C.P. (47) 227

30TH JULY, 1947

CABINET

BALANCE OF PAYMENTS

Memorandum by the Chancellor of the Exchequer

The Cabinet at their meeting on 29th July (C.M. (47) 65th Conclusions, Minute 2) had a preliminary discussion about the Balance of Payments and asked me to make a series of proposals for action, to be considered at their meeting on Friday, 1st August.

I. PRESENT POSITION

2. First let me summarise the main facts of the present position. These are very simple and very unpleasant. I warned the Cabinet on 5th June last that "if the present rate of drawing on the United States Credit continued, this Credit would be exhausted as early as the end of 1947". It is now quite clear that, at the present rate of drawing, the Credit will not last beyond November and will probably be exhausted in October, or even possibly in September. There is no reason for hoping that, unless we take new decisions and appropriate action, the rate of drawing will fall in the near future.

3. The U.K. deficit with the Americas for mid-1947 - mid-1948 according to the latest estimates will be about £600 million. Any diminution of this figure from surpluses arising with the rest of the world can only be small and uncertain.

4. When the United States Credit is gone, we shall be back on what will then remain of the Canadian Credit, probably not more than £400 millions (£100 millions) in November (and not available as we need it), and our other final reserves of gold and dollars which are somewhat less than £600 millions. These are the reserves, not only of ourselves, but of the whole sterling area.

5. If, therefore, when the United States Credit is exhausted, we were to make no change in policy, but were to start drawing on our reserves, those reserves would be
completely exhausted within a few months. No-one could advocate such a course.

6. We are faced in this matter with a most unpleasant dilemma. If, when the U.S. Credit runs out, it is clear that we should get no aid, or inadequate aid, from the Marshall Plan, we should have to embark on a major reversal of our economic policy. The only course open to us would then be to secure our supplies by a process of bilateral bargaining which would be inconsistent with the obligations of the Loan Agreement. Such a policy would involve many difficulties and sacrifices. But, above all, it would stand no chance of success, unless we started upon it with our reserves intact.

7. But it is only too likely that in October it will still be quite uncertain how much aid Europe, and in particular this country, will get from the U.S. The negotiations under the Marshall Plan will probably be continuing and we shall be under the strongest pressure not to alter our existing economic policy, even though this involves drawing upon our reserves.

8. The Cabinet are not called upon to resolve this dilemma immediately, but its existence makes it essential that we should not shrink from immediate and drastic measures to conserve our reserves. Once they have been seriously reduced below their present level, we should be left defenceless against any conditions, no matter how intolerable, which the U.S. Government might wish to impose upon us. Further, any action decided upon now will take several months to show its results in saving foreign exchange so that if we are to prevent a critical drain on our reserves as soon as the U.S. Credit is exhausted, we must act now.

II. ACTION PROPOSED

9. We shall only escape from the present position by a bold programme of measures covering the whole front and, in particular -

(1) An increase in productivity leading to
(a) a larger volume of exports;
(b) increased production of certain goods which would otherwise have to be imported. Agriculture is the outstanding example.

(2) A curtailment of expenditure on imports;

(3) A review of all overseas commitments, which are equivalent to imports, and of their effect on the balance of payments.

10. Such a programme will mean a loss of amenities and some austerity, if not hardship. But it is the only alternative to a much worse fate coming upon us within a few months. It is essential that the programme should be put across in a way which will make our people believe, what is the truth, that such measures are essential to their salvation. It must also give them confidence in the future of this country, provided that all play their part.
III. INCREASES IN PRODUCTIVITY AND EXPORTS

11. Coal. The target for the present "coal year" (i.e. May, 1947 to May, 1948) must be stepped up to 220 million tons of coal, including open-cast. This target allows enough for full production in British industry and for substantial exports.

12. Steel. The target should be 14 million tons in 1948, allocation being primarily to goods directed to export and to such special U.K. needs as coal, transport and electricity generation.

13. Engineering. Subject only to due regard to the re-equipment of our own export industries, a greater emphasis must be placed on export. Thus the export of motorcars should be stepped up to 75 per cent. of production and a part of the present steel allocation should be switched from the production of motorcars to the production of agricultural machinery for export.

14. Textiles. Total production should be increased to a level which will give exports of a value of £250 million a year, without any reduction in the present value of coupons. Every effort should be made to increase production beyond this point and any such further increase should be shared between exports and home consumption.

15. Food Production. The target should be an additional £100 millions a year of agricultural production, to be achieved by 1951 at the latest. There should also be a vigorous campaign to encourage production of vegetables in allotments and gardens. In order to make full use of home grown fruit, the war-time scheme for supplying sugar for jam making to Women's Institutes should be revived.

16. Direction of Exports. There should be a special concentration of exports on the most appropriate markets.

17. Volume of Exports. Our aim must be 140 per cent. of 1938 in the second quarter of 1948, and 150 per cent. by the end of 1948. Production in excess of this level would make it possible to increase supplies to the home market. This target will be difficult to achieve but we must not fall short of it.

18. Goods Transport. Railways and road haulage must be given the necessary resources to enable them to meet the heavy strain which will be imposed by increased productivity.

19. Home Market. Investment will have to be curtailed, except where it contributes to export or to import saving. This will mean some slowing down of new building and of housing except in so far as they help to increase productivity, e.g. the provision of housing for special priority groups.

20. Hours of Work. The workers in many industries have secured a shorter standard working week. This should not be interfered with. But in the present situation the workers, particularly those in the basic industries, must be prepared to work additional hours, over and above the standard week, whether by way of overtime or otherwise.
21. Re-deployment of Labour. We must consult both sides of industry on this. The aim should be to distribute labour from the less essential to the more essential industries. To do this it will be necessary to re-enact the Control of Engagement Order. To make this fully effective, all employers must be required to engage workers through the Employment Exchange, and the power of direction must be invoked against recalcitrant workers.

22. Efficiency of Management. The appropriate Departments must have power to take action where the management of a firm is inefficient and impedes production.

IV. REDUCTION IN EXPENDITURE ON IMPORTS

23. Raw Materials. None of these can be cut much, except perhaps timber. The original programme for this for 1947/48 was £91 millions, including £60 millions hard currency. This should be cut by £10 millions. It might also be possible to make a saving of some millions by postponing part of our cotton purchases.

24. Film Remittances. We must make a heavy cut here, though the total is not large. There are several alternatives, the imposition of a heavy import duty, an embargo on all new imports (but this would not catch remittances on films already in this country), or an agreement with the Americans to leave the dollars here until we are willing that they should begin to draw on them. On this last possibility the Americans have promised to make early proposals. We should aim at saving at least £7 millions in 1947/48 out of a total of £15 millions.

25. Foreign Travel. I propose that as from 1st October next we should reduce the allowance from £75 for 12 months to £35 for 11 months. This would save £12 millions a year out of £30 millions. I am also arranging to limit more strictly business allowances and to save on this a further £3 millions a year, out of £10 millions.

26. Petrol. It has already been decided to save £4 millions out of £87 millions by reducing the basic ration as from 1st October and by making some cut in commercial use. We must do more than this. I propose a further cut on commercial and service use.

27. Tobacco. The cut in tobacco consumption resulting from the increased duty is already saving us £10 millions a year, and this year we are making an additional saving of £10 millions by reduction of stocks to the new consumption level. The total saving will thus be £20 millions, or more if prices fall heavily.

28. Other Consumer Goods. We should make further small savings here amounting to £5 millions a year, but none of this will be from hard currency sources.

29. Food. I propose that we should at once announce that we are going to stop buying over a large range of dollar foods. This would tend to bring down prices, but to strengthen this tendency we should also announce a reduction in our consumption of these goods whether rationed or unrationed, thus creating the impression that our market for these goods is contracting. We
should not announce for how long we are going to stop buying the various articles concerned, but should leave this deliberately indefinite.

30. Our aim must be to make the United Kingdom a buyer's market for food, and thus to break the present outrageous prices which we are having to pay.

The total of the savings which could be effected in this way, on the assumption that buying was discontinued over the period to 31st December, 1947, is £85.9 millions. This includes £13.6 millions for feeding stuffs. These are essential to any increase in our domestic production of food and I suggest that they be omitted from the savings which I propose. The other items are as follows:

<table>
<thead>
<tr>
<th>Item Description</th>
<th>Savings (£ millions)</th>
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<tbody>
<tr>
<td>(1) Items, of which distribution could be maintained from stocks to the end of the year or dispensed with altogether, e.g. animal fats, rabbits and poultry, canned meat products, bacon and ham, canned fish, condensed milk, dried fruit, fresh fruit and nuts, canned fruit and vegetables, coffee; (in the case of some of these items the figure does not cover the whole of our supplies as some is already covered by contracts)</td>
<td>£47.3</td>
</tr>
<tr>
<td>(2) Less items which will be stopped in any case to achieve (for the six months) the reduction in the import programme already decided on by the Cabinet</td>
<td>£22.3</td>
</tr>
<tr>
<td>Other items -</td>
<td></td>
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<tr>
<td>(3) Wheat from U.S.A.</td>
<td>£11.0</td>
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<td>(4) Carcase meat from U.S.A.</td>
<td>£23.0</td>
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<tr>
<td>(5) Cheese from U.S.A.</td>
<td>£9.0</td>
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<tr>
<td>(6) Dried eggs (in bulk from U.S.A. and Canada)</td>
<td>£7.0</td>
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**V. OVERSEAS COMMITMENTS**

31. The two main items of foreign exchange expenditure are civil supplies for Germany and the cost of military forces abroad.

32. Germany. We are liable for half the deficit in the balance of payments of the combined Zone. The current estimate of our liability is £60 millions a year, of which at least £45 millions are dollars.
Overseas Military Expenditure. Our gross liability in foreign currencies at the present time is running at roughly £110 millions in the main areas overseas apart from petrol and food which are included in the United Kingdom requirements.

The distribution of troops is as follows:

<table>
<thead>
<tr>
<th>Area</th>
<th>Number of Men</th>
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<tbody>
<tr>
<td>Germany</td>
<td>130,000</td>
</tr>
<tr>
<td>Austria</td>
<td>13,000</td>
</tr>
<tr>
<td>Italy and Venezia Giulia</td>
<td>25,000</td>
</tr>
<tr>
<td>Greece</td>
<td>9,000</td>
</tr>
<tr>
<td>Palestine</td>
<td>95,000</td>
</tr>
<tr>
<td>Egypt</td>
<td>59,000</td>
</tr>
<tr>
<td>Rest of Middle East</td>
<td>34,000</td>
</tr>
<tr>
<td>India</td>
<td>43,000</td>
</tr>
<tr>
<td>Burma</td>
<td>11,000</td>
</tr>
<tr>
<td>Rest of Far East, principally Malaya</td>
<td>50,000</td>
</tr>
<tr>
<td>Other areas</td>
<td>26,000</td>
</tr>
</tbody>
</table>

Total: 500,000

I recommend that the number of troops in those areas should be reduced by 150,000 by the end of the calendar year.

The size of the Armed Forces at home and abroad is now 1,301,000 and is planned to fall to 1,087,000 by 31st March, 1948. I am sure that we should now decide on a quicker rundown to a lower figure.

VI. CONCLUSION

It is impossible to produce at this stage a balance sheet for the Balance of Payments over the next 12 months. On the income side much will depend on realising the proposed increase in coal production and the other priorities for exports.

What we must keep in mind is that we have a prospective currency deficit with the Americas of £600 millions for mid-1947-mid-1948. Whatever we do at the moment, we shall continue for some time to be in a hopelessly unbalanced position, unless we get very early and substantial new assistance in dollars.

But, even if everything goes smoothly on the programme I outline above, we may well be involved in reducing our final reserves below the danger level. Thus, as the year goes on, we may have to take still more drastic measures. But nothing less than the policy I have indicated above in its entirety will, I earnestly submit to my colleagues, meet the very grave immediate perils which confront us.

An all powers Bill

I am inclined to think that there would be both
practical usefulness and great dramatic value in passing such a Bill as the Emergency Powers (Defence) Act, 1940, which the present Prime Minister introduced in May, 1940. Parliamentary Counsel are considering what modification would be necessary to fit the present situation.

H.D.

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