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SECRET.

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COPY NO. 8.C A B I N E T.THE PRESENT SITUATION.Memorandum by the Home Secretary.

The Prime Minister, at a recent meeting of the Cabinet, suggested that we should now address ourselves to the question of the general course to be pursued by the Government in the present situation. It was agreed that, after a short interval, we should turn to that. In order to avoid troubling the Cabinet with a statement which might be unduly lengthy, I circulate this memorandum. It must necessarily deal with some questions of controversy. I should not, of my own initiative, have raised any of these matters, but since they have been raised, they must be discussed frankly.

1. The failure of the Government to fulfil the primary object with which it was formed, the defence of British credit and the maintenance of the value of sterling, may be attributed, so far as causes within this country are concerned, to the formation of a strong Opposition, which has given the impression that it is against the whole policy of this Government and would, if it came into power, repeal some at least of its most important financial measures; and, second, to the powerful campaign in sections of the press, during the week preceding September 19th, for an immediate general election, without any assurance being given to the public at home and abroad that the conditions at the election would be such as to ensure the defeat of the Opposition. The incident at Invergordon no doubt contributed also. The nervousness of many foreign depositors about the conditions in their own countries would probably not have been the deciding factor if the anxiety about the stability of sterling had been removed.

This is supported by the fact that the formation of the National Government had had an immediate effect in stopping withdrawals. They began again as soon as it appeared that the political position of the Government itself had become doubtful, in spite of the steady support it received from its parliamentary majority. That this view of the situation is right is shown by the telegram of the French Prime Minister, sent in answer to the request for assistance which was made when the Bank of England was reaching the end of its tether. In a very friendly reply, M. Laval said that he feared it was too late to save sterling, and the only particular reason he mentioned was the disturbing effect produced by the belief that a general election was imminent. At a conference held at Downing Street on Saturday, September 19th, at which this telegram was read, I asked the Acting Governor of the Bank of England whether their information confirmed that view. Sir Ernest Harvey said that it did, and that they had "heard the same thing from all over."

Precisely the same factors which led to the disaster that then followed still exist. The £ is heavily depreciated, but there is no reason in the nature of things why the depreciation should not become much heavier still. Some may feel confident that it will not sink below perhaps \$3.50 at the worst, but there can be no assurance whatever that it will not do so. It does not depend upon us, but upon world opinion as to the stability of financial conditions in this country. The announcement of an immediate general election, made under the same conditions as before, would produce the same results as before. There is the gravest risk of a slide in the value of currency, and we have not been informed of the existence of any resources which, once it started, would be adequate to stop it.

2. Those sections of the public who are attracted by the idea of an immediate general election have been led by many of the newspapers to believe that it would be a contest between the Opposition on the one hand and a National Government on the other; that this Government, or one closely resembling it, would go to the country under the present Prime Minister, with an agreed programme in which each section had endeavoured to meet the wishes of the others, and that a mandate would be obtained to enable that Government to carry out that programme in the next Parliament. The Cabinet is well aware that there is no such proposition before us. On the contrary, the Conservative representatives, while advocating an immediate election, have made it quite clear, beyond the possibility of doubt or misunderstanding, that so far as they are concerned they will put before the country nothing else than the full protectionist programme as adopted by their party. That programme includes a general tariff, not limited to ten per cent. or to any other figure; it includes also obtaining permission from the electorate to impose duties on foreign corn and meat and other food-stuffs in certain eventualities. It is not to be expected that the Prime Minister and the Chancellor of the Exchequer and their friends, any more than the representatives of the Liberal party, will join in an appeal to the country to elect a Parliament to carry that policy into law. It is inevitable that, as soon as an election was announced, these matters should become the subject of a vehement public controversy. This would not conduce to the defeat of the Opposition at the polls.

3. The following conditions are likely to prevail a month hence, when, it is suggested, the election would be in progress.

(a) Prices of necessities would have risen considerably in the shops, and might still be actively rising.

(b) The unemployed, and other classes affected by our economies, would have just received their first two or three weeks' allowances on the reduced scales.

(c) The Public Assistance Committees would be coping with hundreds of thousands of applicants.

(d) Demonstrations by the unemployed would certainly be organised in all the large cities and clashes with the police would be frequent. There might even be rioting with loss of life.

(e) A hard battle might be proceeding to check the further depreciation of the £ and of the rupee.

(f) A series of Orders might be issuing from the Government Departments, week by week, designed to check the rise in prices and to prevent profiteering - Orders which might or might not be successful.

Conditions more unpropitious for a general election could hardly be imagined. Meanwhile the Opposition would be carrying on a most formidable campaign. The whole force of the Labour Party would be concentrated in denouncing a policy which first reduced unemployment allowances and salaries and threatened reductions in wages; secondly, had not saved the £, had in fact resulted in an actual rise in the cost of living and might result in a much greater rise; and, thirdly, proposed now to add to all this a further increase through the imposition of a general tariff, including food-taxes. Calculations, made a few weeks ago on the basis that the nation would be rallied to the saving of British credit, to the support of a successful Government and the defeat of a discredited and reckless Opposition, might be wholly disappointed. Instead of the easy victory that was anticipated, the result might be precisely the opposite. It is a gamble on which we have no right to embark while the country is in the grave economic and financial difficulties in which it now finds itself.

It is urged that during or after the winter the conditions would be still less propitious, and that an election now is essential in order to ensure political stability for a considerable period. Foreign observers, it is said, cannot be re-assured until a new parliament has been elected. This again is very speculative. It may well be that the depreciation of the £ will give a temporary stimulus to industry -- as the Stock Exchange evidently anticipates; if that is so, and if there is no serious worsening in European and other overseas markets, unemployment may decline considerably and political conditions would at once become more favourable.

If conditions such as those through which we are now passing had been prevailing in some country on the Continent, and if we learnt that their politicians, instead of concentrating on the measures urgently necessary to control the situation, had plunged into a general election, without having been forced to do so by the legislature refusing to continue its support, we should not be sparing in our criticisms.

(Let me add that all the leading members of the Liberal party, of every school of thought, including Mr. Lloyd-George and Lord Grey, are strongly opposed to an early general election on the lines proposed, and that the Liberal parliamentary party is very nearly unanimous on the point).

4. The Government has several matters of the utmost urgency demanding its attention, which can only be dealt with properly if /

a dissolution of Parliament is not impending, and if we are all ready to continue working together as we have done hitherto.

Not urgent in the same degree as questions directly affecting the price of sterling and of the rupee and questions of domestic prices, but a matter which certainly cannot be put aside or relegated to the future, is the problem of the Balance of Trade. It will be impossible to prevent a lasting and increasing depreciation of the value of our currency if the total payments to be made abroad by this country are in constant excess over the total receipts. The matter therefore demands thorough and immediate examination, and from the first days when this Government was formed, I have continually urged that such an examination should be undertaken. So far, however, hardly any information has been circulated to the Cabinet and no discussion has taken place. The points which clearly need examination are these -

(a) What are the general dimensions of the problem, in relation not only to the usual categories of exports and imports, visible and invisible, but also to the movements of capital in and out?

(b) What are the possible alternative means of solving the problem? -

e.g. restriction of imports;
expansion of exports;
influencing the movements of capital;
devaluation of currency.

(c) With regard to the restriction of imports - Would it serve the purpose in view? How far would it be likely to be followed by retaliation abroad, which by lessening our exports, might leave the balance of trade the same as it was before?

(d) With regard to the expansion of exports, is there any real prospect that the offer of tariff reductions made by the German Chancellor and by the Belgian Government can be brought to a head, and if so, that similar concessions can be obtained in other countries also?

(e) How far is the whole problem affected by the devaluation of the £, either in the immediate future or for as long as the devaluation may last?

I suggest that the Cabinet should engage in a close and continuous examination of these questions, and should not put them aside on the grounds that the only solution worth considering is the establishment of a general system of tariffs, and that we need not spend time on considering that because the Liberal members of the Government would in any case refuse their assent to it, on grounds of principle, even if it were shown to be the indispensable means of redressing our adverse balance of trade. Neither of these assumptions is correct. The Liberal representatives have taken up no such attitude.

5. In answer to the Prime Minister's invitation for an expression of our views as to the course which the Government should now adopt, I venture to suggest the following for the consideration of the Cabinet:

(a) An announcement should be made to the effect that, in view of the events of the last week and the many urgent problems, at home and elsewhere, that have presented themselves as a consequence, the National Government will address itself to those problems in the same spirit of co-operation as presided over its formation.

(b) Special reference should be made to the importance and urgency of the question of the Balance of Trade, and to the fact that it has been agreed that it should be examined on its merits: no remedies, which might be found to be necessary, had been ruled out on a priori grounds.

(c) The Government should make one of its chief immediate objects the international treatment of the gold problem. The preparation should be taken in hand at once for the early summoning of a general international conference. If the United States and France will not co-operate, the countries which have been, or which may be forced off the gold standard should confer together without them. This matter should be given priority and be pressed on from day to day.

(d) Parliament should be invited to pass a very short Bill amending the definition in the Emergency Powers Act so as to cover the present situation.

(e) As soon as that has been done, and the present legislation before the House of Commons has been passed, Parliament should adjourn, arrangements being made as before to summon it at short notice.

(f) The Government would then be free for a few weeks to address itself to the pressing immediate problems, and to the conduct of the Indian Conference. After that breathing space, the question of a general election might again be considered in the light of the situation that would then prevail.

(Intd.) H.S.

Home Office, S.W.1.,

September 24th, 1931.