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CABINET

THE ECONOMIC SITUATION

Memorandum by the President of the Board of Trade

I have read the papers circulated upon this topic and wish to put certain thoughts into the pool myself. These comments are not made in contradiction to the observations of my colleagues but to emphasise certain features of especial importance to the conduct of our trade and commerce.

2. There seem to me to be three central factors in the situation - the rate of exchange at which money can be sold abroad, the rate of interest at which money can be hired at home and the level of the reserves. It may be possible to hold one or even two of these stable, but I believe it to be hard at any time and beyond the range of human ingenuity in times of over full employment to hold all three.

3. It was our main criticism of the policies pursued by Sir Stafford Cripps in the past and it remains one of our principal criticisms of Mr. Gaitskell's policies to-day that they tend to ignore the central factors in the economy and try to operate instead through marginal and selective physical controls. We need to watch that in our natural desire to safeguard what we regard as worthwhile forms of expenditure we ourselves do not fall into the very errors which we condemn in others.

4. The basic problem at home is a degree of inflation which is at once the principal obstacle to exports, the main reason for rising imports, the foundation of the constant pressure of and yielding to wage claims and the necessary pre-requisite for the resort to capital appreciation for income purposes and the general exuberance in the field of stocks and shares. The Socialists lay emphasis on effects; we surely should aim to deal with causes.

5. Artificially to stimulate consumption or for that matter investment in the midst of an inflation is like prescribing whisky to a confirmed alcoholic. Until recently we were selling coal well below its true costs, an evil which is now ended. Yet we still subsidise bread despite the fact that imported grain places a heavy strain on our reserves, in housing we subsidise in the public sector and deliberately depress rents in the private sector and we still give investment allowances notwithstanding the increase in the bank rate, though the demand which we thus artificially create stretches our resources of men and money to the utmost.

6. What we need to do is both to deal with the inflation at its source and demonstrably to be seen to do so. The latter is necessary to inspire confidence abroad and to bring home to businessmen the necessity of adapting their actions to the policies we are pursuing. With this end in view I would propose three things:-

(a) A rise in the bank rate and supporting market operations

I remain firmly of the opinion that as part of any solution we adopt we should raise the bank rate to a realistic level. If a higher bank rate is said to be effective but is held in reserve it could be effective now. If it is said to be technically ineffective then why and for what purpose is it held in reserve?

(b) Measures to reduce consumption and investment

I think that we should end the bread subsidy and the general subsidy on housing. In my judgment we would be wise at the same time to abolish rent control both because this would tend to a more economic use of housing resources and because I believe we should be in any event compelled to it at a later stage. Reluctantly I must also say that in present circumstances I regard initial investment allowances as inflationary and hardly consistent with the use of the bank rate which I advocate above. I would therefore recommend that we should suspend them.

(c) Reduction in Government expenditure

I cannot add much to the suggestions put forward by my colleagues except to say that in my judgment investment in coal and atomic energy should not escape the general arrangements for postponement. In the general measures affecting investment many industries immediately engaged at critical points in our export drive will have to select some projects suitable for postponement and I do not think that any industry, however essential, should be exempt from this healthy exercise.

7. What about wages? It is said that if rents go up and bread goes up the pressure for wage concessions would prove irresistible. The pressure is already proving irresistible. The reason for the wage increases like the reason for higher dividends is the inflation, and we cannot continue ^{to deal} with the inflation on the ground that the measures necessary may themselves provoke wage claims. No amount of exhortation to trade unions or employers, nor in my judgment measures which attempt to restrict profits, will hold wages in existing circumstances. Wages will only be held when employers really take the view that they can no longer afford to pay an increase and trade unionists realise they can no longer afford to claim one and this point will not be reached until deflation has been carried further than at present. The situation which we should have clearly in our minds as necessary to achieve is when the unemployment figure has moved from under 1 per cent to somewhere between say 2 and 3 per cent.

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8. Lastly how against the background of these events should we look at the Collective Approach? Convertibility has always held its dangers both for our export trade and our reserves. In the past we have thought of it in terms of a floating rate and international agreements for the early elimination of import controls. More recently thoughts have turned, I think, towards a much greater degree of fixity in the rate supported by a continuation of discriminatory import controls. These are problems of a fundamental character. I must say frankly that I would find it difficult to reconcile convertibility with discrimination and I believe that the right course is not to go convertible until we can do so safely without these controls. The first thing is however to stop the inflation. As the Chancellor has always said internal stability is a key condition for convertibility.

9. Any effective policy would certainly be politically unpopular. I think the worst thing we could do would be to put out anything which could be represented as a dribble of half measures. Indeed if we go too far we can always manage to retreat a little whereas if we do not go far enough we shall lose the benefit of even those measures which we take. I consider therefore that the interests of our trade and commerce would be best served by the adoption of the measures advocated in paragraph 6 above.

P.T.

Board of Trade, S.W.1.

2nd September, 1955.