CABINET

THE ECONOMIC SITUATION

MEMORANDUM BY THE LORD PRESIDENT OF THE COUNCIL

In view of the success which we have achieved in working out our socialist plans it is right, I submit, to watch carefully that any necessary economic adjustment does not injure their progress, at any rate in essentials. At the same time we have always appreciated that it would take a considerable period to bring the inadequate production of the old inherited system up to a sufficient level, and that there would be setbacks on the way, especially through American recessions and other factors outside our control. Economic ways and means affect political and social ends, and the proper handling of the relationship between them is of decisive importance to our Government. When economic setbacks take place we must beware of pressing on into an economic and political blind alley from which there is no tolerable way out, and which may lead to political crisis and defeat for the Government and the principles for which we stand.

2. The economic system must be safeguarded from breaking under a load it is not yet ready to bear. It is also vital that the Government should govern. Everyone, including our own people and those with whom we are closely associated such as the other countries of the Commonwealth and the Americans, as well as our opponents in the "cold war," should know that the Government clearly recognise the situation, and are tackling it with firm grip and decision. The temptation to defer action until it is publicly seen to be dictated to us by events should be resisted if we are to retain and maintain confidence. If there is one thing the British will not easily forgive it is a "mess." Prompt and convincing measures now will be more effective and will not need to be so drastic as the measures which will become necessary if action is deferred. The following paper is intended to suggest how the working out of our essential plans can be safeguarded while making adequate provision for relieving the strain on the economic machine.

3. The economic crisis is of the first magnitude in its political and social implications. It seems to be largely a crisis of confidence over Britain in the outside world and especially between this country and the United States. The Americans will give us their confidence and support, even if we take measures of which they would strongly disapprove for their own country, provided we look as if we know where we are going and how to get there. It is also a crisis of margins, in that comparatively small percentage changes in our export pattern, our level of prices and costs, and our public expenditure would be quite sufficient to bring the situation entirely under our control. Looking at the papers which have been submitted to us it appears that the economic dangers to our programme fall into three or four closely related but distinct groups.

4. First, there is the expansion and employment of our national resources. We may claim to have been more successful than any other country in turning our economic resources to the best use since the war, in spite of all our handicaps. National production is running at a high and still increasing level, about 6 per cent, above last year, and a long way above pre-war. What is even more important, productivity per man-year appears to be increasing at an annual rate of about 4½ per cent. overall, which means that manufacturing industries must be improving their productivity at a very remarkable pace. Capital investment is running at
On a high, although still inadequate, level, and we are beginning to get a real dividend on some of the resources which have been ploughed back, with steel, for instance, already touching the 16 million-tons-a-year rate. Unemployment also is amazingly low, and we have probably been more successful than any other democratic country in concentrating resources on essentials and on social needs, and in preventing effort from being frittered away.

5. All this is excellent, but the picture is marred by other features which have obstinately resisted elimination. I am puzzled, for example, by the title of the Economic Section Report on Signs of Disinflation (E.P.C. (49) 77), as the picture it gives is of continuing inflation, and I cannot see much disinflation in it. In April people were consuming 10 per cent. more by volume than they were last year at the time of the Chancellor's first disinflationary Budget, and were paying out 12 per cent. more for it. The May figures since issued are even higher. The release of 4 per cent. more tobacco, mainly from dollar sources, has duly been sent up in smoke in spite of prices forced up by taxation to levels which not long ago would have been considered prohibitive. Prices generally rose 2 points in May, and were then 3 points higher than a year ago, against only 1 point higher than last year in April. Food prices were 6 points higher. This was of course foreseen in the Budget but the parallel rise of 3 points in wage rates over the year points to continued inflation.

6. In the first five months of this year wage increases were awarded adding some £25 million annually to the national wage bill. The County Council roadmen took another round of wage increases, their third since 1945, in addition to which they have had their hours of work reduced from 47 to 44 a week without loss of pay. The railway workers, in a socialised industry already faced with a heavy operating loss and with reduced traffic, are also claiming all-round increases which, if conceded, must involve a general increase in charges, or a heavy subsidy from somewhere. Railway fares cannot be further increased, and higher rates for general traffic would merely drive more on to the roads, so any added costs from wage increases are likely to fall on coal, steel and other basic industrial products entering into the cost of our main exports. It is difficult to escape the conclusion that all our great achievements since the war are being imperilled by the renewed pressure to take too much out of the kitty too early, and this at a time when it is a matter of life and death for us to get our costs down, at least as fast as our overseas competitors do.

7. Turning now to the external aspect, the Chancellor of the Exchequer has brought out clearly that we are consuming, at this moment food and materials far in excess of the rate that they can be replaced out of our current or prospective earnings of foreign exchange, plus all the American and Canadian aid in sight. Clearly, unless we are to face the usual awakening which follows a fool's paradise, we must take, without delay, every possible step to avoid dissipating our current assets and resources on enterprises and services which do not directly or indirectly contribute to improving our economic situation in the short or the long run, and we must bear in mind the vital importance of convincing our own people and the world that we are tackling our troubles seriously.

8. The last Economic Bulletin (E.B. (48) 9) shows that the public sense of urgency about our economic difficulties has faded away just when it is most needed. The last Social Survey investigation in March showed that twice as large a proportion (55 per cent. against 28 per cent. six months' earlier) thought that on the whole things were going well, 40 per cent. could think of nothing the Government is asking people to do to help overcome the crisis, and over a quarter mentioned Canada or America as countries where we should buy more food. Those of my colleagues who have followed these Social Survey investigations carried out by the Central Office of Information will have been impressed no doubt, as I have been, by their general soundness.

9. Our immediate task is to reawaken the nation to the seriousness of the economic problem while making clear the new directions in which effort is needed, and confirming confidence in the Government's leadership. Such measures will automatically greatly improve the chances of the United States Administration in gaining acceptance for unpalatable measures on their part to ease our difficulties. I suggest it would be opportune to prepare a clear statement of the problem in simple language and to give it the widest possible circulation among the people, providing we are able to announce straightforward and practicable steps for dealing with the various points on which stress must be laid.
10. If we are to assume that for many years to come the increased earning of dollars and hard currencies will be the only means of averting successive balance of payment crises, should we not also reconsider the incentive to our exporters to sell for hard currency rather than elsewhere or in the home market. We already give encouragement to industry to install new equipment and to do research, by allowances in taxation, and we ensure against bad risks through the Export Credits Guarantee scheme. Could more effective recognition be given to our dollar earning enterprises by some system of taxation rebates (in the next Budget) and meanwhile by permitting them to retain a small share of additional hard currency earnings above their current level, or in some other appropriate way? I cannot believe that in the booming home market conditions already described, enough firms will put enough effort into the thankless task of exporting for dollars as long as firms which do not make this effort enjoy an increasing advantage in profits and in assurance of markets. I am also frequently told, by people who should know, that our selling methods and our selling organisation in both Canada and the United States are quite unable to hold their own against American salesmanship. If there is anything in these criticisms ought not more to be done, and more quickly, to get our best salesmen on to dollar-earning work? We cannot afford to allow our policies to be undermined by too much tolerance for hit-or-miss selling methods in dollar markets.

11. The next aspect of the economic situation which has a close bearing on our programme is public expenditure. Our public expenditure, apart from local rates, is now almost touching £3,000 million, and although a great part of this is clearly essential to financing our programme, it does not seem to make sense that in such an immense total we cannot find, say 5 per cent. worth of expenditure which could be either pruned off or spread over a longer period without serious consequences.

12. According to the Economic Survey, current public expenditure for 1949 (including local authority spending) was estimated to amount to £3,475 million against a national income of £10,000 million or about 7s. in the £. But the amount actually to be raised in rates and taxes to cover public expenditure plus surplus was even higher—39 per cent. of national income, and it now looks as if actual expenditure will approach that level. The incentive to effort for workers as well as professional and technical people and employers is seriously affected by this burden, which, in turn, reacts on our costs, and on our capacity to earn dollars. Sooner rather than later the taxpayer will rebel verbally and at the ballot box.

13. The Chancellor's paper on Growth of Expenditure (E.P.C. (49) 76) shows a continuing prospect of further rises in spending all along the line, and in the absence of the corresponding forecast of the trend of revenue it seems difficult to believe that revenue can be maintained even at present levels without pressing on the limits of the taxpayer's endurance. The position about Supplementary Estimates is especially disturbing, politically as well as financially. In the case of the Festival of Britain budget (which I am convinced will give an early and large dividend in terms of foreign exchange and of a stimulus to improved production through better design and a fuller use of research results), I have agreed with the Chancellor that any increase in expenditure in one direction should be offset by equivalent cuts somewhere else. Could not the same principle be applied to Supplementary Estimates? It seems difficult to defend in present circumstances allowing Supplementary Estimates to become an automatic net increase on the expenditure side.

14. The Government has a responsibility as a whole for the control of expenditure, and I am wondering whether the Economic Policy Committee, or some new Committee of Ministers established for the purpose, ought not to consider what changes ought to be made in the machinery for controlling expenditure and for ensuring that measures leading to increased spending receive prior Government sanction, and to re-examine the policies underlying the 1949-50 Estimates and agree with Departmental Ministers what savings can be made to restore the balance of the Budget and to implement the Chancellor's declared intentions in relation to keeping down the burden of Supplementary Estimates.

15. A similar scrutiny might simultaneously be made on man-power. In the last Economic Survey (Command 7467) provision was made for a reduction during the year of numbers in national Government service by 19,000. This is a small enough target: is it being realised? Local Government service was
forecast to expand by 4,000 (despite the transfer of a number of important functions to national bodies), making a total of 1,455,000 for public administration as a whole. Cannot some saving be made on this immense figure and thereby assist in the reduction of public expenditure? Last year, although the Civil Service numbers were kept below the Economic Survey ceiling, local government exceeded it by 71,000 persons. This year by the end of May employment in local government had already reached the 780,000 level forecast for the end of the year. Is anything being done to prevent our difficulties from being aggravated in the same way as last year?

16. My first object in this paper has been to stress that the economic crisis is and remains a threat to all that we have achieved and all that we stand for. I trust that none of my colleagues are under the illusion that everything will in some way come out all right without a lot more action on our part. At this moment our last reserves of gold and dollars are vanishing at the rate of about £12 million worth a week. At the present rate they would be down to zero in just over 200 days from now, and in far fewer days than that our position will become untenable unless the fall can not only be stopped but reversed. I have not attempted to put forward detailed recommendations for action. That is for the appropriate Ministers to do, but if the country is to avoid harsh and panic measures such as were forced on it in 1931, the present tendencies must be corrected by well-timed, well-planned and vigorous action calculated to safeguard and strengthen the progress we have achieved in the last four years.

H. M.