19th March, 1956.

CABINET

THE ECONOMIC IMPLICATIONS OF FULL EMPLOYMENT

Note by the Chancellor of the Exchequer

Attached is the text of the popular version of the White Paper on the Economic Implications of Full Employment. It is now with the printer and some page proofs may be available for the meeting of the Cabinet on Wednesday. The text will be accompanied by a number of descriptive charts and diagrams which add a good deal to the clarity and force of the document. Unfortunately these are not yet available for circulation.

2. Because of the printing strike the earliest possible date of publication will be in the week beginning 9th April. This is rather a long time after the publication of the White Paper, but I attach so much importance to achieving widespread public comprehension of the ideas in the parent document that I regard it as essential to produce this popular version at the earliest possible date, to give it all the publicity we can, and to distribute it as widely as possible.

3. Any alterations now made to the text must involve some delay in the printing schedule and I shall therefore be grateful to my colleagues if they will be as sparing as possible with the blue pencil.

H.M.

Treasury Chambers, S.W.1.

19th March, 1956.
MUST FULL EMPLOYMENT MEAN EVER-RISING PRICES?

(A Popular version of the White Paper "The Implications of Full Employment")

The greatest economic problem in this country before the war was unemployment. Since the end of the war all parties have agreed on the need, and the broad policies necessary to maintain full employment. The policies have been successful: unemployment, on anything like the old scale, has not returned. But in its place we have had another problem: rising prices. It causes worry and anxiety. It is also a serious danger to full employment itself.

This booklet (and the White Paper on which it is based) are issued to help the country understand what the danger is and how it can be overcome. It explains how we, as a nation, make prices rise and what we can do towards stopping that rise in the future.

SECTION I: HIGH EMPLOYMENT, HIGH OUTPUT...

Since the war, there has been enough work for nearly everyone in the country who wanted it. With nearly everyone working we have each year turned out on average, 3 per cent more goods and services than in the year before. Such a rate of progress should steadily bring to us more wealth and leisure.

The Conquest of Unemployment

Just before the war over 10 per cent of the workers in this country were unemployed. Since 1948, the average has been 1½ per cent. Very few people before the war believed it possible to have so low a percentage of unemployment as this.

The number of people in jobs has gone up year by year since the end of the war. So has the average workers' output. With more people at work and with higher productivity, the whole country's output has risen by an average of 3 per cent a year.

* This includes everything produced for money - services (things like bus rides and cinema shows and the work of the professions) as well as goods.
It is true that the standard of living of the man in the street has not gone up, over the post-war period, as fast as 3 per cent. a year. This was because other needs had first claim on the increase in our production. Exports, first: we have had to get a very big and rapid increase in the amount of goods we shipped abroad to pay for our imports. Then, in the factories, the machines which had gone on working throughout the war have had to be replaced, and new factories, refineries and so on have had to be built. Thirdly, after 1950 we had to rearm again.

For all these reasons, although each year we increased output, it was only in the last two or three years that a large part of the increase could go to improve the standard of living of the average home.

Hopes for the Future

If we can keep up a good rate of increase in production in the future we can look for a steady improvement in our standard of living. The forms that improvement might take would depend partly on our own personal choices: better food and clothes; more comfortable homes; longer and more interesting holidays. It would depend partly on the choices we made as a community - better schools, perhaps, and better roads.

There are a number of reasons for being optimistic, and for thinking that over the years we shall be able to get an increase in production as big as or bigger than in the past. There are plenty of new ideas for better machines, and for making machines do things they have never done before. Firms are giving more attention than they did to finding ways of increasing productivity. And - although we shall certainly need all the coal we can produce for as far ahead as we can see - in the more distant future there is the promise of atomic power.
Other Nations are Expanding

That is not all. It would be very difficult for us in this country to go on producing and consuming more and more goods if other big industrial countries were not doing the same, for we depend so much on world trade. But nearly all the other big industrial nations are committed to full employment under the United Nations Charter and, like us, are looking to steady economic expansion. They know much more now about how best to get it and to avoid disastrous setbacks on the way. There is much more international economic co-operation than before the war. In various international organisations the nations of the world meet and discuss their economic plans. We are trying to expand our economy in a world which is going the same way: and that makes it easier.

So it is reasonable to be optimistic. Our problems are not the problems of wrestling with economic depression, but of keeping economic prosperity.

SECTION II: BUT PRICES GO ON RISING...

But so far we have failed to find a way to prevent prices rising. Compared with the previous hundred years the rise since the war has been startling. What explains most of the price increase is not rising import prices or changes in taxes and subsidies: it is costs of production at home. Prices have risen mainly because incomes - wages and salaries and profits - have risen faster than output.

An Unprecedented Rise

On average the prices of the goods we buy have been higher each year than the year before, sometimes a little higher, sometimes a lot. A basket of goods which cost £1 in 1946 cost about £1 10s. in 1955."

Some people have now become so used to rising prices that they assume it is in the natural order of things, that it has always

* For instance, the Organisation for European Economic Co-operation (O.E.E.C.), the International Monetary Fund (I.M.F.), the United Nations Economic and Social Council (E.C.O.S.C.O.).

/ Throughout the White Paper, the price index of all consumer goods and services is used.
happened. This is not so. The post-war rise in prices has been something quite unusual for Britain. There are index numbers for shop prices - some official and some unofficial - going back to 1850; and the figures are good enough to make it possible to draw one broad, general conclusion: from 1946 to 1955 prices rose faster than in any other nine peace-time years in the last hundred.

Why it Happened

How is this rise in prices of about 50 per cent. to be explained? Three different things have sent prices up, and we know roughly how important each has been. Changes in indirect taxes (purchase tax, petrol tax, etc.) and in subsidies have had some direct effect on prices - but only a small one. They only explain about one-seventh of the rise. That is one influence. Import prices have risen, at times very fast indeed; but they only explain about one-fifth of the rise. That is the second influence. But the really big one is this: two thirds of the rise in price has happened because costs of production at home have gone up.

What does this mean, "costs of production going up"? Suppose the country produces 30 per cent. more goods, and that the people responsible for turning out those goods - both the workers and employers - take between then 30 per cent. more money for producing them. Then, with 30 per cent. more goods and 30 per cent. more money, costs stay the same and prices are not driven up. But suppose, still turning out 30 per cent. more goods, they take 90 per cent. more money for doing it, then with 30 per cent. more goods and 90 per cent. more money, the cost of producing each item rises, and so do prices.

This is what exactly happened in Britain between 1946 and 1955. Between us, we produced 30 per cent. more goods and services and took 90 per cent. more money for producing them. That is the big reason why prices have reached a figure about half as high again as nine years ago.
This happened for Britain as a whole because, all over the country, the same sort of thing was happening for individual industries and firms: wages, salaries and profits together were going up faster than output.

Once the process has started, it tends to go on. When incomes are rising faster than the output of the goods they are spent on, there is bound to be plenty of spending money about. This keeps sales booming. And, when the next round of wage demands comes to be settled, or profit margins come to be fixed, it is easy to pass on the extra to the consumer. This is why it helps to stop prices rising if spending power is cut back: sales are not so easy, and firms find it harder to pass on increases to consumers.

Note that it is not any and every rise in incomes which sends up prices. It is when incomes rise faster than output that prices rise.

The Wrong Link

Incomes have risen faster than output because people have tried to link them to something else. First, they tried to link them to the cost of living. But there were times when the national standard of living was bound to fall, for example, when import prices suddenly rose very fast, after the outbreak in Korea. Then we had to send more goods abroad and import less, and fewer goods were left for the home market. There was no sound solution but to accept a temporary fall in the standard of living. Secondly, when incomes rose for one group of people, there was a natural desire on the part of everyone else to keep up, to preserve his relative position or differential. Thirdly, people, especially in industry, have looked to see how well the other partner is doing, and, for instance, have based a wage-claim on an increase in profits or dividends. (The facts and figures about these are set out at the end of this booklet.) But however tempting it is to try to settle the amount of one’s income by reference to the cost of living, or to what someone else is getting, if that method results in putting incomes up by more than output, it will drive up prices and the cost of living still further.
SECTION III. WHY DOES IT MATTER, IF PRICES RISE?

If prices go on rising, and the value of money goes on falling, it leads to social unfairness and all kinds of economic difficulties. Savings are discouraged. Some people get left behind in the race to keep incomes in step with prices; and it is not the least deserving who get left behind. Most important of all, unless prices in competing countries are rising as fast (and they are not) we are likely to lose export markets. If we do not sell enough exports, we shall not be able to pay for enough imports to keep our economic machine going; and our hopes of a rising standard of living will grow less bright; full employment itself will be threatened.

Inconvenient, Unfair...

If prices rise, the value of money, of course, falls. A number of evils spring from this. To take the least of them first, it is inconvenient: housewives keep having to adjust their ideas of what is a "fair price" in the shops, telephone call boxes have to be adjusted, new bus tickets printed, and so on. But of course there is a great deal more to it than inconvenience. There is the threat to savings. If prices go on rising, in time people will be discouraged from saving; for, if they lend their money, they will not know how much of it, in terms of what it will actually buy, they will eventually get back.

But if we are to have a go-ahead economy, we need a great deal of savings; for we need new factories, machines, roads, schools, houses, and so on. All this investment needs savings, and if people are less willing to save it will be impossible to get enough investment.

Then there is the unfairness. It is true that average earnings have more than kept pace with prices over the whole post-war period (though there were years when earnings fell behind): from 1946 to 1955, while prices rose by 10s. in the £1, average earnings for wage earners employed in industry rose by 17s. in the £1. But these are average earnings, and for industry only; in fact in the post-war period very many people have been left behind. The most obvious sufferer is the man who had saved up for his old age. There are a great many people like this, whose incomes either rise more slowly than prices or do not rise at all.
A big rise in the cost of living never leaves everything as it was before, even if average incomes have risen just as much. Some people gain without specially deserving to. Others lose through no fault of their own. Rising prices make for nagging anxiety, injustice, unrest and bad feeling.

... and Dangerous

The biggest argument of all, especially just now, is the damage rising prices can do to our export trade. All is not well with our trade and payments with the outside world: this shows up in the figures for the gold and dollar reserves. They fell by nearly a quarter last year, and have only risen a little this year. They are much too low. The only good way out of the trouble is to increase our exports.

Why are we not getting enough exports? It is not that world markets for manufactured goods are shrinking: far from it. World trade in manufactures has been rising fast in recent years, and still is rising. The trouble is that our share in this trade is falling. This table shows the shares which the three biggest exporting nations had in world markets for manufactures in 1937, 1950, 1951 and the first nine months of 1955:

<table>
<thead>
<tr>
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<th>U.S.A.</th>
<th>U.K.</th>
<th>W. Germany</th>
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<tbody>
<tr>
<td>1937</td>
<td>20</td>
<td>22</td>
<td>23</td>
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<td>1950</td>
<td>27</td>
<td>26</td>
<td>7</td>
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<tr>
<td>1951</td>
<td>26</td>
<td>22</td>
<td>10</td>
</tr>
<tr>
<td>1955 1st 9 months</td>
<td>25</td>
<td>20</td>
<td>15</td>
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\* All Germany in 1937.

The United States share is a good deal bigger than it was before the war. The German share has been rising very fast since 1950. Our share has come down. Now it is smaller than it was before the war - 2 per cent. smaller - and six per cent. less than in 1950. 2 per cent. of world trade in manufactures is worth some £240 million. 6 per cent. is worth £720 million.
There are a number of possible reasons to explain why our share has fallen since 1950. Some German recovery was inevitable. We were handicapped by having to rearm after 1950. Since 1950, markets in Europe, which is Germany's main outlet, have grown more than markets in the Commonwealth, which are our speciality.

But these explanations cannot account for all of the fall in our share. In fact, the same trouble which is at the root of rising prices at home is also at the root of our failure to get enough exports abroad: incomes have risen faster than output. One result of it is this: manufacturers have found it easy to sell their goods on the home market, and so have not given enough attention to selling them abroad. Delayed deliveries matter too—and they are the direct result of the home market taking too much. Then prices have risen. Probably the biggest single reason why exports are lost is because prices are too high.

There is no direct evidence that our export prices are seriously out of line. But the export prices of different countries are difficult to compare. There is evidence that wage costs in this country have risen faster than in the United States and West Germany. If this goes on, our export prices are bound to become uncompetitive; we shall find that we are not selling abroad enough to buy the imports we must have; and this could easily lead to rising unemployment and falling living standards.

SECTION IV: WHAT CAN BE DONE

Price rises can be checked if three things are done. First, if the Government helps to keep a balance between the supply of goods and the supply of spending money. Second, if employers and workers together agree that the most important thing to do is to raise productivity. Third, if all decisions about incomes—about wage-increases, profit-margins and dividend distribution—are made in the light of the lesson of the post-war years so far: that when the total of our incomes goes up faster than our output, prices are virtually certain to rise.

Holding the Balance

The Government, by raising or lowering taxation, by making it harder or easier to borrow money, and in other ways, can alter the amount the nation has to spend. It has to try to keep that amount
in balance with the supply of goods to spend it on. If it seems that there is not enough spending money to buy all the goods that can be supplied to the home market (while still leaving enough for export), then it can, for example, reduce taxation and so increase the nation's spending. If, on the other hand, there is too much spending money at home, then there is too much temptation to raise prices, goods are taken away from the export markets, too many imports are brought in, and the Government must do something to reduce spending at home. Of course, the Government will aim to keep the amount of spending money high enough to make sure that employment stays high and production goes on rising. But the Government is equally bound to make sure that the nation pays its way abroad.

Rising Output

The problem is that, with full employment and rising production, there is this tendency for costs to rise because incomes - wages and salaries and profits - rise faster than output.

To bring them into line either the increase in output must be speeded up, or the increase in incomes must be moderated, or both; the solution probably lies in a mixture of the two.

First, speeding up the increase in output; or, higher productivity. This demands enterprising management, ready to try new methods and install new equipment. Higher productivity needs workers' co-operation too, of course. Restrictive practices - the rigid demarcation of duties, resistance to dilution or to the reduction of manning scales, working arbitrary fixed stints - all these practices grew up in times of heavy unemployment, and are out of place in a fully-employed economy.

But there will only be full co-operation in raising productivity if there is confidence between management and workers on the shop floor. Some firms can introduce new working methods, redeployment or a new system of payments without difficulty. Others
meet opposition. Some firms succeed in explaining their costs, their profits and future prospects to their employers. Some do not try. Confidence between workers and employers will only come from a full and frank exchange of opinion and information at all levels in industry.

Keeping Incomes in Line

Secondly, the rise in incomes must be kept in line with the rise in output. This is a rule for the country as a whole, not for each individual industry or firm. Here are some points about it:

1. In some industries productivity can be raised much faster than in others. There may be more scope for new machines and new techniques. In these industries where productivity rises fast, prices should be cut: that will be the only way to keep prices stable for the country as a whole. Price cuts are better than income increases as a way of spreading the benefits of higher productivity.

2. Firms should earn the extra profits they may need to finance new investment and expansion from bigger sales, not from higher profit margins.

3. The Government obviously cannot give an opinion on any individual wage-demand, whether it is justified or not; wages are fixed by free negotiation between employees and Trade Unions. Nor can the Government give a view on each dividend distribution. It can only ask those concerned to keep the needs of the country as a whole in mind, and to remember the experience of 1946-55, when prices were driven up 50 per cent, mainly because incomes rose faster than output.
CONCLUSION

Everyone wants full employment, and everyone wants stable prices: but so far, we have succeeded in getting the first and we have failed to get the second. This booklet has set out to explain, in the words of the White Paper, that "How well off we are as a nation depends not on the money incomes we earn, but on the sum total of the goods and services we produce; and as individuals it is what we can buy with our pay rather than the pay itself which determines our standard of living . . . . . . . . If we all press constantly for more money, regardless of how much we produce to spend it on, prices are bound to go on rising. But if we concentrate on increasing productivity, and on keeping costs down, price stability can be achieved along with full employment and a rising standard of living." Between us, we have been mainly responsible for sending prices up in the past; and between us, we can do much to stop that rise in the future.
WAGES, PROFITS, AND DIVIDENDS: THE FACTS

Before setting out the figures, here are some explanations. In what follows profits mean gross profits: that is, profits reckoned before tax is paid or any money put aside, e.g. for the replacement of worn-out machines and buildings (called depreciation). These gross profits in fact are divided into four. The largest part is saved (this includes the money for replacement of building and plant); the next largest part goes in taxes; third come dividends on preference and ordinary shares; and last interest on loans etc. The figures for wages and salaries (that is, the money earned by all wage and salary earners) and for dividends are all before deduction of personal income tax.

1. Wages and salaries are about three times as big as profits.*

2. From 1938 to 1955, wages and salaries rose 3½ times. Gross profits rose 4½ times.

3. But there has been a big change in the way in which companies distribute their profits. In 1938, 47 per cent. in dividends; in 1955 21 per cent. Taxes and reserves are taking much more of companies' profits than they did before the war.

4. So from 1938 to 1955, dividends rose about 1½ times, compared with 3½ times for wages and salaries. (It was from 1938 to 1948 that dividends rose much less than wages and salaries. From 1948 to 1955 they both rose about the same amount.)

5. In real terms - in terms of what money will buy - wages and salaries (from 1938 to 1955) have increased about 40 per cent. Dividends have fallen about 30 per cent.

6. Dividends are about 5 per cent. and wages and salaries about 60 per cent. of total incomes.

* The full definitions of all the figures, and the sources, are given in the White Paper itself.

+ This includes the gross trading profits of nationalised industries as well as those of companies.

++ Excludes all the companies which have been nationalised since 1938. Otherwise the figures would fluctuate up and down as companies were nationalised and denationalised.
Set of Charts to accompany Popular White Paper

1. Unemployment and Prices
Since the war we have had no unemployment.........(Graph of unemployment percentage, 1920 to 1955, with 'World Depression' pointer to 1930-33, and words: 'between the Wars, on average, 1/4 in every 100 workers had no jobs ....... Since 1948 the average has been 1 1/2.)

........ But we have had steadily rising prices ........ (Graph of retail prices, 1920 to 1955, with the words ........ 'So that a basket of goods which cost £1 in 1946 cost about 30/- in 1955'.)

2. Why Prices Rose
The basket of goods which cost £1 in 1946 cost about £1 10s. Od. in 1955.
And this explains the extra 10/- :-

| Change in Taxes and Subsidies | = 1/6 |
| Increase in Import Prices     | = 2/- |
| Increase in Home Costs        | = 6/6 |

3. Meaning of Home Costs
This is what a rise in home costs means:-
When this happens, home costs stay the same............
(Worker and manager say "We've produced 30% more goods and taken 30% more money for doing it......)
...... but when THIS happens, the home cost per article rises, and so do the prices.
(Worker and manager say "We've produced 30% more goods and taken 90% more money for doing it......)
And between 1946 and 1955 this is exactly what did happen in Britain.
4. Wages and Salaries, and Profits

Comparing 1938 with 1955 - wages and salaries have increased $3\frac{1}{2}$ times.

Gross profits $4\frac{1}{2}$ times.

But the division of profits has changed:

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<tr>
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<th>1938</th>
<th>1955</th>
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<tr>
<td>Dividends</td>
<td>47</td>
<td>21</td>
</tr>
<tr>
<td>Interest</td>
<td>15</td>
<td>12</td>
</tr>
<tr>
<td>Savings</td>
<td>29</td>
<td>43</td>
</tr>
<tr>
<td>Tax</td>
<td>9</td>
<td>24</td>
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</tbody>
</table>

5. Wages and Salaries, and Dividends

So these are the changes in wages and salaries and dividends paid out.

And these are the changes in what they would buy (at rising prices).

6. Shares in World Trade

Since 1950 our share in world markets of manufactures has fallen.

(Percentage share in world market of manufactures, 1937, and 1950 to 1955 1st nine months.)

... and between the first nine months of 1954 and of 1955, both Germany and U.S.A. increased their exports of manufactures faster:

- Germany +18%
- U.S.A. + 9%
- United Kingdom +6.5%

7. Wage Costs in U.S.A., U.K., Germany

Average earnings and output-per-man in Manufacturing industry, 1950-55, 1st 9 months:

<p>| | |</p>
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<thead>
<tr>
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<tbody>
<tr>
<td>United Kingdom</td>
<td>+ 4.3%</td>
</tr>
<tr>
<td>Output-per-man</td>
<td>+ 10%</td>
</tr>
</tbody>
</table>
Earnings have risen much more than output per man. So labour costs per article have risen about 30%.

U.S.A. Earnings  
Output-per-man  

Earnings have risen rather more than output-per-man. So labour costs per article have risen about 15%.

W. Germany Earnings  
Output-per-man  

Earnings and output per man have risen together. So labour costs per article have hardly risen at all.

(From O.E.E.C. figures)