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CABINET

THE BALANCE OF PAYMENTS SITUATION

MEMORANDUM BY THE CHANCELLOR OF THE EXCHEQUER

The gold and dollar reserves continue to fall at an alarming rate, and I must inform my colleagues that, unless we tackle this situation with great resolution, there is a real likelihood that by the middle of the year we shall not be able to hold the pound at \$2.80.

2. In the last quarter of 1951 the dollar deficit was \$940 million (£337 million). Since the beginning of this month we have lost \$225 million. The latest forecast for the loss in this quarter is \$700 million, and this will probably prove too low. Even on this estimate, however, the gold reserves will be down to \$1,400 million (£500 million) by the end of June, and this is much the same as the level at which they stood on the day of devaluation in September 1949.

3. Unless we can stem this tide, it will swallow us up, and we shall reach a point at which we can no longer buy the basic food and raw materials on which this island depends, or keep together the sterling Commonwealth as a coherent financial system.

4. We still have time to organise ourselves to deal with this emergency, and all the work which we are doing is laying the foundations for recovery. But there is not much time, and we must use it to full advantage.

The Reasons for the Deterioration

5. The latest estimates for the year 1952, which have been agreed between the Treasury and the Departments concerned, and which incorporate all the decisions which are asked of the Cabinet on internal policy, and the effect of the United States steel, are set out in Tables I and II. They show the United Kingdom balance of payments with the non-sterling area as follows:—

United Kingdom Balance of Payments with Non-Sterling Area in 1952

	(£ million)			Estimate of
	First Half	Second half	Total	October 1951
Imports	1,022	1,061	2,083	2,281
Exports and re-exports	685	740	1,425	1,510
Invisibles (net)	+ 28	- 28	...	+ 26
Defence Aid	+ 113	+ 12	+ 125	+ 25
Deficit with non-sterling area	- 196	- 337	- 533	- 720

6. It is a distressing fact that although we took action to reduce imports and other external expenditure by £350 million, although we are taking substantial steps to free more resources for exports, and although we are now allowing for £100 million of United States defence aid in the first half year and the one million tons of United States steel, our latest estimates show a reduction in the prospective deficit with the non-sterling world (which is the nub from the point of view of the reserves) by £200 million.

7. Two factors have been responsible. On the import side, prices have risen against us (*e.g.*, cotton, non-ferrous metals), and there have been increases in volume too (*e.g.*, steel, coarse grains). On the export side, the general conditions (for example in textiles) are at present unfavourable, and—much more serious—our competitive position in certain industries appears to be deteriorating. Except in the markets of the sterling Commonwealth, where there are inflationary conditions and our exports are in a privileged position, we are tending to lose ground in many lines of business.

8. Normally, the other sterling area countries have a surplus with the non-sterling area (and a deficit with us). That surplus offsets our deficit with the non-sterling area. But on the data which they have submitted to the Commonwealth Finance Ministers Conference, they will be in deficit with the non-sterling area in 1952 to the tune of £120 million—an estimate which is hardly surprising, for they were in deficit of £156 million in the second half of 1951 alone.

9. Thus, with a United Kingdom deficit of £530 million with the non-sterling area, and with the other sterling area countries in deficit there of £120 million, the sterling area as a whole is in deficit of £650 million in 1952. And as our reserves at end-December were only £835 million, the implications are clear.

#### **Commonwealth Action**

10. I proposed to the Commonwealth Finance Ministers that the only possible hope of success could come if the sterling area as a whole could get into balance with the rest of the world in the second half of this year. That is the only way to stop the drain.

11. I accordingly proposed a series of targets for each country (set out in Table III) the net effect of which was that the United Kingdom would reduce its deficit with the non-sterling world to £100 million in the second half (*i.e.*, £200 million a year) if they would turn their deficit into a surplus of £200 million a year. The targets set the individual countries formidable problems, but I am hopeful that they will accept them, and take immediate action accordingly.

#### **United States Aid**

12. We can, in my view, frame our policy on the assumption that we shall receive some economic support from the United States in the second half of 1952. It is obvious that the United States could not take major action to help us, even if the Administration and we ourselves wished it, before the Presidential election. But we are certainly entitled to a share of such funds as may be voted for economic support in the Mutual Security legislation which will shortly be presented to Congress for the United States fiscal year 1952–53. It has always been understood that our defence programme is subject to burden-sharing, and the report of the Temporary Council Committee of the North Atlantic Treaty Organisation made it quite clear that it would be impossible for our defence programme to be effectively carried out if our dollar deficit is not covered. From the 1951–52 Mutual Security Act appropriations we expect to receive \$300 million (£107 million), and the estimates for the first half of this year incorporate this. It is entirely uncertain how much money Congress will vote in the next few months, and how large will be our share; we shall not know until it is too late for us to alter our own policies for the second half-year. A figure of £80 million for the second half-year, including, *e.g.*, United States purchases of military equipment in the United Kingdom, seems a reasonable figure to take as a basis—it would mean that we were getting 50 per cent. more aid in 1952–53 than in 1951–52. This is, of course, all highly uncertain, but we may not get as much during the second half-year, and we certainly cannot rely on getting more.

### Course of Action

13. In a situation like this, our own action is what counts. We must pay our way, and we must be seen to be paying our way.

14. This must be the first and central objective. For if we fail in this, all other objectives—defence, the strength of the Commonwealth, full employment, social welfare, better food—will collapse like a house of cards.

15. The dynamic force which can put us right is our earning power. We have no hope of getting straight unless we can make our exports plentiful and competitive across the whole range of products, by price and by quality and by delivery date.

16. This is of course the reason for the series of measures dealing with the internal economy which I am proposing in another paper. Every measure which we can take to lighten the load on the internal economy directly or indirectly helps to make the economy more flexible and to support our exporters.

17. But it will take time for these measures to become effective, and the reserves are running out. We therefore should take further emergency action against imports.

### Direct Action on Imports

18. The United Kingdom's part in the proposals for concerted Commonwealth action is to reduce our deficit with the non-sterling world in the second half of this year to £100 million (*i.e.*, £200 million a year). This is to be offset by a roughly equal surplus with the other sterling area countries, so that the United Kingdom would be in overall balance, or better, in the second half of 1952. I explained in Cabinet last week that this would mean difficult decisions.

19. The estimates before us indicate that our deficit with the non-sterling world in the second half of 1952 may be of the order of £337 million. These deficits are margins in a very large turnover, but there is no reason to suppose that this is an over-estimate. A 5 per cent. rise in import prices would add £100 million to our non-sterling import bill; the world market for many of our most important exports is in an unsatisfactory condition, which offers little scope for a rapid increase in earnings.

20. Taking the figure of £337 million in the half-year as the starting-point, we need to improve the position by £237 million in order to reduce the deficit to the prescribed maximum of £100 million. Many of my Commonwealth colleagues were sceptical about their ability to improve their position to the required extent, and some may fail. One would indeed like to have a margin on the right side, but I fear this is impossible. Against the £237 million, we can put £80 million (as in paragraph 12) for United States aid, and although the original estimates already allow for all the internal measures which we are taking to stimulate exports, so that we cannot properly allow more on that score, we may find that deflationary action in the other sterling area countries will have some effect in diverting our exports to non-sterling destinations. But we cannot allow very much for this, and it is clear that a substantial reduction in our imports would be required.

21. After weighing the various factors involved as best I can, I have come to the conclusion that it is my duty to put forward a programme of import cuts designed to yield a saving of £150 million, from non-sterling sources, in the year 1952, of which about £100 million would fall in the second half-year.

22. The 1952 import programme, revised by the Departments to take into account the latest prices and availabilities and making allowance for all previous cuts and for the effects of anti-inflationary measures, is set out in Table IV. Substantial reductions have already been imposed, and the issue which is now presented is how further reductions should be distributed between the stocks which have been accumulated as a measure of defence preparedness, the current levels of food consumption, and the raw material supply for industrial production and transport. In my view, the very last resort would be to cut the raw material intake for industry, for they would get us into a spiral from which there is no escape—by creating unemployment and destroying productivity, it would deprive us of any prospect of working our way out of our difficulties. The £150 million programme which I am presenting therefore includes no proposal which would seriously damage our basic industrial potential, for I think we must regard this as paramount.

23. The review of possibilities follows:—

£ million

<i>Tobacco.</i> —Reduction in purchases from North American 1952 crop to 100 million lb. Last year the purchase was 250 million lb. and this means consuming stocks heavily in 1952–53 with risks that prices will go against us in 1953. This will not involve reduced consumption ... ..	16
<i>Petrol.</i> —The only direct way to save petrol is by rationing, which is administratively cumbersome and expensive. In any case there is some doubt whether it would in fact save much foreign exchange. So I advise against it ... ..	...
<i>Films.</i> —There is an agreement in force with the United States film industry which we cannot set aside. So we cannot do anything in this ... ..	...
<i>Softwood.</i> —Our present plans to build 230,000 houses in 1952 and 260,000 in 1953 will need additional imports in 1952 of 90,000 standards (£6½ million) over and above the import programme. There is a strategic stockpile of 215,000 standards, in addition to the commercial stocks (estimated at 400,000 standards at end-1952). By using the stockpile, at some cost to the Exchequer, we could get the 90,000 standards of additional softwood and reduce imports by 125,000 standards. I am reluctant to do this, both on commercial and on strategic grounds, but it would save ... ..	8
<i>Cotton.</i> —The programme provides a seven-month's stock; the Raw Cotton Commission needs a big stock for efficient running, but our prospective 1952 cotton bill has gone up by £47 million since October, and I propose we make a saving in 1952, again predominantly by working with lower stocks, of ... ..	20
<i>Non-ferrous metals.</i> —No building of stocks ... ..	8
<i>Other materials.*</i> —Use of supplies in strategic stockpile to replace current imports, and no new stockpiling purchases of non-sterling materials, together with various miscellaneous savings might save ... ..	20
We should not, however, dispose of our stockpile of strategic metals and ferro-alloys.	
<i>Machinery.</i> —I have considered stopping imports of new machinery from the United States, but do not recommend it; the licensing is already very tight, and we could not gain much this year without real dislocation. I would expect that our action against investment would reduce these imports eventually ... ..	—
	72

\* Including Board of Trade and Ministry of Supply stockpile items.

24. It is at first sight tempting to do a further round of deliberalisation against imports from Europe, many of which are of relatively low essentiality. But I am convinced that this would be mistaken at this stage. Events have shown that we judged the deliberalisation measures last November well; our action was endorsed by O.E.E.C., and we have avoided retaliation. But my judgment is that if we went further now, there would assuredly be retaliation, and we should in fact precipitate a complete disintegration of intra-European trade. We should not gain much net in the balance of payments, and we should be starting a downward spiral. When we are paying 100 per cent. gold to E.P.U., we shall probably have to go ahead, but I think it would be mistaken to embark upon this now, before the need for this action is clear to our European partners beyond any shadow of doubt.

25. The same difficulties would arise if we abstained from a second general round of deliberalisation, but sought to put quota restrictions on a few specific goods, such as wines and spirits, or silks. The balance of payments argument can be effectively deployed if the action taken covers a wide range of commodities, selected without discrimination (as ours was last November) and with reasonable regard to the commercial interests of the supplying countries. But if a few items are selected for drastic treatment, which are of special importance to the economy of the supplying countries, our O.E.E.C. position is indefensible. Retaliation then

becomes inevitable. In the particular case of wines and spirits, restriction would be regarded as being a direct and unjustifiable blow against France. It is anomalous to allow wine to be imported when essentials have to be restricted, but I am sure we should lose more from cutting it than we should gain.

26. We could, however, make some saving in the second half of 1952, without incurring those difficulties, by reducing the quotas on products which have already been deliberalised;

	<i>£ million</i>
<i>Lower quotas on already deliberalised imports</i> ... ..	5-10

27. The arguments against further deliberalisation at this juncture apply, though with somewhat less force, against tourism. But tourism is such a large item—about £40 million a year, or substantially larger than our whole textile imports from Europe—that it is very difficult to exclude it from a list of expenditure cuts. If we made a cut (particularly if we put the ration below £35), we should have to justify it in O.E.E.C. I think we should make a cut, but we should not make it impossible for people to have holidays on the Continent; and we have to bear the French problem in mind as well as our own. A substantial cut would involve some modification of the arrangement under Uniscan for virtually unrestricted travel.

	<i>£ Million</i>
<i>Tourism.—Reduction in ration to £25, with £5 export of notes instead of £10</i> ... ..	10-15

28. The proposals above add up to £92 million. To secure £150 million, it is necessary to cut £58 million from the only remaining important section of the import programme, which is food.

29. The scope for action in food is limited, because of the extent of forward commitments, but the following possibilities add up to £75 million, against the £58 million above:—

	<i>£ million</i>
<i>Wheat and flour.—Reduce total stocks to 10½ weeks' consumption</i> ...	7
<i>Sugar.—Stop buying, and reduce ration by 2 oz. to 8 oz.</i> ...	7
<i>Oils and fats.—Stop buying, and reduce ration by 1 oz. to 5 oz.</i> ...	12

[In both sugar and oil and fats, our forward purchasing commitments are very great. The savings indicated are those which would be made in 1952 by stopping all new non-sterling purchases. If this were done, but consumption maintained, stocks of sugar would be down to 9 weeks' consumption by end-1952, and stocks of oils and fats (of particular strategic importance) to 16 weeks—10 weeks' cover for processing the raw material and 6 weeks' supply for consumption. This living on stocks would of course weaken the position in 1953.]

<i>Meat.—Reduction in purchases from Argentina in next protocol agreement, and in purchases from other sources—saving of 90,000 tons (about 1d. on the ration, now estimated to average 1s. 4d.)</i> ... ..	11
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If we want to buy Argentine meat in large quantities, we shall certainly have to pay about 25 per cent. more for it—so that if we do not cut our purchases very hard, we shall have a bigger import bill.

<i>Bacon.—Discontinuing the Polish contract—between ¼ oz. and ½ oz. on ration</i> ... ..	9
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<i>Coarse grains.—Cut in ration pool from 5½ million tons to 5 million tons (substantial disruptive effect on United Kingdom food production)</i> ... ..	17
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[It would obviously be impossible to cut both coarse grains and imports of meat.]

<i>Cheese.—No purchase of Canadian cheese this year</i> ... ..	2
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<i>Other Government purchases.—Stopping buying miscellaneous foods, such as dried fruit, milk products, canned salmon, &amp;c.</i> ... ..	10
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<b>Total food</b> ... ..	<b>75</b>
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30. To select £58 million from this list of £75 million is a most painful operation. Indeed, this whole programme of £150 million—which is less than 5 per cent. of our total imports, and only about  $7\frac{1}{2}$  per cent. of our non-sterling imports—shows how narrow are the margins on which we are living. If the pound is allowed to fall, this import programme will be automatically cut, for we shall not be able to pay our suppliers. The question really is how to make the cut in the way which gives us the best prospects for recovery, and I would ask my colleagues, when considering their attitude to individual cuts in this list, to consider at the same time what are the alternatives.

#### *Longer-Term Considerations*

31. If we can convince the world that we are putting our internal economy in order, and that we are resolutely acting in combination with the rest of the sterling Commonwealth, to balance the sterling area's accounts and to stop the drain on the gold reserves in June, we can overcome the immediate crisis and restore confidence in sterling.

32. But we shall still have a very long way to go. We are trying at one and the same time to run a country which depends upon overseas supplies for half its food and nearly all its raw materials and petroleum, to carry out defence and international political commitments which involve direct expenditure of foreign exchange of well over £400 million a year, and to act as the centre of a world-wide financial system, based on sterling. We are doing this with a gold reserve which in the course of the next few months is likely to fall to a critical level, and which even now is only about one-fifth of our short-term external debts.

33. I draw three conclusions from this. First, we cannot bear this great load without a massive expansion of our earning power—producing enough of the things which the world wants, at the world's prices. Second, we cannot run the system and maintain sterling without gold reserves far above any level which they have attained since the end of the war, and we shall have to apply our energies as hard to building them in 1953 as we are fighting to stop the drain in 1952. Third, it will take a long and sustained effort to get these foundations of our economy right.

#### *Conclusions*

34. To sum up, I recommend:—

- (i) that it be accepted that the central objective in 1952, upon which all our other objectives depend, is to stop the drain on our gold reserves and thus to safeguard the food and raw material supply, and the purchasing power of sterling (paragraphs 13–15).
- (ii) that we must reduce our deficit with the non-sterling world in the second half of 1952 to an amount not exceeding £100 million (and if possible less) and thus—with a surplus of at least £100 million with the other sterling area countries—be in overall balance in the second half of 1952 (paragraph 18).
- (iii) that in addition to the internal measures before the Cabinet designed to increase our earning power, we should make a cut of £150 million in our import and other expenditure in the non-sterling world in 1952 (paragraph 21).
- (iv) that reductions in purchases of tobacco and raw materials of £72 million be made (paragraph 23).
- (v) that we do not yet embark upon a further round of deliberalisation of imports from Europe (paragraphs 24–25), but seek to make savings of £5–10 million in the second half by reducing quotas on items already deliberalised, and reduce the tourist ration to £25 (paragraphs 26 and 27).
- (vi) that the food and feeding-stuffs programme be cut by £58 million, and that items be selected accordingly from the list in paragraph 29.

R. A. B.

Treasury Chambers, S.W. 1,  
19th January, 1952.

TABLE I  
STERLING AREA BALANCE OF PAYMENTS WITH NON-STERLING WORLD  
(£ million)

	1951		1952		Total	1952 October Estimate
	1st half	2nd half	1st half	2nd half		
<i>Balance with non-sterling countries—</i>						
United Kingdom—						
Imports ... ..	983	1,240	1,022	1,061	2,083	2,281
Exports and re-exports	729	720	685	740	1,425	1,510
Invisibles (net) ... ..	+ 83	- 55	+ 28	- 28	...	+ 26
Defence aid ... ..	+ 3	+ 1	+ 113	+ 12	+ 125	+ 25
United Kingdom current balance ... ..	- 168	- 574	- 196	- 337	- 533*	- 720
Dependent territories ... ..	+ 181	...	...	...	+ 25	+ 50
Independent sterling area†	+ 258	+ 156	...	...	- 145	- 100
Sterling area deficit with rest of world ... ..	+ 271	- 730	...	...	- 653	- 770

\* Assuming all internal measures taken as proposed, and allowing for United States steel.

† Commonwealth countries' own estimates.

TABLE II  
UNITED KINGDOM OVERALL BALANCE OF PAYMENTS  
(£ million)

	1951			1952			October Estimate
	1st half	2nd half	Total	1st half	2nd half	Total	
Imports ... ..	1,643	1,865	3,508	1,676	1,714	3,390	3,620
Exports and re-exports ... ..	1,305	1,410	2,715	1,395	1,510	2,905	2,800
Invisibles (net) ... ..	213	54	267	141	119	260	255
Defence aid ... ..	3	1	4	113	12	125	25
United Kingdom current balance ... ..	- 122	- 400	- 522	- 27	- 73*	- 100*	- 540
Of which with—							
Non-sterling world ... ..	- 168	- 574	- 742	- 196	- 337	- 533	- 720
Sterling area ... ..	+ 46	+ 174	+ 220	+ 169	+ 264*	+ 433*	+ 180

\* The figure of United Kingdom surplus with rest of sterling area in second half of 1952, and thus the figure of United Kingdom overall balance, is deceptive. A continuing surplus of this scale with R.S.A. would be impossible unless we provided them with new sterling resources in order to finance it (particularly Australia, which is the big item). Consequently our exports there will probably be substantially less, and the surplus less, and our overall deficit correspondingly greater, except to the extent to which these exports go to other destinations, thus reducing our deficit with the non-sterling world.

TABLE III  
COMMONWEALTH FINANCE MINISTERS TARGETS

The following are the targets proposed by the Chancellor of the Exchequer:—

	Surplus or Deficit with Non-Sterling World (£ million)		
	Individual Countries' Estimates submitted for the Conference		Target proposed for Second Half of 1952
	Full Year 1952	Half-year	
United Kingdom ... ..	- 410*	- 205	- 100
Colonies ... ..	+ 25	+ 12	+ 27
South Africa (not a member of sterling area pool) ... ..	+ 14	+ 7	+ 25
Non-Commonwealth members of sterling area (Irish Republic, &c.) ... ..	- 73	- 36	(- 10)
Australia ... ..	- 71	- 35	+ 15
New Zealand ... ..	+ 5	+ 3	+ 10
India ... ..	- 78	- 39	- 10
Pakistan ... ..	+ 30	+ 15	+ 25
Ceylon ... ..	+ 23	+ 11	+ 13
Southern Rhodesia ... ..	+ 5	+ 2	+ 5
Total ... ..	- 530*	- 265	...

\* The United Kingdom deficit for 1952 with the non-sterling world is now estimated at 533, instead of 410, and the total deficit of the sterling area correspondingly higher. The difference arises primarily from rises in prices of imports.

TABLE IV

## UNITED KINGDOM IMPORT PROGRAMME, 1952

(£ million)

	<i>Non-Sterling</i>	<i>Sterling Area</i>	<i>Total</i>
Rationed food ... ..	228	331	559
Wheat and flour ... ..	106	11	117
Unrationed food ... ..	201	156	357
Supplies for agriculture ... ..	116	38	154
Tobacco ... ..	44	24	68
Coal ... ..	2	1	3
Oil ... ..	71	105	176
Industrial materials ... ..	1,074	619	1,693
Civil machinery ... ..	52	2	54
Civil manufactures ... ..	107	20	127
<b>Total</b> ... ..	<b>2,001</b>	<b>1,307</b>	<b>3,308</b>
Defence machinery and manufactures ... ..	82	...	82
<b>Total</b> ... ..	<b>2,083</b>	<b>1,307</b>	<b>3,390</b>
Of which strategic stockpile ... ..	33	24	57