CABINET.

GOVERNMENT ASSISTANCE TO RATIONALISATION.

Note by the President of the Board of Trade.

The Prime Minister has authorised me to circulate to my colleagues the attached memorandum which I sent him some time ago, for consideration in conjunction with the memoranda on Unemployment by the Home Secretary, the Chancellor of the Exchequer, and the Minister of Labour.

P.C.-L.

Board of Trade,

24th February, 1929.
I have seen Mr. Richard Guinness as you asked me to do, and I invited Sir John Hindley to be present at the interview. Mr. Guinness's scheme, which I attach (Appendix I), is more or less on the same lines (applied to coal only) as the proposals contained in my memorandum (U.P.5(28)) which I circulated to the Unemployment Committee last July. I also attach a copy of this memorandum (Appendix II).

My interview with Mr. Guinness affords a convenient opportunity for considering whether any Government action, by the use of credit or otherwise, is necessary or expedient in order to stimulate rationalisation in industry, and particularly in coal.

I say necessary or expedient because, even if such action is not necessary, you may regard it as politically expedient at the present time.

Let me take the question of necessity first.

You will remember that in my July proposals I recommended that, if desirable amalgamations in cotton, coal or steel were held up for lack of finance, the Government should provide the necessary capital. I laid down strict conditions, which are set out in paragraph 8 of my memorandum. The Government should only intervene if the necessary capital could not be found through the usual financial channels, that the amalgamations to be helped must be economically desirable, their management efficient, their capitalisation reasonable, and that Government money should not be used to improve the financial position of either creditors or constituent firms, except in so far as their financial position was automatically improved.
by the existence of an efficient amalgamation.

At that time I was not very hopeful that outside money would be found, particularly in cotton, with which I was immediately concerned. But considerable progress has been made since then, and I cannot say to you today that I know positively that definite amalgamations are held up for want of money.

The cotton situation you know. There the Bank of England has come in and found the necessary new capital. All my conditions are secured. The capitalisation is sound, the management is efficient, no one, either constituent companies or Banks, is taking any cash out of the pool; the Banks, indeed, are taking income bonds in place of debentures and surrendering their rights of foreclosure. This is very satisfactory, and it would be disastrous if we did anything in cotton which would prejudice this salutary scheme of reconstruction.

In steel, slow but steady progress is being made. You know the amalgamations which have taken place and are on foot. The Vickers-Armstrong - Gannell-Laird amalgamations are complete; and Cargo Fleet and South Durham are formally amalgamated. I gather that the directorates of Dorman Long and Bolckow Vaughan are now also agreed. If that amalgamation comes off, I have little doubt that close working arrangements, followed, I hope, by complete amalgamation, will take place between the enlarged Cargo Fleet and the enlarged Dorman Long. In Scotland, I understand that the regional amalgamation we have so long contemplated is in sight. I do not know that any of these amalgamations are held up for lack of funds. In
Vickers and Cargo Fleet, there is, of course, no difficulty, as there is plenty of cash; and I have had no complaint from the others. You will remember that, when McKenna was suggesting Government money for cotton, he said that he was quite satisfied that all the money required for steel amalgamations would be found, and probably for coal also.

I may add that, apart from amalgamations, I hope that the steel industry is at last going to set up a single export agency.

Now I come to coal, which is more difficult. There is a good deal of movement in the coal industry. Actual amalgamations have not been very numerous, but there have been some substantial ones, covering, I think, an output of about 70,000,000 tons. But there has been more progress in district schemes. Both the Scottish scheme and the Six Counties Scheme, which embraces the whole of the Federated Area and Lancashire, have now been working for about a year. I hope these schemes will lead to more amalgamations; and in the long run I think they will. The people who see the full value of co-operation want to draw the net tighter. On the other hand, there are no doubt a number of less efficient or more individualistic people who find they can still live under a district scheme.

I am afraid that, here again, I cannot give you any absolute evidence of amalgamations which are desired by the parties; but which are held up for lack of capital. I know of some which are held up because some of the
parties want to be bought out in whole or part; but
that is no part of our business. But, on the whole, I
do think - and in this Hindley agrees - that there are
amalgamations which ought to take place, but which the
parties do not attempt to set on foot today because they
know that, to make the amalgamation a success, new
capital is required which would not attract issuing houses
or investors on any figures which they can produce.

I do believe, therefore, that, if coal stood alone,
Government action might accelerate amalgamations. Let
us then see whether any action other than the finding of
money will help.

The provisions of the miners Industry Act of 1896,
which enabled one or more companies to force their
neighbours into a combine, have not been much used.
Some amalgamations have taken place, because the possibility
of compulsion was in the background. But, generally
speaking, even those who are keenest on amalgamation
are unwilling to take their neighbours into Court and
force an amalgamation through. It has been suggested
that the Mines Department should now take power to promote
amalgamations and take the parties to Court. I still
deprecate this course. I think it is dangerous in
principle. I do not see the answer to the man who says;
"Here you are forcing 12 unwilling people into a single
combine when no one of those is ready to assent or
thinks it a sound business proposition. If the Government
do this, it must assume the financial responsibility".
You might get some schemes where a few of the parties
were willing; but, in that case, if they are keen enough,
they ought to go on by themselves and use the power
of the Act.
I also deprecate this plan on practical grounds. I have seen a good deal of the enormous detailed work which a colliery amalgamation involves, even where the parties are willing. The appraisement of the actual and relative values of unworked mines is extraordinarily difficult, and requires weeks of work in any scheme by able mining engineers; and then, of course, the accountants have to come in. I do not believe that a Government Mines Department could undertake this work on a large scale, unless it retained the services of most of the competent mining engineers in the country. I am therefore against the Government undertaking to force amalgamations.

I think it might be possible and right to extend the powers of Part I of the Act of 1926 to include selling organisations. I know this was objected to at the time; and I myself have advanced very cogent objections to Government action - such as, the political consequences if the Government forces companies into a selling pool, the inevitable result of which is to put up the price of coal to consumers. But I think the country is sufficiently keen to see the coal industry rationalised to ignore these objections; and I think we could now safely extend the 1926 Act to cover selling pools. I think, too, that there might be more willingness to force unwilling neighbours into a selling pool than to force them into a complete amalgamation. Moreover, allowing one company to force its neighbours into a selling pool does not differ materially in kind from forcing a neighbour into a complete amalgamation; and district agreements are accustoming people to some co-operative control over sales. I think on the whole, therefore, this is worth trying.

The only other way of giving Government assistance is by Government finance. From what I have said above both on the
coal industry itself and still more on cotton and steel, I should be doubtful if Government intervention was justified on the strict merits of the case. I naturally ask myself these questions: What evidence is there of actual schemes held up, which will justify a departure from the deliberate policy of the Government since the Trade Facilities Act expired? Would not Government intervention deter colliery companies from facing the stringent terms of reconstruction which are necessary to bring in outside finance? Will not outside finance itself be deterred from what must be a less attractive investment than foreign investments ready to their hand? What will be the effect on other industries? Will not all industries in need of money say that Government money is not only cheap money but easy money? Will not the steel industry, for example, be inclined to sit back and ask for easy money without adequately writing down its capital? Will not creditors see a rather easier get-out than they could otherwise obtain? Will not shareholders say that, if the Government is coming in, it will do something for them, who have lost so much? Will not Lancashire protest that Lancashire has been "under the harrow", that Lancashire has the poorest shareholders (with calls to meet); that Lancashire must have as good terms as anyone else? Will not this cause inefficient and uneconomic cotton schemes to raise their heads again and ask for cheap money to carry on under the old management? If that is so, will the Governor of the Bank be able to keep the issuing houses up to their provisional undertaking to find the money for the sound Cotton Corporation? As regards cotton, it may be said that
the scheme is started; that the backing it has received shows that no Government money is needed; and that the Government can refuse any finance to the cotton trade. I think this is true in fact; but electoral pressure is not conditioned by strict regard for truth.

I am bound to put these obvious difficulties to you. But, if it is thought wise to offer Government help, I think that we could hedge round our offer by such strict conditions that loose schemes could be rejected and only those would get through where there was a real need. This, indeed, will be easier if we merely announce our policy before the election and carry it out afterwards. Still, even so, the very fact that the Government intervenes at all must have some deterrent effect upon private endeavour, both on those who ask for money and those who have to find it.

Let me here make it plain that, while I should not be opposed to an offer of Government finance to assist approved amalgamations, subject to the conditions I have outlined, I am utterly opposed to loose schemes, such as those advocated by Sir Richard Redmayne. This gentleman has frequently proposed that Government credit should be available for any colliery which will improve its plant. I think this kind of proposal thoroughly vicious. Here is no reward for merit; here is no encouragement to amalgamate; it only means that indifferent undertakings will be able to get cheap money to maintain their individual existence when they ought either to die or be absorbed in other and more efficient concerns.

You will next ask me what will be the effect on employment if the Government offer financial assistance for amalgamation. I must say at once that the effect
cannot be considerable. I have continually told the Cabinet during the last three years that the process of rationalisation cannot absorb a much greater number of men at the present time. The immediate effect of rationalisation must be to reduce the numbers employed administratively and industrially in proportion to the output. In the long run a rationalised industry will benefit employment. The industry becomes a more efficient competitor with foreign industries, and it employs the maximum number that can find work in the industry. But the true way of putting the position is this. Without rationalisation, our competitive power will diminish, and therefore fewer people will be employed. Given rationalisation, while we shall employ fewer men per unit of output, we shall, in fact, employ as many as an efficient industry can economically employ.

Even so, I think you have a strong case for saying that the Government is justified; and that it is your policy, to do anything you reasonably can which will make industry the most efficient employer possible, and that your intervention is justified on these grounds.

I take it that, if you desired to announce a departure of this kind, you would do it in general terms, saying that, in order that there may be no risk of the process of rationalisation being delayed for lack of capital in certain basic industries, or, if you preferred in coal alone - that the Government would be prepared, directly or indirectly, to provide the necessary capital in approved amalgamations, if they were satisfied that the necessary capital could not be found in the market. You would also, I assume, state in general terms the limiting conditions, which I have referred to above and set out in paragraph 8 of my former memorandum.

If I were considering this as a practical measure to be decided on its merits, I should naturally propose that,
before taking any decision, the Chancellor of the Exchequer and I should see the Governor of the Bank and the Chairman of the Joint Stock Banks. But we are considering the possibility of this action on the ground of expediency. What would be the attitude of these gentlemen if we saw them? We may assume that the Governor would be definitely and irrevocably opposed. He would bury his new projects and reproach you with the epitaph "Plura moliebatur". Three of the other Bankers would follow his lead. Goodenough would be of the same opinion for other less good reasons, which he would no doubt state in order to show that he was independent of the Governor. Your one hope would lie in McKenna, who might decide to take an opposite view; but I am not sure even of him. He wanted Government money for cotton; but, having seen the Governor get away with that, I am not at all sure that he would support Government finance elsewhere. If then you wish to act, it would probably be wiser to produce your limited offer of assistance without consultation with anyone. After all, you would be saying that the Government only offered to come in where ordinary finance could not be found; and you would not have to table all your precise conditions before the general election.

If action is contemplated, there is a further consideration, which is more for the Chancellor than for myself, namely, whether the more convenient course for the Treasury is to raise the money by guaranteed loans, or by direct borrowing and advances to undertakings. The advantage of Trade Facilities was that, the Government being merely a guarantor, it was easier for the Government to step out of this class of business when their assistance was no longer required. But it must be admitted that Trade Facilities loans have, from the investment point of view, been rather
an anomalous creation. They are, in effect, a Government security, but their market price does not justify that prestige. However, I have written so much about the other aspects of this question that I prefer to leave that to the Chancellor.

P. C-L.

12.2.29.
APPENDIX I.

A PLAN TO BRING ABOUT LARGE SCALE AMALGAMATIONS
IN THE COLLIERY BUSINESS AND TO MODERNISE
AND RATIONALISE THE INDUSTRY.

1. It is assumed that the advantages of amalgamation
and rationalisation are admitted.

2. At present amalgamations are proceeding very slowly,
partly because of the individualistic and reactionary outlook
of many Colliery Owners, Chairmen, Directors, Managing
Directors, and particularly of the Officials as distinguished
from the Shareholders, partly owing to the natural reluctance
of a Colliery that is not losing money to amalgamate with a
Colliery that is, and principally because general opinion
holds that no amalgamation is worth while unless money can
be had at cheap rates to carry through modernisation and
rationalisation.

3. However strongly the Government and popular
opinion may advocate amalgamation, it is not thought possible
for a Conservative Government to force it on unwilling Owners.
Moreover, the technical character and extreme variation of
value between Collieries presents almost insuperable
difficulties to any rough-and-ready solution of this problem
by a formula applicable to the industry as a whole.

4. Nevertheless, it is submitted that a Government
could induce Owners to amalgamate by offering certain ad-
vantages to amalgamations that complied with certain
definite requirements. It is suggested that the constituent
units to any amalgamation must have a sound economic basis,
and therefore that any amalgamation should comprise
approximately 50% of

(a) either the total quantity of the district, or

(b) the quantity of similar quality of Coal mined within
the District.

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5. The advantage offered by Government should take the form of a loan at a moderate rate of interest.

The following are suggested as conditions of the loan:

(a) Interest should not exceed 5%;

(b) The amount loaned to any Corporation, Association or Group, should not exceed, say, 7/6d. per ton of annual potential output;

(c) The proceeds should be earmarked for the development of the property, modernising its plant, the erection of Coke Ovens and By-Product Plant, and the resultant distribution of Gas and other forms of power. No part of the money in question should be used for the liquidation of the present capital commitments;

(d) The loan should be repayable by a sinking fund starting only in the 4th or 5th year and redeeming the loan in 25 years, provided, however, that the life of the Colliery is established at a longer period;

(e) A percentage of profits over an agreed datum line should be allocated to a betterment fund and to a fund for the benefit of the wage earner. It is suggested that 5% of such profits should be allocated to betterment and 5% to the workers' fund.

The effect of this plan would be that, while no pressure is brought on any Colliery to amalgamate, yet the advantages of doing so would become so obvious that it would be impossible to resist them. In a short time the representation of the Coal Industry would be in relatively few hands, controlled by men of high calibre and it is thought that not only would producers be able to control the export business and, if found desirable, enter into international agreements, but that a much more enlightened policy in regard to the labour problems would be pursued. In this regard, it is thought generally better conditions, both as to pay and perhaps a guaranteed week, might ensue.

Further, such an amalgamation would be able to modernise the pits, close bad pits, work full time on good pits, spend money on research and develop what many people
believe still to be the cheapest regular supply of power in the world. It would be easy to develop electricity, gas, and in due course oil, from coal, and other industries which depend on cheap power, all at the pit's mouth.

6. If the whole of the industry accepted the terms, the amount of money required would be about £90,000,000 to £100,000,000, but it is not thought that anything like this capital would be required, and a more probable estimate puts the maximum sum at about £20,000,000 to £25,000,000. The whole of this sum would be spent on labour and British materials, and would immediately give employment.

7. The Government should lend the money to the companies at 5% plus agreed Sinking Fund based on each individual development. The Exchequer should make their own arrangements as to issuing Stock to finance the operation. Seeing that Government credit to-day is on about 4½% basis, in this way the Exchequer should make a profit and it should remove the objection that Government credit was being used for the benefit of capitalists without remuneration.
1. In any scheme designed to help depressed industries our objective should be to make those industries achieve the most efficient organisation for production and sale, i.e., what is loosely called rationalisation.

2. Taking the long view, efficient concentration will produce and sell the maximum amount possible, at home and abroad, and will therefore provide the maximum of work under the best conditions. Moreover, any encouragement to less efficient units to continue in independence is mere dope; it must postpone the ideal concentration, and it is even doubtful whether any immediate advantage in the aggregate of employment is secured.

3. The fact must be faced that rationalisation may actually increase unemployment in some firms. But, unless we can produce the maximum we can sell under the most efficient conditions, employment as a whole cannot be improved.

4. It is important that any action by the State should not retard any combinations which would take place without State help, or deter outside finance from playing its part.

5. I suggest that this risk can be almost entirely prevented if Government assistance is only given in cases where we are satisfied that normal finance is not available, and where the parties combining extract no advantage for themselves other than the advantage of combination; i.e., it is essential that the combining parties should leave all their assets in the business.

6. I propose that the Trade Facilities Act should be restored for the purpose of guaranteeing loans to effect approved combinations in selected industries. A total sum would, of course, be fixed both in order to limit the
extent of Government liability and to encourage prompt applications.

7. I suggest that the industries selected should be Coal, Iron and Steel, and Cotton. I should be willing to include the Woollen and Worsted trades if I thought there was a real prospect of amalgamations there.

8. The Government guarantee would only be given where it (the guarantee) was necessary to bring about an approved amalgamation. Before approving an amalgamation the Government would have to be satisfied -

(a) That the amalgamation was economically desirable, i.e. that the combination would be an economic unit.

(b) That the management of the combine was reasonably efficient.

(c) That capitalization was reasonable.

(d) That no constituent firm should take any cash out of the existing funds or new money of the combine, i.e., each firm would bring into the pool, and leave there all its assets, fixed or floating.

(e) That the scheme will not be used to improve the position of creditors at the expense of the State, i.e., that no creditor should be better off because of the State guarantee than he would have been without it. I realise that this is easy to say and difficult to enforce; but I am quite clear that we must stand for the principle, that we are not going to allow State money to improve a creditor's position more than it would be improved in a sound business arrangement to which the State was not a party. In the last resort, the result might be achieved by liquidating the companies and reconstituting them on amalgamation.

9. The Government would act on the advice of a small but very strong committee. I should not lay down the nature
of the charge to be created in favour of the State; but, as under the previous Act, I should leave the committee to recommend the amount, character, and priority of the Government guaranteed loan.

10. I submit the following considerations as justifying this revolutionary proposal:

(a) Without Government assistance, I do not believe that necessary amalgamations will take place. I know that the Cotton Yarn Association is about to represent to me that an economic amalgamation can take place in the American Section, provided there is some Government assistance to raise working capital. They will represent that the firms concerned have exhausted practically all their working capital; that the members cannot provide more capital themselves, that outside finance cannot be obtained; and that, if the present effort fails, the movement to secure combination in this industry will die. We may criticize the people who constitute the American Section of this trade - and they deserve a full measure of criticism - but criticism won't relieve us of a cotton situation which will become almost insoluble if we cannot help now.

Again, in coal, I am satisfied that there are amalgamations which ought to take place, where once the amalgamation has taken place new capital for improvements is justified, but where outside finance will not be available. The amount of outside money which will be put into the coal trade will be confined to more attractive, or rather less unattractive, propositions.

(b) If this plan is rejected, we may well be driven in a short time to far less economic expedients.

(c) In this plan, as distinct from all our subsidies, Government aid is given only as a reward of merit; it is given only to those who will set their own house in order.
Thus, we should get as the price of our help a more efficient industry and one better able to hold its own.

(d) I am reasonably satisfied that, safeguarded as strictly as I propose, Government action will not deter outside finance. I have sought confidentially the advice of one who is able to give me the best possible opinion of this in the Coal industry. His view is that the plan on those lines would not deter those who are considering financing coal schemes from pursuing those schemes. On the contrary, the fact that other amalgamations were going forward with Government assistance might rather encourage finance to come into the industry, as indicating a healthier tone.

11. I have considered whether Government guaranteed loans should be made available for the renewal of plant. I do not propose this, at any rate at this stage. Once the Government made a general offer of that kind, it would be unable to confine it to firms which are economic units, in size and management. We shall get the result we want in improvement of plant better by giving our help to foster amalgamations, whose new capitalization will, as part of the scheme, include sufficient capital to spend on the necessary re-conditioning of plant.

12. I am satisfied that we need not fear the charge that we are attempting to create trusts and monopolies, or that we shall have any difficulty in resisting a claim for anti-trust legislation based upon our action. In coal, cotton, and steel, productive capacity is so enormously in excess of demand that it must for many years be the object of these industries to sell the largest possible output.

13. What action ought we to take at the present time? It is important that we should not act unless Government intervention is necessary; but we should be ready to act promptly if intervention is required. The opponents of Government intervention will say that ordinary finance can do the work. It is very difficult to check this,
as at present there is a sort of stale mate. The financiers are inclined to say that they can do everything. The industries are slow and reluctant to act at all, and excuse their inaction partly because some of them say that they know they cannot get possible financial terms; others, like many of the steel makers, say that they cannot offer any adequate prospects without a duty. I think we want at the same time to encourage the industries and to test the financiers. I suggest, therefore that the Government should say at this stage that it is ready (indicating the general lines and limitations) to give help by means of guaranteed loans, if necessary amalgamations are held up for lack of finance.

I assume that, before any announcement was made, the Treasury and the Board of Trade would discuss the matter with the Bank of England and the Joint Stock Banks. But I think the general scope of the proposal might well be considered by the Unemployment Committee in conjunction with the other schemes which have been submitted to it.

P.C-L.