E.P. (49) 161
23rd June, 1948.

CABINET

ECONOMIC CONSEQUENCES OF RECEIVING NO EUROPEAN RECOVERY PROGRAMME AID

Memorandum by the Chancellor of the Exchequer

I think my colleagues should be aware of the attached study made in March about the economic consequences of receiving no European Recovery Programme Aid.

Introduction

2. Although three months have passed since the study was made the general conclusions are not thought to be affected. In particular the balance of payments statement in paragraph 1 is still broadly correct in its conclusion, namely that there would be a gap to be closed in 1948/49 of the order of £370 millions. The paper assumed that though the United Kingdom received no aid other European countries would receive a small amount of relief. The contingency to be considered now is that His Majesty's Government finds itself unable to conclude the Bilateral Agreement with the United States while some at least of the other participating countries are unlikely to take this line.

3. The salient points arising from this paper are as follows:-

(i) Gold Reserves

In the interval since the paper was written we have been operating on the assumption that we would receive adequate European Recovery Programme aid. Our total reserves at end June will stand at about £450 millions. The drain during the first quarter was £147 millions and during the second quarter it is unlikely to be less than £100 millions, a total of about £250 millions for six months. We may expect that the drain in the latter half of the year will be at a reduced rate but it is unlikely to be less than £130 millions for the second six months of the year. Consequently at the end of the year in the absence of any drastic measures the reserves would be reduced to £270 millions. Naturally if no European Recovery Programme aid is received we should have to take drastic measures, but we cannot assume that the drain will be stopped immediately (see paragraph 5 of the report). As we regard £500 millions as the minimum safe reserve, and have in fact told the Americans so, the position would be one of the utmost gravity.
(ii) Consequences to the Home Economy

If all the methods of closing the gap dealt with in paragraphs 8 - 15 of the report were taken successfully (and there must be doubts about the Sterling Area on which we comment below), there would only remain something of the order of £215 millions available to finance dollar imports. This would mean cuts as follows:

(a) No further purchases of dollar tobacco. The effect of this would be very grave and we might not be able to apply so rigorous a policy. If we could not, additional cuts would have to be made elsewhere.

(b) Abolition of standard petrol, cut in supplementary ration, extensive reconversion to coal and economies in agriculture and civil aviation.

(c) Reduction of the dollar food import programme to Canadian wheat only. (In the last negotiations Canada said that all the food contracts stood or fell together and we have no means of being certain that she would change her attitude now.)

(d) A cut of about 12% in the total raw material import programme, but not spread at all evenly since some, e.g. wool, come wholly or in large part from non-dollar sources. The maximum cuts in raw materials would be between 15 to 20 per cent of the home industry as compared with last half of 1947.

(iii) The application of these cuts is dealt with in detail in paragraphs 21-33 and may be summarised as follows:

(a) There would have to be reductions in the rations of tea, sugar (8 to 5 ozs.), butter (3 to a little under 2), bacon (to 1 oz.), cheese (to 1 oz. and even less) and cuts in eggs, meat and coffee supplies. The resulting calorie level would be in the region of 2670 per day, i.e. a little below the level during the spring potato shortage and over 10% below the pre-war average (paragraph 26).

(b) No prospect of implementing the agricultural expansion programme insofar as it depends on imported feeding-stuffs (paragraph 27).

(c) General restriction of consumer goods, particularly cotton, less paper for newspapers and books, less goods made of non-ferrous metals (paragraph 28).

(d) There would be extreme industrial dislocation, involving unemployment of perhaps as much as 1½ million, possibly more at first. Furthermore, it would not be possible to forecast in detail which sections of industry would be affected and therefore it is not possible to make plans against such dislocation. It may take a considerable time before revised machinery to distribute reduced quantities of raw materials could be got into proper working order.

(e) Clearly some of the measures proposed could only be really effective by having much tighter controls than those at present exercised. Qualified staff to undertake these tasks could not be collected and organised for many months.
(iv) Sterling Area Deficit

This is dealt with in paragraphs 10 and 11 of the report. The attitude of the Sterling Area would obviously be influenced by the circumstances in which the negotiations on the Bilateral Agreement with America broke down. There is no assurance that many of the assumptions there made would be realised. In fact negotiations, e.g. with India and Pakistan support the view that they would not be realised.

4. I have no doubt that if we receive no European Recovery Programme aid some of the consequences would not be precisely those set out in this paper but we shall then be in the position that any alleviations made under one heading have to be met under equivalent cuts under others. There is no doubt that the broad picture of the gap to be filled and the methods to be taken to do it are as stated.

R.S.C.

Treasury Chambers, S.W.1.

23rd June, 1946.
ECONOMIC CONSEQUENCES OF RECEIVING NO E.R.F. AID

A. INTRODUCTORY

1. The object of this section is to attempt to trace out the main consequences to the United Kingdom's economy if we should receive no United States aid in 1948/9 or in subsequent years.

This contingency is now remote. It is however, impossible fully to appraise the economic consequences of American Aid, outlined in the preceding section of this report, without a statement of the alternative. Moreover aid is not likely to be adequate to our needs - our reserves will continue to fall - nor is its continuance beyond the first year certain. The tendencies described in the following paragraphs are, therefore, of continued relevance to our fundamental economic problem of the short-term future.

2. What follows is not a plan, or a set of proposals. The changes that would take place would be so complex and unrelated, there would be so many uncertain factors, that precise forecasts are out of the question. Moreover, much would depend on choices between alternative policies. These, we cannot anticipate: we can only suppose that particular decisions are taken. But we have attempted to make our assumptions clear.

3. Assumptions. To define the problem we start by assuming:

(a) that, though the United Kingdom receives no direct aid, the United States give Europe relief sufficient to prevent famine and unrest, but insufficient in itself to allow any further recovery of output, and any added competition with us for imports or in export markets.

(b) that it is outside our province to discuss economic decisions with strategic implications which might well be necessary. But we have assumed that we shall be anxious to avoid any steps that would grossly affect the economic life of Europe.

(c) that the countries of the Empire reduce their calls on dollars and maximise their earnings of them by generous efforts of economy and production.

4. Method of Argument. As soon as it became clear that we were to receive no aid, we should have to make a set of drastic decisions which would produce rapid and largely unpredictable changes. For example, we would try to break dollar contracts but it is impossible to say how fast or in what way we could do so; we would have to re-negotiate many bilateral trade agreements, but we cannot say precisely what our bargaining position would be; there might be large and sudden changes in world trade and prices, but their direction is not easy to forecast. We therefore, do not attempt to forecast the precise chain of events after the first series of decisions. Instead, we have attempted to define a single position through which the economy would probably move fairly soon and to describe what would be happening at that date.
5. We start with the present plans for the year 1948/9. (Those are in effect based on a tacit assumption of fairly ample E.R.P. assistance). We have then supposed that we have in a few months entirely to stop any further drain on our gold and dollar reserves.

This approach disregards three factors that would in fact delay the decline of the economy: (a) clearly we could not in fact stop the drain on reserves overnight, and we would probably have a few reserves still to lose. But the drain could not last long for the simple reason that the reserves are small. (b) Stocks of food and materials could be run down: not for long. (c) We might find, if really pushed to it, that we could sell a few more foreign assets for gold or dollars. (This is a highly technical subject and it is certainly not clear that even short-period advantage could be gained, but certainly in precise plans for a "non-Marshall world" it would need study.)

There are many imponderables, the short term effects of which we have also had to ignore: industrial unrest, malnutrition, greater labour mobility, more realism and, therefore, more effort among managers and workers, and at a further remove changes in the terms of trade and the volume of world trade.

Prima facie therefore the broad assumptions made may fairly describe a state of affairs which without E.R.P. aid we should reach in a few months, say at some date in 1949. The quantities given may therefore be thought of as rates at that time.

6. Section B shows the gap to be closed. In Section C we describe the big adjustments we have assumed to close the gap. In Section D we describe the consequences to the main sectors of the home economy, and in Section E we briefly examine some of the longer term or more indirect effects of the initial and more deliberate adjustments previously defined.

B. THE GAP TO BE CLOSED

7. The following table gives an extremely rough estimate of the balance of payments with the dollar area (United States of America, Canada and American account countries) in 1948/9. It uses the import programmes recently prepared (the "X" programmes) to illustrate desirable imports on a continued basis of austerity. The last two columns state the adjustments that we assume would be made, and the resulting rates of expenditure and earnings on their completion (and before all the secondary or long term consequences of these changes worked out).
### Balance of Payments with Dollar Area

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<tbody>
<tr>
<td><strong>U.K. Imports from Dollar Area</strong></td>
<td>6 million</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food &amp; Agriculture</td>
<td></td>
<td>130</td>
<td>-55</td>
<td>75</td>
</tr>
<tr>
<td>Raw Materials</td>
<td></td>
<td>165</td>
<td>-75</td>
<td>90</td>
</tr>
<tr>
<td>Manufactures.</td>
<td></td>
<td>45</td>
<td>-25</td>
<td>20</td>
</tr>
<tr>
<td>Oil (Civil Imports)</td>
<td></td>
<td>50</td>
<td>-20</td>
<td>30</td>
</tr>
<tr>
<td>Tobacco</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Films</td>
<td></td>
<td>5</td>
<td></td>
<td>5</td>
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<tr>
<td><strong>Total</strong></td>
<td>530</td>
<td>395</td>
<td>-180</td>
<td>215</td>
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<tr>
<td><strong>Other Net Gold and Dollar Payments</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oil (Military and Civil Transactions) (net)</td>
<td></td>
<td>55</td>
<td>-20</td>
<td>35</td>
</tr>
<tr>
<td>Other Items</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td><strong>Rest of Sterling Area</strong></td>
<td></td>
<td>-15</td>
<td>-10</td>
<td>-25</td>
</tr>
<tr>
<td><strong>Deficit with Dollar Area</strong></td>
<td>265</td>
<td>60</td>
<td>-60</td>
<td></td>
</tr>
<tr>
<td>Gold and Dollar payments to other non-Dollar countries</td>
<td>155</td>
<td>65</td>
<td>-60</td>
<td>5</td>
</tr>
<tr>
<td>Gold purchases (net)</td>
<td></td>
<td>-10</td>
<td>-10</td>
<td>-10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>530</td>
<td>155</td>
<td>-150</td>
<td>5</td>
</tr>
<tr>
<td><strong>Receipts from Exports and Re-exports</strong></td>
<td>115</td>
<td>180</td>
<td>40</td>
<td>220</td>
</tr>
<tr>
<td><strong>Total drain</strong></td>
<td>1025</td>
<td>370</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### C. Methods of Closing the Gap

1. A dollar gap of £370m. would have to be closed. The problem would be to cut the various expenditures or increase the various earnings in ways which made the total readjustment to the economy with the minimum dislocation. To do this even roughly requires that we take a view on such questions as whether adequate food is more important than full employment; the set of adjustment assumed is therefore arbitrary.

2. **Exports.** The most strenuous effort would have to be made to expand exports to the dollar area. As a financial total, the gap is less than a quarter of the total exports to all destinations planned for 1948. It might, therefore, be supposed that we could so far to close it by the "diversion" of export goods. Presumably we should be prepared to adopt the most drastic measures. But on practical grounds we have been forced to conclude that an annual rate of additional dollar export earnings of £40m. is as much as could be expected within a year. Most of this would have to consist of cotton textiles, woollen goods and coal being the other main items. While metal goods of all kinds could certainly be increased they are at present so small an item in our exports to the dollar area (£20m. in 1947), that in the short term no large allowance for their expansion is reasonable.
10. Sterling Area deficit. The sterling area deficit of £60m. is made up of a Colonial surplus of £40m. and a deficit on account of the rest of the sterling area of £20m. The Colonial surplus might be improved to £50 as a result of the diversions from United Kingdom and other soft currency consumption: coffee, rubber, tin and hardwood (£6m. or £8m.) hides, sisal, asbestos and non-ferrous metals (another £1m. or £2m.). Diversions from the rest of the sterling area would also be needed. Ten from India should yield an additional £5m. (although there are complications about the relationship between Calcutta and Mining Lane); fruit (mainly apples) from Australia and New Zealand could yield another £5m. On the assumption that the political difficulties were overcome, butter from Australia and New Zealand could yield nearly £50m., which is one half the present rate of import from these two countries, and which would involve us in a loss of two fifths of our present supplies.

11. To stop this drain altogether another £50m. would have to be saved from dollar imports into the rest of the sterling area. To achieve this India and Pakistan in particular would have to be kept firmly down. A plentiful supply of textiles would be necessary: the Sterling Area has recently been taking United States textiles at the rate of about £50m. a year. Other exports from the United Kingdom would also have to be stimulated. It should be remembered that the attempt to impose excessive economy upon some Dominions might set up strong pressures towards their leaving the sterling area, or diverting supplies which we would wish to retain or dollar invoicing for their exports to us.

12. Gold and Dollar Payments to other Non-dollar countries.

The aggregate figure for 1948/9 has of necessity been somewhat arbitrarily estimated. It contains an allowance of £30m. for the Argentine - this being the approximate current deficit on the half year following the end of our current agreement, £10m. for Germany and a variety of smaller payments for Egypt, Persia, Finland, Belgium and so on.

We shall have some dollar earnings, from interest, shipping, etc., that we could use without difficulty to continue payments of this kind, but we should probably not be allowed, in bilateral agreements, to convert a net surplus with, say, Canada (which itself has a dollar deficit with the U.S.A.) into gold or U.S. dollars for other non-dollar countries. We assume therefore that these payments have to be reduced to a trickle, by cutting imports and expanding exports.

As an annual rate in 1949 our Argentine deficit may be estimated at about £60m. We might conceivably increase exports by £10m., though this implies a 25% increase in a very short period. Thus the remainder of the gap has to be closed by a cut of £50m. in imports.
The stopping of the other drains would raise difficult policy decisions on Germany and on military expenditure in Egypt; it would certainly require the most strenuous efforts to expand exports to Belgium, Finland and Egypt, among which oil and capital goods would have to be provided. Equally we might have to forego imports of the most essential kind—among them, timber, cotton and steel.

13. Oil Transactions. The £55m. here shown represents the net dollar cost of oil now sold to non-dollar countries, the dollar cost of the overseas oil expansion programme, and it includes also some £8m. for all United Kingdom military requirements. We assume that no large reduction in the latter is possible. The oil expansion programme is likely to yield a very high return in hard currency or hard currency saving. The major burden of reduction must therefore fall on the soft currency purchasers of oil from United Kingdom sources. By and large this must imply reductions in European and sterling area purchases of oil (or the provision of dollars at the expense of other dollar purchases). We have taken a figure of £220m. as the saving to be achieved. The measures entailed would hamper European recovery and would therefore be only reluctantly taken; but the cuts in their consumption would not proportionately be very different from those we are assuming for ourselves (see paragraph 17 below); and we may assume that we should be able to increase coal exports as some measure of compensation. But we might have to face indirect effects on our imports as a result especially of Colonial and Dominion economies.

14. The items of gold purchases and other items cover a wide miscellany of transactions. We have assumed that by attempting strict control of remittances (including profits of subsidiaries, entertainment earnings, royalties etc.) restriction of selling expenses, etc., our earnings might be increased by a small amount.

15. These adjustments imply that, after allowing for invisible earnings, all but £5m. of our dollar area export earnings of £220m., would be available to finance the import programme. The currently planned rate of imports of about £395m., would have accordingly to be reduced by nearly half to £215m.

16. The allocation of these £215m. between alternative uses would be extraordinarily difficult. The small total of £5m. for film remittances would have to go, at a cost, which could be variously assessed, to the amenities of life in this country. No expenditure is shown for 1948/9 in Table I on tobacco, since there is a current decision to make no further purchases. To maintain present consumption levels when stocks are exhausted would in fact cost about £220m. in United States and Canadian dollars, and this would provide about three-quarters of total supply. We assume that despite the grave fiscal and other implications of allowing consumption to fall to a quarter, this would be faced. (See paragraphs 24 and 25 below).

+ The financial statistics of the oil industry are now being re-examined and it is likely to emerge that the dollar drains used in the paper are rather too high.
17. The 1948/9 dollar-expenditure on United Kingdom civil imports of oil of £50m. represents about half of total planned expenditure on oil. At 15.9m. tons, these imports are substantially above 1947 figures, (when stocks fell fast) even though they assume no basic petrol ration, and no further fuel oil conversions beyond those at present in progress. But they also assume that industrial output would continue to rise, that the motor transport industry would continue to expand, that we should provide oil for the new oil using plants now being installed (partly as a result of Government encouragement), and that the mechanisation of agriculture would be continued.

We have assumed that we could reasonably attempt a saving of £20m. in the 1948 programme or say 3-4 million tons of planned consumption. This would involve (a) a heavy cut back below 1947 levels of motor spirit consumption, including not only the abolition of supplementary petrol to private motorists, but a sharp reduction in commercial and transport usage; (b) extensive reconversion to coal usage in industry; (c) a very tight control over agricultural usage, and (d) proportionate economies in minor usages such as civil aviation. Such a sharp reversal of current trends would involve temporary dislocation in important fields of industry, and a continuing restraint on industrial productivity. It would also increase pressure on coal supplies and rail transport; but this might be borne.

18. On present intentions we shall spend some £15£m. on manufactures in the dollar area in 1948/9. By far the greater part of this is machinery (£3m.), and most of the remainder are "goods for industry" (£9m.)—specialised manufactures, spares, components and the like. Both categories are extremely diverse—plant for opencast coal and agriculture are the largest single programmes, and the rest is specialised plant for a wide range of industry. As without E.R.P. aid we might for some years be unable so much as to maintain output on existing equipment with the imports of materials we could afford, it would be bad policy to use our resources to add to our total equipment. We have, therefore, assumed that this expenditure might be reduced to £20m.

19. These cuts leave £165m. available for dollar area food and raw materials. The division of this reduced sum would present the worst of all the planning dilemmas. Among the possible alternatives, we have chosen a raw material programme of £90m. and a food programme of £75m. The latter happens to be about the minimum level that would leave our bread supplies unaffected; the former allows industrial output to continue at perhaps 10% below the rate in the last half of 1947 but has drastic effects upon building. But other patterns are possible. For example, we could maintain building or maintain industrial output by cutting bread; or we could restore bacon and sugar, (which take the worst cuts), by further reductions in industrial output.

20. The £90m. dollar area raw material programme implies cuts of £75m. We may also suppose that of the £20m. cut on Argentine programmes, £3m. is taken on the small raw material component, almost all hides. Excluding the cuts from other countries that have already been mentioned in paragraphs 11 and 12 above, the aggregate reduction amounts only to some 12% of the total raw material programme. But this is a misleading proportion. The programme we have considered allows generally for rising consumption, and increased stocks. Some cut can therefore be taken without reduction of output below recent levels. On the
other hand, the cuts cannot be evenly spread, since some commodities - of which wool is the most important example - come wholly from areas where no cut would be required, while others only come to a very small extent from the Western Hemisphere. In yet other cases without the dollar supplies other non-dollar imports cannot be efficiently used - carbon black required for motor tyre production is a case in point.

21. The maximum cuts would amount to some 15-20% on supplies to home industry by comparison with consumption during the latter half of 1947. This would apply to non-ferrous and light metals, softwood, paper and pulp and to a large range of miscellaneous materials. At the other extreme with some materials, such as steel and hardwoods, the complete excision of the dollar supplies would still leave sufficient to allow United Kingdom consumption to be at or above present levels. The effects of the cuts would therefore be widespread, but they would not be universal. They would cause an acute distortion, as well as a general contraction.

22. The cuts in food and feedingstuffs programmes, must reach £55m. from dollar sources and rather over £45m. from the Argentine, with further cuts on sterling area programmes, as has been suggested in paragraphs 10-11 might be of the order of £30m. The programmes on which these cuts fall stand at £770m. for food and £110m. for feedingstuffs for 1948/9 from the world as a whole, but in these totals the £22.5m. allowed from the Western Hemisphere includes three quarters of the wheat, two-fifths of the carcase meat and the sugar, and over half the feedingstuffs.

23. We should not have a free choice between the alternative ways of making these cuts and we would be faced with extremely difficult bilateral negotiations. We cannot guess what agreements could be made, but we suppose that we keep the Canadian wheat, and flour but abandon all other dollar food supplies, of which the Canadian bacon, the Caribbean sugar and Canadian eggs and cheese are the greater part. (This is almost certainly too optimistic). The Argentine cuts we concentrate partly on linseed oil (which might gradually be made up from home agriculture) on some animal fats we are now taking unwillingly, but most of all on coarse grains of which 15m. tons costing over £20m. are in the programme. If we could dispense with three-quarters of these (as an immediate measure), carcase-meat and mealcake could be left unaffected.

D. CONSEQUENCES TO THE HOME ECONOMY

24. These readjustments to the balance of payments would administer a number of violent shocks to the home economy at a number of separate points. The results to the structure of output, exports, investment, consumption and employment are extremely difficult to assess. We should be faced with an abrupt transition from a partially suppressed inflation to something not unlike a slump. It is conceivable that after the initial period of dislocation we would in fact move into a depression of the classical kind, with heavy reductions in investment due to general pessimism and uncertainty in the business world leading on to a spiral of declining income and demand. But we have assumed that this is avoided, if only because some types of investment could be expanded in nationalised industry and other public sectors, and because taxation could if necessary be relaxed promptly.
25. Administrative Problems

The rapidity of adjustment that would be required would be much greater than anything achieved in the past, and would almost certainly be beyond the administrative means available. No controls similar to those we have today could ensure the expansion of hard currency exports supposed; nor distribute in an ideal and fair way the reduced supplies of e.g. non-ferrous metals, the end-uses of which we do not now attempt to control. It is virtually certain that we should have to adopt rough and ready methods. We would have to loosen many price controls which could scarcely work with raw material supplies reduced and widespread substitution being called for. We might have to consider devaluation in an attempt to aid exports to dollar markets, and to discourage the demand for dollar materials. We should have to prohibit rather than restrain the use of e.g. non-ferrous metals in inessential uses if we were to protect export output. We should have to be prepared for obvious maldistributions of resources, critical bottlenecks, and paradoxical surpluses to a much greater extent than today. This applies especially to manufactures, but there would of course also be serious strain on agricultural policy and consumer rationing and an expansion of all kinds of black market.

The fiscal problems would be most difficult. Some expenditures would rise (e.g. unemployment benefit by $150-200m.); some revenues would fall (e.g. tobacco duties by something like $200m.). In the early stages the spending of accumulated savings might offset the fall in income due to unemployment. The cuts in building would reduce the call for savings. If there were a period of dislocation during which output was low but expenditure remained high, it might even be that acutely inflationary conditions developed, despite rising unemployment.

26. Implications to the level of food consumption

The cuts assumed in Canadian and other dollar imports, and in Empire butter, tea, and coffee imply heavy reductions in rations: sugar, to 5 ounces; butter, 3 to 1½; bacon, to 1 ounce the year through; cheese to even less; with other cuts in eggs and meat. Miscellaneous non-dollar imports would also probably come down. The reduction in calorie intake below the programmed level of 2,690 would probably be about 220; i.e., the level would probably be a little below the level during the present period of potato shortage, and over 10% below the pre-war average. But even if in the long run agricultural adjustments restored total calories, the diet would be even more distorted from the traditional pattern than the present.

27. Implications to Agricultural Policy

In paragraph 22 we supposed that as an immediate measure Argentine meat imports were not reduced, and that the whole reduction fell on coarse grains. This implied a reduction in the latter that might (if certain compensating supplies could be obtained elsewhere) permit feedingstuff rations to continue as at present, but which would wholly wipe out any development of the livestock expansion programme. Whether it would in fact be better to reduce overseas meat supplies and take more coarse grains, or lower the extraction rate and provide feedingstuffs at the expense of direct bread supplies and a further cut in calorie intake would of course be important issues of policy. It is at least clear that the agricultural policy as a whole would need re-examination. Much would depend upon estimates of longer term changes in, e.g., the terms of trade and relative prices of cereals and livestock.
28. Implications to other Consumption

The main directly adverse effects upon the level of consumption of items other than food have mostly already been mentioned. Pressure on cotton supplies and the need to export a major dollar saver and dollar earner would virtually remove consumer cotton goods from the home market. The reduction in leather imports would have a large effect upon the supplies or the quality of footwear. Par less motor traffic than is now permitted would be possible. Newspapers and books would be reduced. The whole range of consumption using non-ferrous metals from trivialities to electrical gear of all kinds would be curtailed. The cinema industry would be worse disorganised than it has been recently. A reduction of three-quarters in tobacco consumption would greatly affect morale, and, having regard also to the fiscal effects, it may be thought that we have been unrealistic in not assuming that we would in the event prefer to cut food or raw materials rather than cigarettes. On the other hand service industries would be free to expand, and the shortage of domestic workers both in institutions and private homes might be relieved. (Indeed such work might even be a fit object for encouragement as providing work requiring little material). These changes would between them amount to a very sharp change in the standard of living. It should not be unbearable but it would certainly call for much patience and a willingness to change old established habits.

29. General Implications to Industrial Output

The effects of some of the cuts in imports, such as those in timber and hides would or could be confined to particular industries. Other cuts, such as those in oil, non-ferrous metals, and in the whole range of chemicals and miscellaneous materials would directly or at few removes, affect all manufactures and would tend, where they did not reduce output outright, at least to raise costs and lower productivity. There would need to be, if output were to be maintained, an early adoption of substitutes, and there would be little time for their discovery, but given a strong enough money motive a good deal might be done (no doubt at the cost of lowering standards) by for example, using steel, which would be relatively plentiful, in place of aluminium or timber, concrete in place of timber, alternative materials for paper making, rubber in place of leather, wool in place of cotton and so on.

30. Consequences to Investment

The most obvious effects would flow from the reduction of capital goods imports. Given other requirements this might mean a cut of some 250,000 standards in the building industry, and though not all this need fall on new housing a reduction of new house building to something of the order of 50,000 might be inevitable, with the use of substitutes. The electricity generating programme would almost certainly have to be curtailed, mainly because of the reduction in non-ferrous metals. Further direct effects would be the reduction in capital goods imports and the widespread consequences to output of the dislocations already discussed.

31. These are effects on supply, but as has been said, demand, now stimulated by labour shortage, would also change. Shipbuilding, and mechanical engineering are sectors in which
slumps might easily occur. But some of the adjustments, in particular, reversion to coal usage, would entail fresh expense. Public investment, road transport, reclamation of some parts of iron and steel could be expanded and there would be a very strong case for a prompt expansion of dollar-saving investment, if necessary by Government action, especially in the chemical and oil refinery fields. A wholesale collapse of investment could be avoided. Moreover export demand might continue at a generally high level; we have already presupposed special efforts to supply capital goods to some countries in place of gold or dollars.

32. Consequences to Exports

We have already assumed that exports to hard currency areas, and dollar-saving exports to the sterling area have to be pushed extremely hard, at a time when costs generally would probably be rising. But the material cuts could not be confined to home market production and we should almost certainly find it impossible to maintain total exports for production reasons; overseas demand also might contract. We have taken no account of these possibilities in the review of the short term crisis, however, because it might be possible for a time to concentrate the reduction of exports on the less essential exports to areas with which we should otherwise be currently in surplus, i.e. on "unrequited" exports.

33. Consequences to Employment

There would be large primary effects on employment in metal using industries, building, clothing, road transport, and paper consuming trades. Some of these might be offset by reduction in specifications, the use of substitutes, and so on. There might also be a secondary reduction in the distributive trades. On the other hand the service trades, and domestic service could increase, and mining, farming, and wool textiles could expand. Women might leave industry in large numbers, and the present pressure for the industry to stay would be reversed. On balance we estimate that unemployment might, apart from the work-spread effects of short-time and reduced hours, rise to something like 1,500,000.

B. LONGER TERM PROSPECTS

34. The broad sketch given in the preceding sections tries to depict the most favourable state of the economy that we might manage to reach in, say, a year after it had become certain that we would get no E.P.P. Aid. Things might well be worse if the downward readjustment could not be achieved in an orderly manner. They could probably not be much better. But this sketch presents only one phase. Four major long-term factors should be mentioned.

35. First, the dreariness of the consumption standards to which we should fall, the inadequacy of the national diet and the increase in unemployment might give rise to unrest and inefficiency. These would probably lower output and exports still further and might start a "downward spiral" to which there would be no obvious end.
36. Secondly, there might be a change in the terms of trade in our favour. This might come about in two separate ways.

(a) Since the United Kingdom is by far the largest importer from Canada and the Argentine the reductions in our purchases might start movements in the prices of their products. In itself, a fall in import prices would be beneficial since it would reduce the quantitative cuts in imports and raise the real value of our remaining reserves. But the same fall in primary product prices would, if due to this cause, very probably reduce the demand for our manufactories. On balance, we might gain somewhat if these effects were confined to these countries; but if there were a general reduction of world trade the gain would be much more problematical.

(b) There might, independently of anything our crisis compels us to do, be a lowering of import prices as a result of increased efficiency and output among primary producers following upon the high prices they now enjoy and the fading of the effects of war. This would not affect the demand for our exports, and would therefore be wholly favourable. But changes of this kind could only be gradual: they could not be relied upon to extricate us quickly.

37. Thirdly, we might in two or three years expand our exports, especially of capital goods. Little allowance for this had been made in the account given of short period adjustments, since the time lags are very substantial. But there are physical limits to these additional exports (which in any case are very vulnerable in a world slump situation) and they would be alternative to home investment, and this might not be much above the maintenance level. But we could try to plan more deliberately than we do today that we sell capital goods that would directly or indirectly increase the output of goods we would wish to import. If we secured the close co-operation of Europe and the Empire in a joint effort of this kind we might gradually end the worst of the limitations on output.

38. Lastly, we might hope for a rise in the level of the United States imports and of American foreign investment. Either of these developments might replenish the supply of dollars to the rest of the world and permit a resumption of multilateral trade. This would relieve us by removing the prime cause of the whole crisis. Developments of this kind although perfectly possible are not in any way certain, and they are wholly outside our control.

39. We give this brief review of the longer-term prospect to show that there is no reason to suppose that the short-term crisis we have described would necessarily be transient. All the longer-term developments are extremely uncertain but it seems on the whole likely that the economy, having moved to a generally lower level, would tend to stay there for a considerable time.

March, 1946.