



(c) crown copyright

Printed for the Cabinet. August 1955

SECRET

C.P. (55) 111

Copy No. 41

31st August, 1955

CABINET

THE ECONOMIC SITUATION

MEMORANDUM BY THE SECRETARY OF STATE FOR FOREIGN AFFAIRS

Some days ago I sent the memorandum below to the Prime Minister and the Chancellor of the Exchequer.

At their suggestion, I am circulating it to my Cabinet colleagues.

H. M.

*Foreign Office, S.W. 1,
30th August, 1955.*

DIZZY WITH SUCCESS

Our trouble is that there is too much money bidding for the labour available. This applies in the production both of capital goods and of consumption goods. The result is to push up the price of labour unduly. Employers cannot help themselves. The effect on discipline and output is bad. It is not so marked in factory production or repetition work (where the character of the plant sets the tempo) as in building, civil engineering, and the like, where each job is an individual and not a repetition task.

2. I do not believe that the margin is very great. We are not 50 per cent. overloaded—more like 5 per cent.—10 per cent. But this makes all the difference.

3. There are two ways of dealing with this situation. The first, (as in war, siege or socialism) is to restore physical controls, especially on imports, and regulate all production by a Government plan. We tried this in 1945-51 and, if we want it again, the Socialists had better do it. For they like it, since they really regard expansion and increase in wealth as rather immoral. (Socialists are economic puritans. It is part of their doctrine to use taxation as an economic instrument to control inflation—i.e., take much more in taxes than you need as revenue, in order to cream off excessive purchasing power.)

4. The second way (which as Conservatives we must adopt) is to use a variety of methods (recognising that growth is healthy in itself) calculated to prevent rank and excessive expansion. All that is wrong to-day is that the pace is a bit too hot.

(i) Monetary

To reduce the basis of credit, as the Chancellor is already doing. But the Bank Rate could be increased, if not at once, at the right moment. Open market operations could be pressed further.

(ii) Administration

(a) Do not subsidise *consumption*, which is already too high (i.e., abolish the bread subsidy).

(b) Do not prevent anybody producing capital goods with his own money (like building a house) but do not subsidise such investment. (Cut off housing subsidy, except for slum clearance.)

(c) Since Government financed or supported schemes of *capital development*, especially in the fields of engineering, civil engineering, and construction, are already pressing too heavily on an overloaded market,

(i) *postpone* what will inevitably add to the jam (e.g., roads) and thus result in further competitive bidding for labour;

(ii) *reduce* and *retard* schemes, however desirable, which have the same effect (e.g., hospitals, public buildings, Government offices, and the like). Nationalised industries should be included in the scrutiny, especially as to their methods and designs which are usually wasteful.

(iii) Defence

(a) Consider seriously cutting *service* to 18 months. This could not be undertaken *before* the election, because the Socialists would merely have raised the bidding and promised 1 year. It may well be possible now.

(b) Make a complete review of types of weapons and abandon those which may be obsolete or obsolescent, by land, sea and air in new conditions, (e.g., fighter aeroplanes, mine sweepers and other defensive weapons). Any reductions will give us men, for the workshops; metal; and factory space. (The mere fact that, at the end of your defence economies, the *financial* costs may be almost as high, must not depress us unduly, so long as we obtain a *real* economy of effort, both of man and machine power, and of materials used.)

(iv) Fiscal

(a) To encourage Production

This should be by *reduction* of taxation, not by increase.

- (i) Reduce or remit income tax on another range of income tax payers—and raise *earned* income limits to encourage the managerial and entrepreneur class.
- (ii) Reduce purchase tax in order to lower cost of living on articles which are of general use.

(b) To stimulate Saving

- (i) Increase tax on distributed profits—reduce (or abolish) tax on undistributed profits.
- (ii) Consider all schemes for *making saving more attractive*, e.g., can the public be given an opportunity of subscribing to a loan with some speculative or equity interest (e.g., for colonial development)? Or what about tax-free loans? Or increase in allowances for insurance payments?

(v) Tariffs

Since we have turned our back on controlling imports through physical controls, can we do something through higher and even, in certain cases, prohibitive tariffs? Now that quotas, &c., are not respectable, must we not revert to tariffs?

Exchange

5. Convertibility is the logical end of our policy since 1951. I have never been very happy about it, because I have always had sneaking doubts about the whole "free trade" policy which we have followed. However, it has certainly worked out pretty well and I am not unduly alarmed by the inflationary situation. I believe it is marginal and can be checked by some, or all, of the means already described. But, with full employment and an expanding economy, there must be some "give" somewhere. In the years between the wars, we took it on the level of employment. We can't do that again, and survive politically. Our currency (having freed commodity markets and decided to support transferable sterling) is virtually convertible—if you know how, and a lot of people do know how.

6. Having done, or shown that we intend to do, some or all of the things set out in (i)–(v) above, we might well take the plunge. At present, we are in the absurd position that no foreigner will buy sterling against his future commitments until he needs it, because of the fixed rate. Since he doubts whether we can maintain the \$2·80 rate, he holds off. He can't lose by doing so, and he may gain. But do *not* devalue, to a *fixed* rate. You won't be able to hold it. Get some flexibility.

H. M.

21st August, 1955

