable. But he in fact agrees with me in not imposing this burden of blame on his great-grandparents: according to him they were not profligate in their consumption, merely incredibly stupid in investing their savings.

For Crafts apparently knows better than his great-grandparents. They could have had a quarter more consumption in 1911 simply by passing a law in 1871 banning all investment abroad. What a marvel of ingenuity is such economics! How wonderful! By hobbling itself, Britain is made truly free. By offsetting the decisions of its businessmen, it is made rich. By a mere transfer of funds from one investment to another, its consumption is raised. The reader may notice a more than superficial resemblance to the marvellous and wonderful economics of certain Treasury advisers since Keynes. Good public policy can provide enormous free lunches to us all if only the dullards presently in power, or (if we are in power) in the City or the country or Zurich, will listen. Further, these policies are discoverable not by some tiresome empirical inquiry but by pure right reason unalloyed, possibly expressed in a few figures on the back of an envelope.

Such self-confidence in second guessing deserves a sterner test than mere comment-writing. It is always a serious point to ask the American Question of an economic historian who discerns some missed opportunity in the past, "If you're so smart why aren't you rich?" Sometimes he can answer, "I discerned the opportunity precisely because I am looking backward; I do not claim to have better powers of prediction than the businessmen I study." But Crafts and many other critics of the late Victorians cannot answer this way, for they claim to have discerned missed opportunities of such magnitude and obviousness that anybody but a fool at the time would have seen them. This is why they so often conclude that the late Victorians were fools. Thorstein Veblen, for example, was scornful of the ridiculous little trucks on the British railways; Duncan Burn was shocked at the neglect of Lincolnshire ores; and Crafts, along with others, has found a way to wealth in redirecting investment abroad to home.

The astonishing magnitude of the new wealth is seen most easily by setting Crafts's world against the world that was. He emphasizes the increase in consumption by 1911 of a quarter. But it must be noted that this is achieved by an increase in net domestic income in 1900 prices of a third (comparing Crafts' £2,634 million with Feinstein, Table 5, cols. 12 minus 14 for 1909–13), and this in turn by a net domestic capital stock in 1911 twice its actual size. By keeping savings at home the British people could have had two Forth Bridges, two Bakerloo Lines, two London housing stocks, two Port Sunlights. The common sense of this piece of political economy is, of course, that the rate of return would

be driven down to nil. So deep is his fascination with the arithmetic of growth, however, that Crafts does not notice this problem.

Its centrepiece—and the source of the free lunch—is the assumption that foreign investment earning 5 per cent could be brought home to earn much more than 5 per cent (or the 1 per cent to which Crafts programme of investment would drive the economy), namely, 10 to 12 per cent. The 5 per cent (or less) we know from the return on foreign bonds. The 10 to 12 per cent we believe we know by dividing the "income of capitalists" (that is, 40 per cent of income) by the value of the capital stock. That the 40 per cent of income called the "return to capital" contains incomes incomparable with the safe return on an Indian railway bond does not bother Crafts, or his predecessor in this error, Dr Kennedy. It contains, of course, the basic return to capital (5 per cent), but also large incomes from accumulated depreciation funds, managing, self-employment, land, and, most of all, risk. The identity between Crafts's magic and the assumption that these incomes would somehow accrue to funds kept at home is easily demonstrated. Crafts's world achieves high rates of growth of income (Y) by way of the contribution of capital, that is, the high growth of the capital stock ($\triangle K/K$) multiplied by "its" share in income (α). But this product can be shown to be equal to the rate of saving out of income (s, or 12 per cent by assumption) multiplied by the prevailing interest rate on capital (i):

$$\alpha\left(\frac{\triangle K}{K}\right) = \left(\frac{iK}{Y}\right)\left(\frac{\triangle K}{K}\right) = \left(\frac{iK}{Y}\right)\left(\frac{sY}{K}\right) = is.$$

There is no mystery here: if £10 out of £100 is saved and is put to work earning 10 per cent, then income rises in the next and all future years by £1; and this £1 must be, arithmetically speaking, the "contribution" of the rising capital stock to economic growth, which is to say that the left-hand side of the equation must equal the right. In Crafts's world we know α ($= 0{\cdot}4$), $\triangle K/K$ by decade (e.g. 3·75 per cent per year during 1872–82), and s ($= 0{\cdot}12$). We therefore know the interest rate, i, that he is implicitly assuming could be earned on home investments. In the case of 1872–82 it is $\alpha\ (\triangle K/K)/(s) = 0{\cdot}4\ (0{\cdot}0375)/0{\cdot}12 = 0{\cdot}125$, which is to say that savings kept home could earn 12·5 per cent (it falls gradually to 9·7 per cent in 1902–11). But we know that this conclusion is somewhat deficient. We know that it is nonsense to suppose that Victorian investors would have forgone 12·5 per cent at home in favour of 5 per cent abroad. We know in fact that comparable assets earned comparable returns at home and abroad, with bonds earning around 5 per cent and the right of ownership, with its risks and rewards, more. And we know the source of the nonsense, for Crafts has fallen headlong into a trap lying in wait in the national income statistics for economists who use arithmetic rather than behaviour to guide their research—the trap of assigning to sleeping "capital" all the incomes that cannot be assigned to labour. In the article I warned of the trap (p. 453, middle paragraph; Fig. 1), but I should have warned louder, and shall do so here. There was no divergence of 7 per cent between foreign investments earning 5 per cent and domestic investments of the same sort earning 12. They were not of the same sort. Nor is the point at issue one of private *versus* social return: if the domestic return had been

12 per cent it would have been a 12 per cent available to any private holder of Indian government bonds, an unarbitraged divergence leaving him less than half as wealthy as he could have been. But there was in fact no such 12 per cent available for being a domestic bondholder. He would have to have been as well a landlord, manager, and risk-taker, selling tickets and doing the washing-up on the side. Had Victorians done more of these things Edwardians would have been richer—a remark that applies with equal force to Americans of the Gilded Age and Germans under Bismarck—but nothing in the record suggests that the British Victorians were by international standards unusually neglectful of their duty to their children.

The rebellion of children against their Victorian fathers is a stock description of British intellectual life between the wars. It should be recognized that the description applies to economic as well as to literary history. Keynes, the friend of Strachey and the rest, insisted throughout his career that the Victorians Did It To Us by sending their savings abroad. The anti-Victorian frame of mind dominated writings on British economic history for many a year. Perhaps it is time to stop looking for the Victorian failure that brought death into the world and all our woe with loss of Eden. Perhaps we should free ourselves from the pre-occupations of Keynes and his intellectual brothers. And if we wish to criticize or defend the Victorian achievement we should certainly eschew blackboard history. Or at any rate we should do it right.

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