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BRITAIN'S ECONOMIC PROBLEM

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BY

C. A. R. CROSLAND



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P R E F A C E

I W R O T E this book in the hope that others, like myself, might be weary of browsing through innumerable articles scattered in many different journals, and might find it convenient to have a general account of the British foreign trade problem within the two covers of a single book. Part I is an historical account of post-war developments, Part II (to which readers bored with detailed narrative may proceed direct) an analysis of the nature of the future problem.

Since the text was written last autumn, the balance of payments has continued to improve and is, for the moment, once again in surplus. But I still believe the problem of long-run solvency to be every whit as urgent as it is here portrayed. The present position is precarious in the extreme, and we shall be lucky to survive another year without a crisis.

I am well aware that this is, in a sense, only half a book: that it sets out the external problem in great detail, and the conditions required for its solution, but only lightly sketches in the internal policies that will be needed. To deal fully with the latter would call for a second book of equal length. But it seemed worth while to display the external problem at some length, since the right internal policies will not be forthcoming, or properly supported, unless the nature of the task is first understood.

Part II contains a number of hazardous guesses disguised as detailed figures — both assumptions about the future, and targets for exports and production. These are intended merely as rough guides to the orders of magnitude involved, and not as exact predictions of what may happen or what will be required. So far as the target figures are concerned, moreover, it is uncertain whether they will in practice be achieved. But it clears the mind to set out the conditions for an ideal solution; if this proves beyond our abilities, recourse must be had to less agreeable measures.

P R E F A C E

Much of the book is concerned with primary shortages and high prices. But the immediate future may bring primary surpluses and falling prices. Yet I maintain that the first situation, and not the second, will be typical of the next decade; and those who read this book during a period of recession, and feel inclined to smile at the dark prophecies of shortage and inflation, should reflect that they may be witnessing only a temporary break in the long-run trend.

Mr. I. M. D. Little has read the book through in manuscript most attentively, and his comments, both literary and material, have been a great comfort. I must also mention Mr. N. Kaldor; I have had continuous, and to me most fruitful, discussions on these matters with him, and I more than once detected myself making points which I remember to have derived from him. Naturally neither of these gentlemen has any responsibility for what is here set down, least of all for the political views expressed in the last chapter.

I am indebted to Miss Rita Andrews for her great help in typing the manuscript.

C. A. R. CROSLAND

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ABBREVIATIONS

<i>Bull. Inst. Stat.</i>	<i>Bulletin of the Oxford Institute of Statistics.</i>
<i>E.C.E. 1948, 1949, etc.</i>	<i>Economic Commission for Europe Economic Survey of Europe in 1948, 1949, etc.</i>
<i>E.J.</i>	<i>Economic Journal.</i>
<i>L.C.E.S.</i>	<i>London and Cambridge Economic Service Bulletin.</i>

PART ONE

THE RECENT PAST

I

THE PROSPECT IN 1945

WHEN the Labour Party took office in July 1945, it at once found itself confronted with an unexpected situation. It had had years, even decades, in which to familiarize itself and the country with the details of its traditional programme of socialist reform, and it had naturally assumed that this programme would command its undivided attention once in office. The depression of the 1930s had, it is true, shown the necessity for a short-term economic policy, and full employment took its place alongside social reform as a prime objective. But it was always thought that the Party would come to power during a slump, and that the monetary expansion required to combat depression would at once justify and facilitate the pursuit of the traditional objectives of equality and higher living standards. Economic and social policy would thus march hand in hand.

Instead, the Party found itself faced by an economic crisis of such urgency that it overshadowed the task of reform, and moreover of such a character that it inhibited instead of facilitating the pursuit of higher living standards.

The incoming Ministers may well have been depressed by the size of the problem facing them. The war-time dissipation of capital at home and abroad had been on a gigantic scale. To restore the pre-war volume of capital per head required an expenditure (at 1945-46 prices) of £7300 millions, or a volume of new capital equal to one-quarter of the country's total 1938 capital assets;¹ while external disinvestment during the war amounted to £4000 millions.² It was clear that very large increases both in home investment and in exports would be needed to repair this damage.

These fresh exactions were laid on the economy at a time

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when consumers' demand for goods was also abnormally high. The cumulative effect of six years of shortages had naturally created a pent-up demand for durable consumption goods of all kinds, and ample means existed, in the shape of liquid assets created by war-time saving, to make this demand effective. It was estimated that this piled-up consumption demand might by the end of the war have amounted to £2500 millions (at 1945 prices).³ The simultaneous imposition of these several demands on an economy which had first to be reconverted from military to civilian production presented an economic problem of the most formidable character.

But it was the immediate possibility of external bankruptcy which dominated the whole scene. This was a problem little discussed in the immediate pre-war years. A generous income from foreign investments, and apparently inexhaustible supplies of cheap food and raw materials, concealed from the general public the slow but steady loss of strength that had occurred over the previous four decades. The foreign balance seemed to have righted itself after the upheavals of 1931, and although the three years prior to the war all showed a small deficit, this was not of a sufficient size to arouse alarm when compared with the foreign assets held.

No such comfortable complacency was possible in 1945. Lord Keynes wrote at the time that 'we fought this war on the principle of unlimited liability and with more reckless disregard of economic consequences than others more fortunately placed'. Foreign investments had been sold, large debts incurred, vast quantities of gold used up, the shipping fleet heavily damaged, and export markets sacrificed. Once Lend-Lease was cut off, Britain was faced, to quote Lord Keynes again, with 'what might be called without exaggeration a financial Dunkirk'. It was a dramatic phrase with which to illuminate the gravity of the crisis, but it was, as it turned out, a bad analogy. The battle of the foreign balance, at first conceived as a short sharp

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struggle or at the worst a three-year war — one big push, then back to normal — was gradually seen instead to be a protracted struggle involving Britain's future for a generation ahead. It is this struggle which is the theme of this book; the other facets of the post-war economic problem are discussed only in so far as they bear on this central theme.

II

Everything depended on a sufficient increase in exports. But it was clear that the necessary exports would not come spontaneously merely because they were needed, but would require structural changes and a concentration of effort on producing the right underlying economic pattern.

There were in particular four prior conditions which needed to be fulfilled.

The first was a large increase in industrial production and output per man. Home consumption and investment demand were so high as necessarily to absorb a large share of output, and the requirement of higher exports would have been frustrated unless total production were very buoyant. And more was needed than merely the automatic rise in output which full employment would bring — it was essential that output per man should also rise if these manifold demands were all to be met.

The performance here can be quickly summarized. Total industrial production by 1950 was 50 per cent higher than in 1938.⁴ More significant, output per man in industry was 26 per cent higher than the 1935-38 average. This may be considered a creditable performance. The average European increase in output per man over the same period was only 6 per cent, and no single European country (apart from Ireland, industrially tiny) achieved a higher figure than the British — the only ones to equal it were Sweden, which (besides enjoying a Socialist administration) had the advantage of war-time neutrality, and Czecho-Slovakia. Of the larger

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capitalist countries, France showed no increase at all, Italy one of 6 per cent, while Belgium, whose deflationary policies were constantly urged on the British Government by its orthodox critics, actually had a *lower* productivity than before the war.

It may come as a surprise to many to know that the rise in productivity, besides exceeding that of other European countries, also matched that of the United States. Real product per head over the whole economy rose by 2 per cent per annum between 1946 and 1950 (by less in the first pair of years and more in the second), though the rise slackened to 1 per cent in 1951;⁵ in the U.S. it rose annually by 1½ per cent over the period 1929-50.⁶ Thus the British post-war effort slightly bettered the average American performance over the previous two decades (as well as the British performance in the inter-war period). In manufacturing, the British increase in output per head from 1946 to 1950 was about 6 per cent per annum,⁷ and this was roughly similar to the U.S. rate of increase.⁸ (But in 1951 the British increase slackened to 3 per cent, while the American continued at the previous rate.)

Naturally it would have been agreeable to obtain even larger increases than these. But to show a level of industrial output, within five years of the end of the most damaging war in British history, half as high again as before the war, and an increase in productivity comparing so favourably with other countries, suggests that the underlying basis of British economic recovery was sound. In 1951, however, renewed difficulties over steel supplies, affecting a large range of industrial output, showed that more still remained to be done.⁹

III

The second necessity was to ensure the right structural pattern of output. It was not sufficient to have a general

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indiscriminate spurt in production, regardless of the altered pattern of demand; the distribution of resources had to be adapted to the needs of the payments crisis.

In general terms a shift of resources was required towards the manufacturing industries. Previous decades had seen a steady trend towards the so-called 'tertiary' industries — the distributive trades and consumer services — and this was regarded as a symbol of a rising standard of life. But it was clear that post-war Britain, with her foreign investments halved and immense tasks of reconstruction in hand, could no longer afford the luxury of tertiary industry on the pre-war scale; a sector which contributed nothing either to exports or capital investment had to be restricted to a smaller share of total resources.

Table 1 shows the most important changes in the distribution of the labour force between 1939 and end-1948.

TABLE 1

INDEX OF NUMBERS EMPLOYED AT END-1948 (1939 = 100)

Secondary Industries:

Manufacturing Industries	108
Basic Industries	112
Building and Civil Engineering	104

Tertiary Industries:

Distribution	83
Hotels and Catering, Entertainments and Sport	101
Other Services	91

(Source: *Ministry of Labour Gazette*)

This shows a marked shift from tertiary into secondary industry, and considering that it occurred in a period of very high consumer demand it must be considered a not unhealthy general pattern. By the end of 1951 the distributive trades had lost 400,000 workers as compared with 1939, while the manufacturing industries had gained 1,000,000; as a result the ratio of those employed in manufacturing to

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those employed in distribution rose from 2.5:1 to 3.3:1. The distribution of the labour force was then as follows.

TABLE 2

PERCENTAGE DISTRIBUTION OF CIVILIAN EMPLOYMENT AT END-1951

Manufacturing Industries	40
Mining, Agriculture, Building and Contracting	15
Transport and Public Utilities	9½
Professional and Personal Services, Finance and Commerce	17½
Distribution	12
Public Administration	6
	100

(Source: *Ministry of Labour Gazette*)

But it was not enough even to expand manufacturing industry as a whole. Export and investment demand fell primarily on the metal-using and engineering industries, and it was these groups which needed to grow relative to the rest. There had been since the beginning of the century a steady shift away from older industries, such as textiles, towards engineering, vehicles, etc., but this movement had to be accelerated if the British economy were to sustain the new burdens imposed upon it by war-time losses.

Fortunately this acceleration did take place, partly during the war itself. In 1907, the metal trades (iron and steel, non-ferrous metals, engineering, etc.) employed 20 per cent of the man-power in industry, and chemicals 2 per cent, while 28 per cent were employed in textiles, clothing and leather. By 1935 the metal trades had risen to 24 per cent and chemicals to 2.5 per cent, while the textile and allied trades had sunk to 22 per cent. By 1948 the pace of change had so far quickened that the metal trades were employing over 30 per cent, chemicals 3.7 per cent, and textiles and allied trades only 15 per cent. In terms of the net output of industry, the metal trades now contribute over one-third

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(engineering over one-sixth), compared with one-fourth (engineering less than one-eighth) in 1935.¹⁰ The fruit of this shift of resources was an engineering output by 1950 82 per cent higher than pre-war, compared with a European average of 33 per cent; no industrial country in Europe showed so large an increase.¹¹

But there still remained certain specific problems. With the end of demobilization, when the economy began to assume its peacetime shape, it became clear that a small group of important industries was dangerously short of resources. Usually the scarcity appeared as one of labour. Coal, textiles and agriculture had all strikingly failed to recapture their pre-war labour forces, and all were industries vital to British recovery. A shortage of coal was capable, as the 1947 fuel crisis showed, of disrupting the whole of industrial production, besides exerting a constant drag on efforts to restore the foreign balance. The textile trades immediately after the war were lagging most obviously behind their export-potentialities, while agriculture was of central importance on the side of import-saving.

Although some contribution to higher output in these industries might come from increased productivity, a substantial movement of labour towards them was still necessary. All manner of ways of securing this were discussed, in particular the adoption of a wages policy. This solution was never attempted. Nevertheless, wages did rise in these industries more than the national average. In addition some foreign workers were introduced, while for two and a half years a limited degree of direction of labour was in operation. These measures fell far short of the planned manpower policy which was being urged on the Government by its critics, and nobody can pretend that a final answer was found to the manpower problem in a full employment economy.

But the process of nibbling away did have its effect.¹² By 1949 agriculture and textiles were no longer seriously

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undermanned. Coal remained a source of anxiety, its labour force fluctuating in the most alarming manner, but on the whole the trend was upward, and this, together with a rise in output per man, was sufficient to avert any repetition of the 1947 crisis. Yet the coal shortage remained a serious handicap to the export drive, since a margin of safety at home was only maintained by holding exports down to an insignificant figure; this was one direction in which success was far from complete.

In addition to these undermanned industries, there was one important industry — steel — where insufficient output was due to a shortage not of labour, but of capacity. It was clear from the start that a problem must arise here, since the concentration of export and investment requirements on the engineering sector greatly increased the need for steel. The industry put forward plans in 1946 for an expansion of production from 13 million tons (in the best pre-war year) to 16 million tons, and although this was widely (and rightly) criticized at the time as too unambitious, it was at least something to start on.

The actual behaviour of output is shown in Table 3. In 1946-47 steel was still seriously short, and was a factor slowing down the rate of increase in total output and exports. But the large increases in production in each of the years 1948-50 greatly eased the position, and although bigger supplies could have been absorbed the shortage was not catastrophic, and by 1950 appeared to be over (except for sheet and tin-plate). It reappeared, however, in an acute form during 1951 (due to a lack of foresight in not guarding sufficiently against the inevitable drying-up in supplies of German scrap). Moreover, as in the case of coal, the home market demand was satisfied only by starving export markets of supplies, and it will be argued later that a large increase in capacity is still required.

But for the bulk of the post-1947 period the needed expansion in manufacturing output was not badly held back by a

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shortage of steel; and Table 4 shows that the rise in British output compared very favourably with the performance of other European countries (and especially Germany).

TABLE 3

CRUDE STEEL PRODUCTION (INGOTS AND CASTINGS): MILLION TONS

1937	1947	1948	1949	1950	1951	1952
12.98	12.72	14.88	15.55	16.29	15.64	16.42

(Source: British Iron and Steel Federation)

TABLE 4

EUROPEAN CRUDE STEEL PRODUCTION: MILLION TONS
ANNUAL RATE

	<i>Best pre-war year</i>	<i>1936-38 average</i>	<i>1947</i>	<i>1951</i>	<i>1952 1st half</i>
U.K.	1939 13.4	11.9	12.9	15.8	16.3
W. Germany	1938 17.9	16.1	3.0	13.5	15.0
France	1929 9.7	6.2	5.7	9.8	10.7
Saar	1938 2.5	2.4	.7	2.6	2.7
Belgium	1929 4.1	2.1	2.8	5.0	5.2
Luxembourg	1929 2.7	1.9	1.7	3.0	3.0
Italy	1938 2.3	2.1	1.6	3.0	3.4
Holland	—	—	.1	.5	.5

(Source: *Economic Commission for Europe*)

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IV

The third necessity was for a high level of expenditure on capital equipment. War-time losses in this direction had been severe, and on top of this both the total population and the numbers at work had increased, so that additional capital was required merely to maintain pre-war standards of equipment per head of employed population. But more was wanted even than this. Pre-war standards compared unfavourably with other industrial countries, and post-war Britain, faced with a fight for survival, urgently needed to provide her workers with more capital than they had before.

Before the war, with idle resources available, a determined Government could easily have raised the annual level of investment. After the war the task was more difficult. Savings were at a low level as the public, after the enforced austerity of the war years, insisted on spending lavishly. However ruthless the Government, there was a limit to the amount of investment which in practice could be carried through without inflation; and there was the further complication that the bulk of our exports (and later the arms programme) competed far more directly with home investment than with consumption.

In the light of these inherent difficulties, the magnitudes involved were very large. Professor Robinson has calculated¹³ that the cost of restoring capital equipment to pre-war levels would (at 1945-46 prices) work out as follows:

	£Mn
(1) Making Good War Damage	1500
(2) Arrears of Repairs, Maintenance and Replenishment of Stocks	3000
(3) Provision for Population Growth	1800
(4) Provision for Growth in Civil Employment beyond (3)	1000
Total	<u>7300</u>

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In the same study, he concluded that by the end of 1950 net investment since the end of the war had done a little more than cover the first two categories, i.e. the total national capital had reached in physical terms about the pre-war volume. At the then rate of investment, he estimated that it might take until 1954 to cover the last two categories, i.e. to restore capital per head in industry to the pre-war level. Naturally this sort of calculation must be treated with some reserve, as Professor Robinson points out. Since new investment does not follow the same pattern of distribution as existing capital, the above conclusion is quite compatible with a large improvement in particular sectors of industry; and in coal-mining, agriculture, and many branches of engineering, for example, the amount of equipment per head is now well above pre-war. Moreover, restoration of equipment usually means replacement with new equipment, and where the latter is of improved design a real increase in capital has taken place, which is masked under the heading 'Making Good War Damage'. A superficial assessment may thus be too unfavourable.

Even allowing for this, the achievement up to 1950 may not sound very impressive. But bald absolute figures like these are not easy to assimilate and assess, and do not always give a significant picture. To put the matter in perspective, one must examine post-war investment as a proportion of national income, and make comparisons with pre-war and other countries.

It appears that in 1937-38 the proportion of U.K. resources devoted to gross investment at home was 18.2 per cent, whereas from 1947 to 1950 it averaged over 21 per cent.¹⁴

Since total resources were larger in the later years than in the earlier, it is clear that the volume of annual investment was substantially higher than pre-war. This conclusion is confirmed by an E.C.E. calculation¹⁵ that gross U.K. investment in fixed capital rose (in millions of dollars at 1938

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prices) from 3583 in 1938 to 4120 in 1949. This represents not merely a gross absolute increase, but also a rise in net investment per head of population from 34 to 41 (dollars in 1938 prices), the 1949 figure being higher than for any country in Europe save Norway.

But investment in Europe as a whole was high. The E.C.E., in its *Survey* for 1949, found that it was generally over 20 per cent of gross national product — roughly equal to the American figure between 1880 and 1930, when the U.S. economy was expanding fast. Moreover during that period population was growing rapidly, so that social investment was necessarily high relative to industrial investment. In Western Europe, with a more or less stationary population, the ratio of industrial to total investment should over a long period be large, and the 1947-50 level of total investment, if sustained, might then easily give an increase of 50 per cent in industrial production over a decade.

This draws attention to the fact that figures of total investment can give a seriously misleading picture if the object of interest is industrial re-equipment. Critics sometimes complained that investment in Britain, although higher than before the war, had increased by less than in some other countries, both absolutely and as a proportion of the national income. This is true. But the reason was that expenditure on new house-construction, by a striking act of political self-abnegation, and at a not negligible cost in terms of social suffering, was held a good deal lower than in the immediate pre-war years; consequently the share of social investment in the total was much diminished, and that of industrial investment much enlarged. The actual picture, therefore, was that capital expenditure on housing and public works was considerably lower in real terms than before the war, while investment in fixed capital by businesses (public and private) was roughly a third higher.¹⁶

It would, in theory, have been possible to devote a still

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larger proportion of the national resources to new investment. But considering the inflationary pressure, the immediate demands of the foreign balance, and the fact that the existing level was high relative both to pre-war and other countries, this would not have been a sensible policy. Indeed the Government was much criticized for holding capital investment as high as it did (most notably and consistently by Mr. R. F. Harrod), and large cuts here would certainly have been the easy way out of many of the post-war difficulties. One can never dogmatize about the right level of capital expenditure, but perhaps on balance the post-war level was not far wrong — though this carries no moral for the future, now that the exceptional pent-up pressures have abated.

The last general responsibility which the Government had, if it was to create the right economic climate for solving the external problem, was the avoidance of inflation. Its performance in this respect is discussed in the next chapter.

v

Once these matters were attended to, the stage was properly set for the main drama of the export struggle. Many contemporary calculations were made of the increase in exports which would be required.¹⁷ The official target was set at 75 per cent above pre-war,¹⁸ and there was little inclination to consider this figure excessive. The separate factors entering into these calculations may be summarized as follows.

(1) The fall in net investment income due to external disinvestment. Out of a 1938 total of £3725 millions of overseas investments, £1118 millions were realized during the war to finance essential imports (mainly in the period before Lend-Lease began). In addition, external liabilities of over £3000 millions were incurred, which implied an increased

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liability for interest charges. And lastly the post-war U.S. and Canadian loans called for from 1951 onwards for annual interest payments of some £45 millions. Merely to offset this large fall in net investment income would, it was estimated, require a rise in the volume of exports of 30 per cent over the 1938 figure.

(2) An additional 10 per cent of exports would be required for amortization payments on the new debts incurred.

(3) Given the loss of net assets, the country could not afford to run a deficit as it had done in the immediate pre-war years. This deficit had average £40 millions annually from 1936 to 1938, to eliminate which would require a further 10 per cent rise in exports.

(4) This triple increase in exports would itself require additional imports, since British exports have an average import-content of 15 per cent (reflecting our dependence on imported raw materials). A further 10 per cent rise in exports would be required to offset this higher import demand automatically generated by the export drive.

The 60 per cent increase already indicated was a measure of the strict extent to which Britain's position had worsened as a result of war-time sacrifices, plus an allowance for the long-term deterioration which had caused the pre-war deficit.

(5) But in addition the expected higher levels of population, output and incomes, if allowed to exert their natural influence on demand, were thought to involve an 8 per cent increase in imports over pre-war, to cover which a further 15 per cent rise in exports would be needed.

This gave a total required increase in exports of 75 per cent, and such appeared to be the calculations which underlay the official target figure. This increase would, it was thought, provided matters did not deteriorate any further, pay for a volume of imports (say 15 per cent higher than pre-war) which freely reflected the choices of private and industrial consumers, and at the same time give a comfort-

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able surplus (of perhaps £100 millions at 1945 prices) for the repayment of debt.

But during the immediate post-war years, there were other temporary factors which must further enlarge the prospective deficit. Government overseas expenditure was abnormally high, and it would inevitably be some time before terminal military liabilities petered out. Net income from invisibles was non-existent. The merchant shipping fleet was still only three-quarters of its pre-war size, and much of it was over age. Tourism must take some time to recover, and receipts from financial services were very low after the six-year interruption.

These temporary weaknesses raised the export target to over 100 per cent above the 1938 level. Nobody thought, of course, that the pre-war volume of exports could be doubled in the early years of peace, especially as Britain was starting at a disadvantage. In the interests of the war effort, exports had been allowed to fall to only 29 per cent of their pre-war volume during the war, and even in 1945 had only recovered to 45 per cent. Markets had been lost, and contacts interrupted. The war had given an added stimulus to industrialization abroad, and the export potential of the U.S. had vastly increased. In these circumstances there must inevitably be an interval before exports could be adequately built up, and it was therefore obvious, first that imports would initially have to be held drastically below their 'free' level, and secondly that substantial further borrowing from abroad would be necessary while the export drive got under way.

The official estimates¹⁹ were of a £750 millions deficit in 1946, falling to £500 millions for the two years 1947-48, with 'some modest deficiency' in 1949 and 1950 before a stable equilibrium was achieved. It was to cover this cumulative prospective deficit that the American loan was negotiated, and it was hoped that it would tide over the period to 1949, by when exports would have reached their target and the

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temporary factors mentioned above would have reverted to normal. The 75 per cent rise in exports, if it could be steadily maintained (which many doubted), would thereafter give a payments equilibrium at a generous level of imports — always assuming, as the official calculations did, that the terms of trade settled down at their pre-war level.

VI

But within the general problem of the overall balance there existed a narrower but even graver difficulty. Many countries (notably those in the sterling area) were prepared, for a time at least, to finance a continued British deficit by providing further credit. In the short run, therefore, a failure to balance accounts with these countries would not be disastrous, though it must involve a piling-up of future liabilities.

But certain other countries, which came to be known as the 'hard currency' countries, were not so willing, and any deficit with them which could not be covered out of the U.S. loan would involve immediate payment in gold or dollars. Such a deficit could not be endured for long without the reserves, already very low at the end of the war, falling to danger point, and the task of achieving an equilibrium in this direction was thus even more urgent than the task of achieving an overall balance. But it was not merely more urgent: it was also more difficult, since this group contained precisely those countries with whom our balance of trade was most likely to be unfavourable: in the short run because their trading position had been much less damaged than our own by the war, in the long run for structural reasons to be analysed later. The countries mainly concerned were Canada, several South and Central American countries, Belgium, Switzerland, and above all the United States; indeed in the last analysis it was really a dollar problem.

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It was not merely the U.K. that was concerned. The growth during the war of the central Sterling Area dollar pool — the system whereby Britain acted as 'dollar banker' for the whole of the Sterling Area — meant that many other countries' trade accounts were equally important. The central reserves could be drained out of existence just as easily by an Indian or Australian as by a British hard currency deficit, and the danger of this happening was greatly heightened by the enormous balances which many Sterling Area countries held in London as a result of British expenditure during the war, and which provided ample funds with which to finance a drain on the central reserves. This growth of sterling liabilities relative to gold and dollar assets imparted an element of instability to the whole post-war trading scene, and indeed was to exacerbate matters almost beyond endurance.

Under normal circumstances, the dollar problem might have been expected to disappear as the overall deficit gave way to a balance, since even though a dollar deficit remained it would then be covered by an equivalent surplus with the rest of the world. But in fact, owing to the continued non-convertibility of other currencies, the non-dollar surpluses which gradually emerged were of no use in covering the dollar deficit, and the strain on the gold reserves continued to be measured by the gross deficit with the dollar area, and not the net deficit (if any) with the world as a whole.

The detailed causes of the emergence of a severe dollar payments problem were mixed and subtle. Before the war the U.K. always had a substantial deficit in its visible trade with the dollar area, only partially covered by a surplus on invisible account. The balancing factor was the overseas Sterling Area, though it is not true, as is often supposed, that this area invariably earned a massive surplus by selling its primary products to America — indeed in 1938 it actually had a small dollar deficit. But it is true that in most years it

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earned a small dollar surplus, and further that the then non-Commonwealth parts of the Empire (specifically Malaya, Burma, India, Ceylon and West Africa) habitually earned a large surplus which accrued to Britain in payment for their trading deficit with us; and, lastly, the Commonwealth had a very large current production of gold.

The role of gold can hardly be overstressed. The large Commonwealth production meant not only that certain countries which had a dollar deficit could finance it out of current gold output, without calling upon the U.K. for dollars; but also it meant a sustained flow of gold to Britain in payment for the excess of U.K. exports to the Commonwealth. It was this gold, in turn, which Britain used for settling its deficit with the dollar countries.

Such, then, was the pre-war position: a British dollar deficit on trading account (of some \$500m. on the average of years 1934-38), covered partly by a surplus on invisible account (\$150m.), partly by the dollar surplus of the colonial empire, India and Ceylon (\$200m.), and residually by new gold from the rest of the Sterling Area, especially South Africa.²⁰ Empire gold production amounted annually to to over \$500 millions, and its significance may be gauged from the fact that it was sufficient to pay for one-half of the total dollar imports coming into the whole Sterling Area, and comfortably exceeded the Area's trading deficit with the dollar world.

This position of equilibrium was destroyed by the war. Initially, of course, the trouble was due to the abnormal dependence of the sterling countries, shared with the rest of the world, on dollar sources of supply, combined with the difficulty of rebuilding an export trade which had shrunk to insignificant dimensions. But this should have been only a transient phase.

The more permanent causes of the deterioration were as follows.

- (1) The mere fact of a rise in prices (and this even by 1945

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was of the order of 100 per cent) increased the U.K. visible dollar deficit in money terms by the same multiple.

(2) The U.K. dollar terms of trade had already deteriorated sharply by 1946. Dollar imports consisted mainly of food and essential materials which in the post-war world were sought after by almost every other country, and as soon as price controls were taken off in the U.S.A. this universal demand helped to drive up American prices, and the U.K.'s visible deficit was still further enlarged.

(3) Much of the reduction in invisible income resulting from the sale of assets and the new liabilities (which were referred to earlier) was in terms of dollars; it was estimated¹¹ that nearly 1000 million dollars' worth of securities and investments were realized during the war, and the servicing of the U.S. and Canadian loans would from 1951 onwards cost a large sum annually. The pre-war surplus on invisible account was therefore certain to be replaced by a deficit.

(4) An even larger change for the worse had occurred in the dollar accounts of the overseas Sterling Area, where many structural changes of a permanent character had taken place. The dollar area was now notably less dependent on the Sterling Area for its raw materials—particularly for natural rubber and tin, traditionally the largest dollar earners in the Commonwealth. At the same time, growing populations and the gradual process of industrialization in the Far East, coming on top of war-time dislocation, resulted in a higher net propensity to import; India, for instance, was never likely to revert to her pre-war position as a net exporter of wheat, nor the Far East as a net exporter of rice. A large R.S.A. dollar deficit emerged as soon as the war was over.¹²

(5) Even more important than the change in respect of commodity trade was the altered position of gold. Whereas other prices had already doubled by the end of the war, the dollar price of gold remained fixed at its 1938 level, and its purchasing power over goods was in consequence drastically reduced. It was, moreover, less profitable to produce, and

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current output had fallen off. Britain had to reconcile herself to receiving a smaller volume of gold of less value in terms of other commodities.

These were the reasons why a serious dollar problem confronted the British Government in 1945, in addition to the general difficulty of the overall balance. It was a problem that had to be faced in the most disadvantageous circumstances possible. The reserves were little over half what they had been in 1938 — in real terms much less owing to the rise in prices; and they were constantly threatened by the existence of huge unfunded sterling balances. Dollar exports had been disrupted by the war, and the whole Commonwealth, in common with the rest of the world, was clamouring for dollar goods. These temporary disabilities, superimposed on the permanent structural deterioration, boded a very arduous and trying climb to solvency.

NOTES

¹ PROFESSOR E. A. G. ROBINSON, 'British Economic Policy, 1945-50', *L.C.E.S.*, May 1950.

² Sale of assets 1.1 million, increase in debt 2.8, loss of gold and dollar reserves .1 (Cmd. 6707).

³ M. KALECKI, *Bull. Inst. Stat.*, vol. VI, Nos. 16-17, 1944, p. 274.

⁴ The figures in this paragraph are taken from E.C.E., 1950.

⁵ C. F. CARTER, *L.C.E.S.*, August 1951; F. W. PAISH, *L.C.E.S.*, March 1952; A. A. ADAMS and W. B. REDDAWAY, *L.C.E.S.*, September 1952.

⁶ L. ROSTAS, 'Changes in the Productivity of British Industry, 1945-51', *E.J.*, March 1952.

⁷ CARTER, loc. cit.

⁸ ROSTAS, loc. cit.

⁹ v. Part II, chapter v.

¹⁰ L. ROSTAS, *The Times Review of Industry*, April 1952.

¹¹ E.C.E., 1950.

¹² For a fuller discussion of this process, v. C. A. R. CROSLAND, 'The Movement of Labour in 1948', *Bull. Inst. Stat.*, May and July 1949.

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¹³ *L.C.E.S.*, May 1950.

¹⁴ *Loc. cit.*

¹⁵ *E.C.E.*, 1949, Tables 29 and 30.

¹⁶ *The Sterling Area* (European Co-operation Administration, Special Mission to the United Kingdom, London 1951).

¹⁷ Cf. G. D. A. MACDOUGALL, 'Britain's Foreign Trade Problem', *E.J.*, March 1947; T. BARNA, 'Britain's Balance of Payments', *The Banker*, June 1946; P. E. P., *Britain and World Trade*, June 1947.

¹⁸ Cmd. 6707.

¹⁹ Cmd. 6707.

²⁰ Figures taken from *The Sterling Area* (*E.C.A.*, op. cit.).

²¹ 'Britain's U.S. Dollar Problems, 1939-45', D. F. McCURRACH, *E.J.*, September 1948.

²² The abbreviation R.S.A. will be used throughout this book for the Sterling Area other than the U.K.

II

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THE period opened favourably. Instead of the £750 millions deficit envisaged during the Washington negotiations, the deficit in 1946 was only £344 millions.¹ Imports were much lower than expected, largely owing to the non-availability of goods abroad, and for the year were only 67 per cent of their 1938 volume. Exports, on the other hand, expanded more rapidly than had been hoped, and in the last quarter were running at 110 per cent of pre-war — a remarkable achievement which represented a doubling in volume over a twelve-month period. Three-quarters of the U.S. and Canadian lines of credit still remained untouched at the start of 1947.

But this was not an earnest of things to come. The Government anticipated that the deficit in 1947 would again be around £350 millions, and that nearly half the dollar credits would be intact at the end of the year. In fact the year turned out disastrously. The overall deficit emerged as £545 millions, the dollar deficit was larger still, and the U.S. loan was virtually exhausted by September.²

Both sides of the account contributed to this deterioration. The import bill came out at over £100 millions higher than anticipated owing to an unexpectedly large rise in import prices — 19 per cent from end-46 to end-47; indeed had it not been for severe import cuts in the autumn this would have added nearly £300 millions on to the bill. The terms of trade, which had not moved during the previous year, now moved sharply against the U.K. from 108 to 116 (1938=100).

On the side of exports, a volume target of 140 per cent of pre-war had been set for the end of the year, but all that was

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achieved was 118 per cent. The main reason for this shortfall was the very inflated level of domestic demand, which was both preventing a large rise in industrial output and also sucking too many goods into the home market. The February fuel crisis was a symptom of a *malaise* in the economy which inevitably reacted on the export trade.

Yet 1948 saw an equally spectacular change in the opposite direction. The overall deficit fell to £26 millions (it had been expected to be £250 millions), and even the dollar deficit was reduced by half. Imports were held down to three-quarters of the 1938 level (roughly the same volume as the previous year, despite a large rise in the national income), though a further rise in world prices added £100 millions on to their cost. But the export drive really got under way after the fitful progress of the previous year, and exports surpassed expectations by reaching a volume of 136 per cent of pre-war; earnings rose in consequence by £450 millions, and this was mainly responsible for the change in our fortunes between the two years.

The other large change was in the invisible account, which moved from a 1947 deficit of £120 millions to a surplus of £177 millions. This was partly due to a fall in Government expenditure overseas (from £230m. to £92m.), partly to a rise in net shipping earnings (from £33m. to £76m.), and partly to a large increase in the overseas earnings of British oil companies.

1949 showed a further small improvement, and there was actually an overall surplus of £6 millions. Exports were a good deal higher, imports exactly at the planned level, and invisibles steady. This was the first time that Britain's current account had shown a surplus since 1935, and only the second time since 1930. It is interesting that even in the first half of the year, when the pre-devaluation dollar crisis was moving to its climax, there was only an insignificant deficit of £15 millions (which was no deterioration on the previous year); this is striking proof of how discrete the

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dollar problem was from the situation in respect of the overall accounts.

In 1950 the improvement was more than maintained, and the surplus rose to £258 millions. Exports finally exceeded the post-war target of 175 per cent of pre-war. Imports showed a small rise, but were still only 86 per cent of the pre-war volume. Compared with the previous year exports rose in volume much more than imports, but this was offset by a further worsening in the terms of trade, and the visible deficit was the same as in 1949. (This gives a somewhat over-favourable picture, as stocks were substantially run down during the year.) But the invisible surplus rose by over £200 millions to £404 millions, thus enabling the current account balance to show a large surplus.

The basic disturbances due to the war had now in large measure been overcome, and the reserves stood at a higher level than at any time for a decade. There were still serious weaknesses, especially on the dollar account, but the position appeared to be sufficiently under control to be left to Britain's unaided efforts, and Marshall Aid was suspended from the end of the year.

The 1949-50 position of surplus, even though impermanent, was attained a good deal earlier than had ever been thought possible. At the time of the 1945 Washington talks, when many unduly optimistic assumptions were made and not challenged, it was assumed that a deficit would persist until 1950, and as late as December 1948 the Government, in its Long-Term Programme submitted to O.E.E.C.,³ foresaw a deficit up till 1952-53; nor was this criticized at the time as over-pessimistic. In the light of these prognostications the performance of the three years 1948-50 was clearly not without merit.

But 1951 showed how very uncertainly poised the achievement was. Everyone realized after Korea that the impact of world rearmament on the British economy would be serious. Import prices rose fast as the nations tried to stockpile raw

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materials, while at home the arms programme inhibited any large increase in exports. But the official hope was that the surplus would merely be eliminated, and not replaced by a large deficit. In fact the 1950 surplus of £258 millions turned into a deficit of £465 millions (almost as large as in 1947, although of course prices had risen in the meantime), and in the second half of the year it was running at the rate of £788 millions.

The main change was on the side of imports, which jumped by 50 per cent from £2372 millions to £3494 millions. Two-thirds of this deterioration was due to the fact of a 26 per cent rise in price, consequent on the world commodity inflation caused by rearmament. Some increase in volume had also been allowed for and was inevitable. Stocks had been run down in the closing months of 1950, and required to be rebuilt in the ordinary course of events; moreover a sum was set aside for strategic stockpiling, and it was natural to anticipate that additional materials would be needed for the arms drive. The large rise that took place in raw material imports was therefore to be expected.

But what was much less welcome was the increase in the import of food and manufactured goods; large extra quantities of canned food and textiles, for example, were brought in from the Continent as a result of further concessions to trade liberalization. In consequence the total volume of imports rose by 12 per cent on the previous year and reached, for the first time since the war, almost the same level as in 1938.

Exports, contrary to the fears expressed by the three Labour Ministers who resigned at the time of the Budget, exactly came up to expectations. They rose slightly in volume to a level of 179 per cent of 1938. But of course this rise was inadequate to offset the combined effects of worsened terms of trade and higher import volumes, and the trading deficit therefore rose fivefold.

The surplus on invisible account fell by nearly £100

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millions. This was entirely due to the first interest payments on the U.S. and Canadian loans (£40m.), and the increased purchases of refined oil from the U.S. made necessary by the loss of Abadan.

The year 1951 thus showed in the most dramatic fashion how impermanent the previous equilibrium was. Everything that could have gone wrong did go wrong, and most of the changes were outside the Government's control. It was a year of quite abnormal price movements in internationally-traded goods; rather over half the adverse swing was due to the 13 per cent deterioration in the terms of trade, which by itself was enough to produce a substantial deficit. The loss of Abadan could not have been foreseen. Imports were bound to be higher as raw material stocks were built up after the de-stocking of the previous year.

No doubt some of the import increase was unjustified. But total imports, even now, were barely equal to the normal pre-war volume. Yet in the meantime population had risen, and industrial activity was higher by one-half. By any standards of normal need or free demand, therefore, the 1951 import programme was far from excessive. Yet it helped to bring the foreign balance to disaster. Such was the impoverishment of Britain six years after the war.

In 1952, once again, the pendulum swung back, and the deficit gave way to a small surplus. Imports fell heavily after the Government import cuts, and the terms of trade improved. But stocks were again run down, and imports were certainly too low to permit a sustained rise in production.

II

What is to be the verdict on these years? Inevitably it must be a mixed one. In relation to expectations and the

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performance of other countries, the record was excellent. Compared with the need, it was not sufficient.

The post-war plans for higher exports were wholly achieved, somewhat to the surprise of many observers who had found them over-sanguine. Even in 1945 it had not been expected that the 175 per cent target would be attained much before 1951, while in the gloomy days of 1948, when the Long-Term Programme was being prepared, the Government did not venture to hope for more than 150 per cent of pre-war in the early 1950s. But in the event 150 per cent was exceeded in 1949, and the figures for 1950 and 1951 were respectively 177 per cent and 179 per cent. This easily surpassed the performance of other European countries, none of whom could boast so large an increase; the average European figure in 1950 was 124 per cent, and only two countries were above 140 per cent, a figure which Britain had left behind as far back as 1948.⁴

There really is no evidence here of the soft flabby economy and the raging inflation of which hostile critics were always complaining. The relationship between inflation and the foreign balance, which is analysed in the Appendix to this chapter, is a very uncertain and complex one. But crudely it can be said that a failure of exports to rise after the war could have been taken as *prima facie* evidence of the existence of inflation, provided that this failure could be traced either to (a) the absorption into the home market of a large volume of goods potentially saleable abroad, or (b) non-competitive export prices; and conversely a very large rise in exports, especially if it were not merely an absolute rise but also an increase relative to total output, could be taken as *prima facie* evidence of the absence of inflation. It is true that the connection is not exact. Controls of perfect efficiency would divert more goods to export whatever the state of home demand. But controls are not of perfect efficiency, and although they played a role of major importance they could not, if home demand had been really excessive, have pre-

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vented a large-scale seepage of potential exports into the home market.

The facts have been given above. After a disastrous setback in 1947, when the inflationary pressure was serious, exports rose not merely by the very large absolute figures quoted above, but also as a proportion of total output. It is true that the picture was not consistently favourable; after the 1949 devaluation British exports increased by less than those of other devaluing countries, and the reason appears to have been a rise in home consumption. But over the period as a whole exports steadily increased their share of the country's total production, and it would have been quite impossible to have steered this enormous volume of goods abroad had inflation really been as severe as some commentators alleged. Home consumption was generally held down to the point where increases in output could go largely into higher exports, and British export prices rose by less than those of other European countries — and by much less than import prices. (Indeed over a large part of the period it was widely argued that British goods were being sold too cheap, and many pressed for an upward revaluation of the pound.)⁵

The evidence from the behaviour of exports is therefore that inflation from 1947 onwards was not of a damaging severity, and that what little existed was such as could be neutralized by physical controls. These controls were widespread and (with a few glaring exceptions, such as commercial vehicles) effective. Allocation schemes for scarce materials, rationing, and purchase-tax were all used to ensure that a high proportion of output was kept off the home market, and their success may be judged from the cases of motor cars and whisky, over three-quarters of the output of which, despite a very pressing home demand, was steered into export.

It is right to claim specific credit here for planning. Quite apart from the Budgetary techniques which gradually

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reduced the general inflationary pressure, the use of administrative measures was decisive. Those who reject planning, and yet proclaim their devotion to full employment, have a difficult case to argue. They would claim that an 'equilibrium' full employment level of demand would, given the right exchange-rate, permit the export of just the required quantity of goods. The claim is doubtful enough under any circumstances in view of the immobility of resources. But under post-war conditions it had no validity at all because of the large pent-up demand, left over from the war, for just those durable goods (from cars to textile machinery) for which the export prospects were brightest. Even suppose that current demand had been brought into exact balance with current supplies of the main range of non-durable consumption goods, so that no one could argue that general inflation was present, there would still have remained this accumulated demand for vehicles, metal and electrical goods, and far too many would have found their way into the home market. There were in practice only two ways of dealing with this situation — either to reinforce disinflation with physical controls, as was done, or to give up the aim of full employment and reduce internal incomes to the point where even this wholly exceptional demand for durable goods, backed as it was by large war-time savings, did not exceed the trickle of supplies available for the home market.

On the side of imports a high degree of austerity was observed throughout the period. It had been assumed that a volume well above pre-war would be needed to satisfy the higher population, output, and employment — perhaps as much as 15 per cent higher. Yet only in one year (1951) did the volume even approach the pre-war level, and in no other year did it exceed 89 per cent of that level. (The average of European countries, by contrast, imported in 1950 6 per cent more than before the war.)* Since imports were thus held down by quantitative controls far below their 'natural' level,

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no one could argue that inflation was inflicting damage in this direction; if any inflationary pressure existed, it was successfully neutralized.

Given full employment, even a wholly non-inflationary level of demand would have pushed imports higher than pre-war. The factor of planning and controls, by holding them below pre-war, was therefore again decisive. There was little tendency amongst the anti-planners to argue that we were importing too little — one would rather have supposed the opposite from their reiterated use of such phrases as 'living beyond our means'. Yet, assuming a commitment to full employment, how else than by using quantitative restrictions would they have held imports below pre-war, despite the higher employment and population?

It might in theory have been done by permitting the external value of the pound to depreciate to the point where imports were so dear that no controls were needed to restrain them (and exports so profitable that no controls were needed over home demand). But if anything like full employment was maintained, the devaluation would have had to go to quite fantastic lengths, given the strength of internal demand for imported food and materials, and for the easily exportable types of durable goods. It would have involved, not merely the certainty of a severe cost-inflation as money incomes were vainly driven up in pursuit of rising prices, but also a large fall in the standard of living. It would have been nonsensical to undergo all this in preference to the use of controls, and it was never seriously advocated as a main remedy.

The only other possible method would have been to abandon the full employment objective, and reduce home demand to the point where free consumers' choice itself dictated the lower level of imports. It is hard to imagine just what degree of unemployment this would have involved, but it must certainly have been very high. Thus only by the use of controls, in regard to imports as well as exports, was it possible to combine full employment and external solvency.

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Abandonment of planning would have meant the sacrifice of the first objective to the second.

The low volume of imports is a further answer to those who have spoken so foolishly of the 'flabby economy'. It meant a very genuine sacrifice to the British public that they should have been prevented from enjoying that level and variety of foreign goods (including holidays abroad) that they would have liked. No other country in Western Europe imposed this degree of austerity on its people, and it is extraordinary that so little credit has been given to the British achievement of raising exports and reducing imports, as compared with pre-war, on a far larger scale than other countries. That this should have been necessary was regrettable, that it should have been so thoroughly accomplished was surely meritorious.

Such is the credit side of the post-war account.

III

The debit side is that the achievement, though good, was still not good enough. The balance attained in certain years was still very precarious, and only too liable to disappear with bewildering speed. The events of 1951 showed that even three successive years of tolerable equilibrium were no guarantee of permanent solvency, and surpluses and deficits succeeded each other in a very alarming manner. The kaleidoscopic nature of the changes may be seen from the following list of surpluses or deficits in the five half-yearly periods from January 1950 to mid-1952 (£ million):

+46, +183, -71, -394, +24

In any case, it was not enough to achieve a mere balance as in 1948 and 1949: a substantial surplus was needed, and this was only once attained (in 1950). The reserves were still in real terms far below their 1938 level; only a bare

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start had been made on the task of rebuilding the overseas assets that had been liquidated during the war; and a large volume of overseas debt, requiring eventual amortization, still remained.

Moreover, in the years when a balance was achieved imports were held down to a level far below what consumers would freely have demanded if left to themselves (and sometimes stocks were run down in addition). And looming over everything was still the dollar problem, unsolved and intractable even when apparent viability was achieved on the overall account.

How was it that the position was so precarious, and imports of necessity still so low, despite the fulfilment of the export objective? The post-war calculations assumed that exports at 175 per cent of pre-war would, on certain assumptions about invisible income, pay for imports some 15 per cent higher than pre-war and still give a substantial surplus, and that even an export figure of 150 per cent would pay for pre-war imports and allow a surplus.

Matters turned out very differently, as the following Table shows.

TABLE 5
EXPORT — IMPORT VOLUMES AND CURRENT ACCOUNT BALANCE,
1949-52

	1949	1950	1951	1952
Export volume as percentage of 1938	151	177	179	167
Import volume as percentage of 1938	84	86	97	89
Surplus or Deficit (£ million)	+6	+258	-461	+170

(Source: *L.C.E.S. Bulletins*)

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If things had gone according to plan, all four years ought to have shown a very large surplus, and 1950 and 1952 a positively gigantic one. Yet they did not.

Was it the assumption about invisibles that proved false? It had been assumed that an additional 30 per cent of exports over pre-war would be needed to cover the loss of net investment income, which at 1938 prices might amount to £150 millions, but that otherwise invisibles would (after a transition period) show the same sort of surplus, in real terms, as in the old days.

This prophecy was almost exactly fulfilled in respect of net investment income which, allowing for price-changes, never recovered to much more than one-third of its pre-war level.⁷ The other items on the invisible account did not follow expectations so exactly. Net shipping earnings even in 1951 were, in real terms, only half their pre-war value.⁸ Government expenditure abroad, as a result of greatly increased commitments in the international field, remained throughout the period much higher than had been anticipated, and even in 1949 was almost equal to the combined net revenue from all the remaining invisible items. But by 1950 'other' invisible earnings (especially from British oil companies overseas) were large enough to offset both the increased Government expenditure and the fall in real shipping earnings. On balance, the invisible items other than dividends and interest then gave, as had been expected, an equivalent surplus to pre-war in real terms, so that taking the whole invisible account the only large change was the expected loss of investment income. It was not here that the falsification of post-war hopes occurred.

The factor which upset all calculations was the deterioration in the terms of trade. The post-war target was based on the assumption that export and import prices would rise by the same amount, and even in 1948 it was assumed in the Long-Term Programme that the terms of trade would not worsen beyond their then figure of 117 (1938=100).

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But in fact they had worsened by 1950 to 126, and in 1951 they reached a new peak of 143, from which they only recovered to 132 in 1952

The weight of the additional burden thus thrown on the British economy can be simply illustrated. The assumptions underlying the 175 per cent target have been described above. If this target had been adjusted annually to take account of the movement in relative prices, it would have altered as follows.

1946	1947	1948	1949	1950	1951
192%	209%	211%	211%	230%	266%

Put differently, the original target assumed that no extra exports would be needed to offset worsened terms of trade. In the event, extra exports above 1938 were so needed, taking the years 1946-51 in succession, to the following extent: 17 per cent, 34 per cent, 36 per cent, 36 per cent, 55 per cent, 91 per cent. Of course there was no question in practice of achieving export increases of this magnitude, however vigorous our efforts, and it was soon clear that the import target was hopelessly ambitious.

Even at reduced levels of imports the burden was very severe. To buy the 1950 volume (only 86 per cent of pre-war) required an extra £182 millions of exports at 1938 prices (or over £450m. at current prices) — compared with £40 millions to eliminate the pre-war deficit and £150 millions to cover the loss of investment income.⁹ But this was not the full measure of the sacrifice borne by the British consumer, since in addition to the £182 millions of goods surrendered to pay the higher import prices, he had also to forgo (at 1938 prices) £110 millions of imports which he was enjoying before the war. By 1951, when imports finally rose to nearly the pre-war volume, the burden had risen at current prices to £1100 millions — nearly one-tenth of the gross national income.¹⁰ (Taking all the various changes for

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the worse in our foreign trade position, they together claimed one-third of the entire post-war increase in the national product.)

The burden imposed by this disturbing new factor in our affairs thus easily exceeded that imposed by the war-time losses which had dominated the earlier discussions. It explains why the achievement of the 175 per cent export target did not suffice to guarantee solvency, and why imports had to be harshly restricted to very low levels. But for the worsened terms of trade, Britain would have been substantially in surplus from 1948 onwards, and the task of post-war recovery as such could be considered as completed in 1950 when exports finally reached the figure set for them. But instead of the solvency which this should have brought, Britain found herself faced with a new problem of an evidently more permanent and structural character, and even more impoverishing than the consequences of war.

APPENDIX

The state of the foreign balance has become, amongst orthodox economists and financial journalists, the favourite criterion of whether or not inflation can be said to exist. It is, however, a very misleading one. After all, Britain had a negative foreign balance from 1936 to 1938, yet during those years unemployment averaged over 12 per cent.

It is, of course, true that the level of the national income is a predominant influence on a country's balance of payments; and it is also true (*cet. par*) that a rise in monetary demand will cause its balance to deteriorate (by raising imports and, less certainly, restricting exports). But it is certainly not true that a negative foreign balance proves the existence of inflation. It may prove instead that the country's exchange-rate is out of alignment, or that depression exists in the countries to which it normally exports.

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Nor is it true that a deterioration in the foreign balance proves that inflation has increased. It may be a consequence of intensified deflation abroad, or of worsened terms of trade, or of a currency devaluation by its competitors in export markets. The exact condition of the foreign balance depends on the level of incomes both at home and abroad, the level of prices at home and abroad, and the rates of exchange between currencies. It is thus quite wrong to suppose that it fluctuates solely in response to changes in home demand, or that a deficit must be due to, and therefore proof of, the existence of inflation. Internal demand is only one of a number of determinants.

In a controlled economy, moreover, it is a much less important determinant than under *laissez-faire*. With no controls, it is inevitable that a rise in home demand should increase imports, and likely that it should diminish exports (either by causing prices to rise or by sucking goods into the home market). But in a controlled economy the increased imports may be prevented by quantitative import restrictions, the effect on prices by price controls, and the pressure on export-goods by physical controls. Under these circumstances the relation between inflation and the foreign balance is even more difficult to assess exactly.

None of this intended to show that no such relation exists, or that inflation is not harmful to export prospects. It merely shows that a deficit on foreign account is not of itself proof of inflation, but may be due to any of a number of factors, and may indeed co-exist (as so frequently in the inter-war period) with severe depression. To argue from a deficit to inflation requires proof that there exists (a) a volume of imports patently swollen by excess demand above some full employment 'norm', or (b) a large quantity of goods, potentially exportable, but drawn instead into the home market, or (c) a deficiency in exports due not to deflation abroad, but solely to non-competitive prices.

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NOTES

¹ All figures in this and the next chapter, unless otherwise stated, are taken from *United Kingdom Balance of Payments White Papers*, the annual *Economic Surveys*, and the quarterly *L.C.E.S. Bulletins*.

² The dollar history of these years is described in the next chapter.

³ Cmd. 7572.

⁴ E.C.E., 1950.

⁵ The necessity for devaluation might at first sight appear to contradict this. In fact it does not, since it was due not to any increased inflationary pressure in Britain, but to the emergence of a structural problem of the under-valuation of the dollar relative to almost all other currencies (*v.* next chapter).

⁶ E.C.E., *op. cit.*

⁷ Britain thus remained a creditor country in the sense of still enjoying a net investment income from abroad, even though on a reduced scale. But it appears that on capital account she had become a net debtor; before the war assets of £5300 millions were balanced by liabilities of only £1300 millions, whereas by 1950 assets of £6000 millions were more than offset by liabilities of £6800 millions. (A. R. CONAN, *The Sterling Area* (Macmillan, 1952), pp. 141-2 and Appendix I.)

⁸ Some of these comparisons with pre-war differ by significant amounts from those given by Mr. Conan (*op. cit.*, chap. 1). The reason is that I have taken as the basis of comparison the average balance of payments figures from 1936 to 1938 (as given in Cmd. 6707), whereas Mr. Conan takes the figures only for 1938, which does not appear to have been a very representative year.

⁹ These estimates agree broadly with some made by PROFESSOR PAISH (*L.C.E.S.*, March 1952): that worsened terms of trade had required even by 1950 a diversion of £197 millions of output from the home market at 1938 prices, compared with £130 millions

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necessitated by the loss of overseas income and £60-70 millions to eliminate the pre-war deficit.

¹⁰ If import prices had risen since 1938 by the same amount as export prices, the cost of imports in 1951 would have been £2800 millions (c.i.f.) instead of £3900 millions, and the trading deficit under £100 millions instead of £1200 millions.

III

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AS with the overall balance, so the dollar front was quiet at first, and 1946 passed off with deceptively little sign of crisis. But in 1947 came catastrophe.

The total gold and dollar drain during the year amounted to \$4131 millions.¹ The U.S. and Canadian credits were drawn down by \$3200 millions, and the former, of which it was planned that half should still be intact by the end of the year, was virtually exhausted by September. Despite these very large drafts on credit the reserves fell by \$600 millions, and the position at the end of the year looked desperate.

The largest single reason for this deterioration was a rise in the direct U.K. deficit with the dollar area* from \$1328 millions in 1946 to \$2301 millions in 1947, due almost entirely to a rise in imports; and there was also a further deficit with other Western Hemisphere countries. Some of this was inescapable. The sudden rise in American prices after President Truman took off price controls played a large part; and prices were rising in other dollar countries also. Britain, like the rest of the world, was still abnormally dependent on transatlantic sources of supply; in 1938 only 31 per cent of our imports came from the Western Hemisphere, but in 1947 44 per cent, and the volume of such imports was actually higher than pre-war within a total that was lower by a quarter. Perhaps there was some laxity here; certainly matters were not improved by a discreditable Tory campaign against 'unnecessary' austerity and the prolongation of rationing.

Adding to this current deficit certain unavoidable capital transactions also involving payments in gold, the U.K. had to

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finance a net dollar expenditure of nearly \$3000 millions — 70 per cent of the total loss, or 60-65 per cent if only current items are taken into account. When compared with a figure of \$3800 millions of dollar loans still unused at the beginning of the year, this shows that Britain would very soon have run through the credits even had there been no other calls upon them.

But in fact there were other such calls. The dollar account of the overseas Sterling Area³ worsened proportionately even more than that of the U.K. — from a surplus of \$64 millions (counting gold sales) to a deficit of \$759 millions. The reason was again largely to be found on the side of imports. Dollar imports into the R.S.A., which before the war were less than one half of dollar imports into the U.K., had by 1947 risen by \$1700 millions, compared with an increase of only \$1000 millions in the case of the U.K.; and their volume was three times as high as pre-war. But the rise in net dollar expenditure certainly cannot all be accounted for by an increase in strict current import requirements. Sterling convertibility was due in July as one of the conditions of the U.S. loan, and it was foreseen that it might lead to a serious drain on the central reserves. Some sterling area countries therefore resolved to move in first while the going was good, and took the precaution of converting large amounts of their accumulated sterling balances into dollar goods. No other explanation is compatible with the sudden and unforeseen change from a position of comfortable R.S.A. surplus in late 1946 to one of acute deficit in the first half of 1947.

To make up the total drain of \$4131 millions, there was an additional leakage of dollars to certain countries in Europe and South America (notably Belgium and the Argentine), amounting perhaps to \$400 millions and indirectly resulting from the convertibility experiment in July-August.

It is clear in retrospect that convertibility, although not the main cause of the 1947 crisis⁴ and although for political

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reasons probably unavoidable, was bound to turn out badly at a time when the whole world was desperately short of dollars.⁵ In theory it was confined to earnings on current account, but there were too many ways in which foreign countries could convert sterling into dollars in amounts exceeding their 'normal' trading surplus with the U.K.; while in the case of the R.S.A. free access to the central pool, combined with the ownership of large sterling balances, provided too strong a temptation to one or two less comradely countries as soon as there appeared a danger that tighter controls might later be clamped down.

II

The dollar outlook at the end of 1947 was thus exceedingly bleak. The American Loan was all but gone, the reserves were down to a microscopic level, the direct U.K. deficit was enormous, and the R.S.A. was a considerable net drain. There was no possibility of eliminating the deficit completely in the course of a few short months — indeed no one had ever thought that it could be eliminated so quickly after the end of hostilities. It was clear that if no additional U.S. aid was forthcoming there would need to be dollar import cuts of so ruthless a nature as to threaten both full employment and the basic rations of the British people. The rest of Europe found itself in the same predicament, and indeed the whole world economic scene was overshadowed by the dollar shortage.

Fortunately more U.S. aid, in the form of the Marshall Plan, was forthcoming, and for three years was to play a decisive part in European recovery. At the same time the dollar account showed in 1948 a striking recovery.

By a sustained effort of discrimination, the proportion of U.K. imports coming from the Western Hemisphere was reduced from 44 per cent to 33 per cent (roughly the pre-

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war figure), and their volume was cut to less than pre-war; this marked the end of the abnormal dependence on transatlantic supplies. The consequent fall in the dollar import bill was the biggest single reason for the year's improvement. Exports picked up encouragingly, and were 30 per cent higher than in 1938. The U.K. dollar deficit therefore declined from \$2301 millions in 1947 to \$1061 millions, and affairs seemed to be settling down to a more normal and predictable pattern.*

The R.S.A. account also improved, by some \$700 millions, and the total Sterling Area deficit declined from \$4131 millions to \$1710 millions — roughly the planned figure. Even this would have been insupportable with gold reserves of only \$2000 millions at the beginning of the year, but Marshall Aid enabled it to be borne. The outlook at the end of 1948 thus looked much more reassuring than a year before. The immediate post-war problem, deriving from destruction and dislocation in the non-dollar territories, seemed at last to be over; and American aid was promised for some years ahead.

But it has to be noted that there was a complete shift in the pattern of Sterling Area dollar payments as compared with before the war. Instead of a British deficit covered by gold and colonial dollars from the R.S.A., the British deficit in 1948 was reinforced by an R.S.A. deficit in addition, even allowing for gold sales. In other words the entire overseas area, with all its gold and raw material resources, was not merely not replenishing the U.K. reserves annually, but was actually draining gold away from the central pool.

This was too great a *bouleversement* of the traditional position to be bearable for long. No doubt Britain had permanently to reconcile herself to a smaller dollar deficit, and a smaller gold contribution from the R.S.A. But she could hardly be expected to finance an R.S.A. deficit as well as her own, and it was clear that the R.S.A. account must quickly be brought into balance. This would never be possible as

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long as dollar imports remained, as they were even in 1948, at double their pre-war volume.

III

But in 1949, instead of consolidation, there came disorderly retreat. The world economic climate suddenly changed, deflationary tendencies made their first appearance for a decade, and the U.S. in particular stumbled into a minor recession whose consequences were very severely felt all over the world. As the year went on sterling came under increasing pressure, which eventually culminated in devaluation.

The causes of this sudden crisis are not at once apparent from the figures. The *Economic Survey* had budgeted for a U.K. dollar deficit in the first half of the year of \$520 millions. In fact it came out at \$571 millions — not far above the estimate, and still appreciably lower than in the corresponding months of 1948, though \$112 millions worse than in the second half of 1948. Dollar exports showed no decline, and the small rise in the deficit was wholly due to a rise in imports. The overall current account meanwhile showed a modest surplus.

A somewhat sharper change for the worse occurred in the accounts of the R.S.A. Here an anticipated deficit of \$60 millions emerged as one of \$177 millions, which was a rather serious worsening as compared with the \$32 millions of the previous six months and in view of the obvious necessity for the R.S.A. to move rapidly into a position of balance. Admittedly part of this deterioration was unavoidable, since it stemmed from a fall in the export of primary products consequent on the U.S. recession. But there was in addition a further rise in dollar imports into the R.S.A. (excluding South Africa, which since 1948 had agreed not to draw on the central pool); and the flow of gold to Britain also fell.

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The total deterioration in the Sterling Area position seems very small when compared with the crisis figures of 1947 or 1951. Yet it was sufficient to compel devaluation for two reasons. First, the greater detail of quarterly figures showed some alarming changes, and a sharp deterioration between the first and second quarters.

TABLE 6

STERLING AREA TRADE WITH UNITED STATES AND CANADA
(\$ U.S. Million.)

	<i>1948 Quarterly Average</i>	<i>1949 1st Qr.</i>	<i>1949 2nd Qr.</i>	<i>1949 3rd Qr.</i>	<i>1949 4th Qr.</i>
United Kingdom:					
Exports	145	142	129	127	130
Imports	333	313	412	343	324
Trade Balance	—188	—171	—283	—215	—193
Rest of Sterling Area:					
Exports	325	308	280	238	277
Imports	411	395	437	332	293
Trade Balance	—86	—87	—157	—94	—15

(Source: *L.C.E.S. Bulletin*, May 1950)

The biggest changes were the rise in British dollar imports and the fall in R.S.A. dollar exports, though ironically enough neither of these called obviously for devaluation—the first because it was reversible by administrative action, the second because it was due to a recession in American demand, which in these circumstances was likely to be very

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inelastic to price changes. But the two slighter trends shown by the quarterly figures were in the long run the more disturbing ones — the fall in British exports, and the tendency of R.S.A. dollar imports to show sudden upward movements. (The importance of the latter point is much greater than the Table would suggest, since dollar imports into South Africa, which was not now a member of the dollar pool, fell sharply in early 1949.) These two trends had very serious implications for the future, since it was clear that as Marshall Aid tapered off a large fall in R.S.A. imports and a rise in British exports were absolute prerequisites of solvency. If the movement were in the reverse direction, there seemed no hope of ever closing the gap without some drastic change in policy. A devaluation of sterling was indicated, for reasons shortly to be explained.

Secondly, the level of the gold reserves was exceedingly low (much lower than in 1951), and there was no additional reserve to cushion the situation as there had been in 1947 in the shape of the American loan. Things were thus drawn very fine, and when in April the deficit rose to a figure larger than current Marshall Aid receipts, so that the reserves began to fall, much alarmist talk began. Devaluation was in the air, and this encouraged speculation against the pound, despite the overall balance and a much smaller dollar deficit than in 1947 or 1951. The pressure rapidly mounted, until it presented such a threat to the dwindling reserves that in September Sir Stafford Cripps was forced to announce a reduction in the dollar parity of the pound from 4.03 to 2.80.

The object of devaluation was not to restrict dollar imports into Britain. These were already restricted so far below the level that a free market demand would have set as to be virtually insensitive to price changes. Nor was it to encourage exports from the R.S.A. Consisting as they did largely of primary products, their sales were somewhat invariable over a wide range of price. Indeed since for many of them

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the world price was in effect set in the dollar market, devaluation made little difference; on the average, their dollar prices declined by only a small amount, and their sterling prices rose to nearly the same extent as the fall in the exchange value of the pound. The results in terms of dollar earnings thus were not, and were never expected to be, significant.

Devaluation was intended to achieve three results. The first necessity was to reverse the speculative movement against sterling. It is always doubtful, once the expectation of devaluation has become widespread, whether the existing value of a currency can be maintained. Sterling is particularly vulnerable owing to its use as a world currency, the very wide area of trade over which it is wholly or partially convertible into other currencies, and the plentiful supplies of it available in the shape of unfunded London balances. It does not then require any enormous unbalance in the foreign account to force it into a position so weak that extrication is impossible at the existing exchange-rate. Certainly by the beginning of August the pressure was such that it could not have been relieved except by devaluation.

The second object related to dollar imports into the R.S.A. When the early months of 1949 showed no sign of improvement, it was clear that some violent action was required. The Finance Ministers of the Commonwealth met in July, and agreed to a belated cut of 25 per cent (which for Britain meant a cut to little over half the pre-war volume, but for the R.S.A. as a whole still left the volume half as high again as pre-war). But the difficulty was that many of the offending countries (e.g. India) did not have the benefit of a set of controls sufficiently effective to implement this decision, which was therefore in danger of remaining merely a pious hope.

But Britain could influence the situation vicariously by altering the price-relationship between British and dollar goods, and devaluation was intended to make British prices

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so attractive relative to dollar prices that the 25 per cent cut would be effective even in countries whose imports were subject to market and not administrative decisions.

The long-term object related to British exports. In a world starved of goods, these had encountered since the end of the war a lively sellers' market, and considerations of price were seldom so important as the factor of delivery dates. This abnormal post-war demand had made possible the steep rise in exports that occurred from mid-1947 to end-1948. But in 1949 the upward movement was reversed. The volume fell from 156 per cent of pre-war in the first quarter to 146 per cent in the second and 142 per cent in the third, and dollar exports fell proportionately more than the total. The prospect of reaching the export target appeared to be receding.

This set-back was not due, as was widely argued at the time, to an increase in home inflation which suddenly priced British goods out of world markets — on the contrary, British wages and prices were virtually constant from January to September of 1949. Moreover a study of world trade figures confirms that the cause was not something peculiar to the British economy. European exports as a whole showed the same trend as British exports, and American imports in particular declined not merely from Britain, but from all other countries also — as so often, it is at the U.S. balance of trade that one must look for the true explanation.

The real cause must be sought in the change in business conditions in the Western Hemisphere, and more particularly in the sudden collapse of the post-war inflation in the United States. The central fact was the decline in the value of American imports from Europe by about one-third from the last quarter of 1948 to the second quarter of 1949.⁷ This was in part a normal consequence of the American recession in spring 1949, but it was aggravated by a further exceptional influence. Until 1949 British (and European) exports to the U.S. had been sustained not merely by very high

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American incomes, but also by post-war shortages — it was easier to obtain delivery of certain imported goods than of similar American goods. But as soon as the enormous productive capacity of the U.S. had cleared away the waiting lists, American consumers reverted to their normal preferences and shifted their purchases away from European imports. The most revealing event of spring 1949 was the drying-up of the previously quite substantial U.S. sales of British cars when the waiting-lists for American cars were finally eliminated.

The same trends were to be observed in other Western Hemisphere markets, exports to which from Europe and Britain also declined in 1949. As soon as American goods began to be in surplus, transatlantic customers reverted to their traditional preference for these goods, and in this they were abetted by a fall in American export prices and an increased sales effort on the part of American business-men now that profits in the home market were beginning to contract.

Much of the deterioration in 1949 was therefore due to changes on the side of incomes and physical supplies. But these changes had certain implications for world price relationships, since if European exports to dollar markets were no longer to be artificially buoyed up by inflationary incomes and post-war scarcities, they must be able to compete in price. And once the Western Hemisphere was purged of abnormal inflationary influences, it became evident that prices were seriously out of alignment.

Already in 1948 the Economic Commission for Europe had commented on the rise since pre-war in European export prices relative to American prices. This was hardly surprising. Since 1939 the U.S. had been exposed to far fewer economic stresses and strains, and the war-time increase in American productivity found no parallel in Europe. It was this structural factor, rather than any difference in monetary policy, which was responsible for the

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unbalance in price relationships. 'The present undervaluation of the dollar . . . is not so much a reflection of the over-valuation of European currencies caused by monetary factors (i.e. the inflation of price and wage levels), but rather a reflection of the rise in American productivity, which might have caused the dollar to become under-valued even if European price and wage levels had remained stable.'⁸

Britain, whose productivity advance in the post-war years had matched that of the United States, suffered less from this than other European countries. But here too the war-time rise in productivity had been much less than in America, so that despite a less steep rise in wages British export prices had risen significantly compared with U.S. prices. This differential movement, masked for a time by inflation in America, became very apparent as soon as the U.S. recession jolted transatlantic buyers back to a more normal degree of price-sensitivity, and induced in addition a further fall in American prices.

Moreover, even if the sterling-dollar price ratio had remained the same as before the war, devaluation of the pound might still have been necessary. The pre-war price relationship only enabled Britain to pay for 30 per cent of her dollar imports by exports. In the future, with diminished aid coming from invisibles, gold, and the R.S.A., a much higher figure would be needed, and it was doubtful if this could be achieved without a change in the dollar value of the pound.

Devaluation was intended to ensure first that British goods should be able to maintain and then increase the American sales built up with so much effort in the post-war years, and secondly that they should not be ousted by American goods in other hard-currency markets, but rather should increase their share in exports to such markets. It is not sufficiently realized that two-thirds of Britain's dollar deficit was with countries other than the U.S. — mainly in the Western Hemisphere (Canada in particular), but also Belgium and

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Switzerland in Europe. These dollar payments to third countries, only made possible by the fact that the deficit with the U.S. itself was considerably less than the value of Marshall Aid, were a central and disturbing feature of the post-war pattern of trade. If an approximate balance could be achieved in this direction, the whole dollar problem would be two-thirds solved.

The re-alignment of sterling (and many other currencies) against the dollar must be seen as marking the end of the post-war transition in respect of currency relationships, and as an adaptation of exchange values to the altered requirements of post-war trade. It could not by itself guarantee an equilibrium, since many other factors determine trade balances besides the ratio of prices; but it was certainly a necessary condition of one.

I V

The effects of devaluation on the speculative position were immediate and potent. The drain on the reserves ceased at once, and during the winter of 1949-50 they were replenished to the full extent that they had been depleted before. The second objective — the restriction of dollar imports into the R.S.A. — was similarly accomplished, with the help of the decisions taken at the Commonwealth Finance Conference, and their value fell between 1949 and 1950 by \$490 millions. Already the last quarter of 1949 saw an approach to a sterling-dollar balance, and the immediate expectation from devaluation could be considered as fulfilled.

But the long-run effect was almost impossible to assess, since it was largely swamped by the recovery in U.S. business activity which, together with the initiation of the stock-piling programme, greatly eased the world dollar shortage. At first sight the results of devaluation on British exports were encouraging. The total volume rose from 151 per cent of

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pre-war in 1949 to 177 per cent in 1950, and exports to the U.S. and Canada also rose, especially in the latter part of 1950. In the most important categories of goods (metals and manufactures, machinery, cars and transport equipment), of total exports from the U.S. and Western Europe to the rest of the world, the British share rose between 1949 and 1950 from 31 per cent to 36 per cent, while the U.S. share fell from 49 per cent to 39 per cent.*

But when looked at in detail the picture appears more sombre. 1950 witnessed a large expansion in the volume of world trade as a whole. Within this expansion, those countries which had devalued by 20 per cent or more showed a rise in export volumes of one-third, while other countries which had devalued by much less or not at all showed either a much smaller increase or an actual fall (e.g. Belgium, Italy, Switzerland). This suggests that the general efficacy of exchange-rate movements is considerable.

But although the percentage share of the U.K. in world exports did increase slightly, it did so by less than that of other devaluing countries, and the rise in exports was little more than could be accounted for by the rise in the volume of world trade. It appears that a simultaneous rise in home consumption of a number of export goods (e.g. textiles and certain kinds of machinery) inhibited the expansion in exports which devaluation should have made possible. By contrast, in the other devaluing countries (e.g. Western Germany and France) there existed idle capacity which could be brought into use to exploit the new situation. This shows that when a sudden rise in export demand is expected, special control measures need to be taken to ensure the requisite availabilities if the alternative of a reserve of unused capacity is to be avoided.

The results of devaluation on British exports, therefore, although beneficial, were not as great as might have been expected, and were outweighed by the general consequences of world boom. But on a long view it was certainly true that

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there was little chance of permanent solvency at the old exchange rate, and whatever the fluctuations in world trade it would sooner or later have been necessary to give sterling a more realistic external value.

V

The outbreak of the Korean War in June 1950, and its far reaching repercussions, had as shattering an effect on the world economic as on the diplomatic and military scene, and 1950 witnessed another of those violent swings in the dollar position which were already characteristic of post-war history. The Sterling Area found itself with a large dollar surplus. On the side of the U.K., imports showed the biggest change, falling from \$1600 millions in 1949 to \$1200 millions. Exports could not be expected to alter so rapidly, since devaluation meant that a large increase in volume was needed merely to give the same dollar value as before; nevertheless they rose from \$672 millions to \$865 millions, and this represented a very big increase in volume. Whereas in 1949 only 35 per cent of imports from the U.S. and Canada were covered by export earnings, in 1950 the proportion was 75 per cent. The invisible account also improved, and for the first time since the war showed a small surplus.

The result was a reduction in the U.K. deficit from \$1137 millions to \$295 millions, which was a great deal more rapid an amelioration than anyone had dared to expect. The rise in exports was encouraging and helpful, but the main benefit came from the large switch in imports from dollar to non-dollar sources. This process of switching had been going on steadily since 1947 as availabilities increased in the rest of the world, and it reached a point in 1950 where dollar imports formed a lower proportion of a lower total volume than before the war.

The R.S.A. did equally well. Taking gold into account it

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showed a surplus of \$706 millions instead of a deficit of \$127 millions. The main improvement came on the side of imports, which fell by \$490 millions; but export earnings also rose by \$360 millions. 1950 thus showed a reversion to the pre-war pattern of sterling trade, with the U.K. earning dollars from, instead of paying them to, the overseas countries of the Commonwealth.

The combined Sterling Area surplus was \$805 millions instead of a deficit of \$1511 millions in 1949. Since in addition a substantial volume of Marshall Aid was received, the central reserves showed a large appreciation, and it was agreed that Marshall Aid should be suspended — two years before it was due to end, and before any other country in Europe was able to dispense with it.

This was all very cheering, and at first sight the dollar problem seemed finally under control. But in fact a major part of the improvement came late in the year under the impact of the Korean War and its consequences. The rearmament programmes which were announced in August, and the rush on the part of American public and private buyers to stockpile materials of which a shortage was thought to threaten, led to a wild commodity boom of which one of the largest beneficiaries was the British colonial empire, whose dollar earnings in the second half of the year showed a sudden jump to a level three times as high as that achieved in 1948-49.

V I

Clearly, therefore, no conclusions could be drawn from 1950, as developments in 1951 very quickly showed. The dollar surplus melted away as quickly as it had come, and was replaced by a deficit of \$1164 millions. Since Marshall Aid had been suspended, the shock had to be taken by the gold reserves, which in spring 1952 reached their lowest

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figure since the crisis days of mid-1949. For the third time since the end of the war Britain and the Commonwealth found themselves caught up in apparently uncontrollable disaster, and faced with the need for the same sequence of import cuts and exchange restrictions.

Had it not been for the favourable out-turn in 1950, which lulled people into a sense of false security, this crisis would have come as much less of a surprise than the two previous crises in 1947 and 1949. It was hardly to be hoped that Western rearmament on the scale proposed, and the consequent violent disturbance to commodity markets, would pass off with no tiresome consequences. The very rapid swings in raw material prices must necessarily have created serious (though reverse) problems both for primary producers and industrial nations; while the British arms programme was bound to hold up the expansion of exports and heighten the need for imports. But nobody expected a crisis of quite the severity that actually befell.

The most obvious change was the leap in British dollar imports from \$1200 millions to \$2000 millions. Some deterioration was to be foreseen. It was natural that stocks, already low, should be increased in a situation where war was thought to threaten. But this does not explain the whole increase of one-third in import volume. Most of the extra imports were from the U.S., and they largely consisted of food and tobacco (though also refined oil). It is hard to believe that all this was strictly justified at a time of incipient dollar stringency; the trouble was that the stringency was inadequately foreseen. On top of the higher volume came a further deterioration in the terms of trade, and the net result was a dollar import bill which could not possibly be supported.

Dollar exports rose a little, but this was entirely due to higher prices, and the volume was slightly lower than the previous year. This cannot be blamed on Britain, since U.S. imports as a whole fell off sharply during the last three

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quarters of the year. The invisible account worsened from an approximate balance to a deficit of over \$250 millions, the fall being wholly due to payments on the U.S. loan and the loss of Abadan.

The U.K. dollar deficit therefore rose from \$295 millions in 1950 to \$1241 millions in 1951.

On R.S.A. account the picture is more confused, since there is little consistency between the first half of the year, when boom conditions still prevailed in most commodity markets, and the second half, which saw a sharp break in raw material prices. The colonial surplus was higher, but the independent R.S.A. countries, after a small surplus in the first half, ran into a large and growing deficit in the second half. The change was not on the side of exports, which earned more than the previous year, but on the side of imports, which showed a huge increase — from \$590 millions in 1950 to an annual rate of \$1410 millions in the second half of 1951 (despite the fact that imports from Britain were also very much higher). It was, of course, natural that the high incomes generated by the commodity boom should encourage higher imports, but a spending spree on this scale imposed an intolerable strain on the reserves, especially as it was wholly indiscriminate as between dollar and other goods.

But perhaps not too many conclusions should be drawn from 1951. The sequence of events touched off by the Korean War was of a wholly exceptional character, and will hardly be repeated in normal times. American imports first rose by 20 per cent and then fell by 15 per cent in a comparatively short period, and the world's primary-producing areas were bound in consequence to experience the most violent cycle of boom and slump.

In 1952, after another Commonwealth Finance Conference, import restrictions were once again clamped down (and strengthened by the fall in primary producers' incomes); and a precarious dollar balance was restored.

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VII

The dollar history of these years presents such a bewildering sequence of sudden reversals of fortune that it is not easy to find the right perspective or to draw conclusions for the future. Which period is to be taken as representing a norm to which future developments may be expected to approximate? The years up to 1948 were abnormal on account of the after-effects of wartime dislocation; in 1949 the picture was confused by devaluation; while the years 1950-52 were dominated by world rearmament. On the face of it the first half of 1950 appears the least disturbed period, and so the best basis for study; the purely post-war factors had spent their force, devaluation had had time to take effect, and the Korean War was still in the future.

The dollar problem at that time seemed to be within sight of solution, and the Sterling Area was in surplus for the first time since the end of the war.

The British trading deficit was not large — indeed it was lower than pre-war even in money terms, still more in real terms. Had the volumes and terms of trade remained unchanged, it would have more than doubled since before the war owing simply to the rise in the world price-level. In fact the sterling-dollar terms of trade moved heavily against Great Britain, and this would have enlarged the deficit still further — perhaps to three times the pre-war figure. But this outcome was avoided by the severe control exercised by the British Government, which raised the volume of dollar exports to 30 per cent above pre-war, while holding the volume of dollar imports more than 30 per cent below; as a proportion of total imports, the latter were only 18 per cent, compared with 34 per cent in 1947 and 23 per cent pre-war. Exports were sufficient to cover 60 per cent of dollar imports, compared with 27 per cent in 1938. (Britain alone of the Marshall Aid countries succeeded in raising dollar exports relative to dollar imports in this way — a further

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answer to much of the superficial criticism of the time.) As between 1934-38 and first half 1950, the trading deficit therefore actually fell from \$470 millions to an annual rate of \$390 millions; this represented a very large fall in real terms.¹⁰

The invisible account showed a deterioration from a surplus of \$150 millions to one of \$80 millions (annual rate).

The U.K. dollar balance as a whole thus showed a small improvement from a deficit of \$320 millions in 1934-38 to one of \$310 millions, reflecting an improvement in the volumes of trade just sufficient to offset the unfortunate price movements and the deterioration in invisibles.

This was certainly a rate of deficit which it was reasonable to expect could be balanced by the net earnings and gold output of the R.S.A., and in this period it was quite easily so balanced. The R.S.A., for the first time since the end of the war, had a substantial trading surplus (an annual rate of \$350 millions compared with \$50 millions pre-war); this came mainly from the colonies, but even the independent members of the Commonwealth had at long last moved over from huge deficits to a small surplus. This, it is true, was a rather belated achievement. In 1948 the R.S.A. had a deficit of over \$400 millions, due to the fact that, unlike the U.K., it showed no increase in dollar exports relative to dollar imports — on the contrary, the latter had risen *pari passu* with the former, and were double the pre-war volume;¹¹ since the sterling-dollar terms of trade had worsened also for the R.S.A., this was sufficient to convert the small pre-war surplus into a large deficit. It was not until the first half of 1950, when the 25 per cent import cuts became effective, that the R.S.A. began to earn the dollar surplus which one would expect such a primary-producing area to earn at a time of unprecedentedly high activity in the United States.

But a very large deterioration had occurred in respect of gold. Gold exports were higher than before the war, but their value in terms of goods was much less. If the price of gold had risen in the same way that other prices rose, an

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additional \$500 millions of gold in value would have been available; such was the loss caused by the American refusal to advance the dollar price of gold in line with other world prices.

Three conclusions may be drawn. First, there was no change for the worse in the physical pattern of trade, consequent on inflation or some other disgraceful cause. Great Britain showed a higher volume of exports and a lower volume of imports, the R.S.A. a roughly equal rise in both. The changes for the worse were the worsened terms of trade, the altered position of gold, and the unfavourable change on invisible account; of the three, the gold factor was much the most important.

Secondly, Britain had made a greater effort of adjustment to the new situation than the R.S.A. in terms of reduced imports relative to exports, and there was a bigger improvement in its trading account than in that of the R.S.A. This can be seen by doubling the pre-war figures of their respective deficit and surplus (to show roughly the effect of the doubling of the world price level, with no other changes), and comparing the result with the post-war balances.

Thirdly, however, the overall position was a not unhealthy one. The smaller British trading deficit and the larger R.S.A. trading surplus were sufficient to counter-balance the unfavourable changes, and the overall account was comfortably in balance on the basis of the old triangular pattern of trade.

But could this be regarded as a normal situation, and a safe guide to future probabilities? A closer examination shows that it was the product of an unusually favourable constellation of circumstances. American production had recovered from the recession of the previous year, and was at a boom level. Moreover, inventories were being built up, and imports therefore rose sharply to an exceptionally high volume which was unlikely to last indefinitely.

Secondly, dollar imports into the Sterling Area were uncomfortably low. British dollar imports were only held

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down by drawing on stocks, and any exceptional circumstance like the 1951 arms programme was likely to push them suddenly up again. R.S.A. imports, although so much higher than before the war, were again only held down in obedience to the behests of the 1949 Commonwealth Conference, and there was no assurance that this self-restraint would last for ever.¹³

Thirdly, the equilibrium depended on the maintenance of the existing terms of trade.

Fourthly, the invisible account was certain to worsen when interest and amortization payments became due on the U.S. and Canadian loans.

The balance of early-1950 was thus extremely precarious, and depended on a set of circumstances which could not all be expected to persist. This was shown by the events of 1951, when every one of these circumstances changed. Both British and R.S.A. imports rose in volume, the terms of trade deteriorated, the invisible balance became negative, and the modest surplus was transformed into a huge deficit. Some part of the worsening might have been avoided by a tighter control of imports, and some of the unfavourable factors were also self-adjusting. As against this, American incomes, although fractionally lower than in the previous period, were still sustained at an unusually high level by the rearmament boom, and it was far from clear that U.S. imports would always be as high as they were in 1951.

Balancing these factors against each other, it is evident that (say) the second half of 1951, with its dollar deficit of \$1500 millions, has at least as much right to be considered 'normal' as the first half of 1950, with its dollar surplus. At any rate, it was clear that six years after the end of the war lasting viability was still a long way off, and that a permanent deterioration had taken place in the trading position of the whole Sterling Area. The period closed, as it opened, with the dollar shortage still acute; and a radical new effort of adjustment was manifestly required.'

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NOTES

¹ All figures in this chapter are given in U.S. dollars. Unless otherwise stated they are taken either from the *U.K. Balance of Payments* White Papers or the annual *Surveys* of the E.C.E.

² The terms 'dollar area' and 'dollar trade' are unfortunately ambiguous. In official British publications they refer to the U.S.A., Canada and the 'American Account' countries in Central and South America. In many international publications they refer only to the U.S.A. and Canada. They were at one time loosely used to refer to the whole Western Hemisphere, or even 'hard currency' countries generally. The consequence is a most exasperating tendency to apparent discrepancies between different sets of figures. In this book the terms are given their official British connotation, unless otherwise stated.

³ The Sterling Area includes all the members of the Commonwealth (except for Canada and Newfoundland), together with Burma, Iceland, Iraq, Jordan, Eire and Libya. These are the 'Scheduled Territories' under the 1947 Exchange Control Act.

⁴ A detailed examination of the way in which the U.S. loan was exhausted between July 1946 and August 1947 supports this conclusion. The total spent in this period was \$3350 millions. Of this, \$2345 millions was required for net dollar expenditure by the U.K. (i.e. about 70 per cent), \$620 millions for the net dollar requirements of the R.S.A., while \$385 millions represented the conversion of sterling into dollars by third countries, mainly in Europe. The extent to which this run-down reflected a capital loss and not a normal set of current transactions is impossible to determine exactly — it depends partly on definition, and in any case requires more detailed information than is available about thousands of individual transactions. But on the basis of these figures it is hardly conceivable that more than one-quarter of the loan could have seeped away on capital account as a direct result of convertibility. That is not to say that this quarter did not represent a disastrously large amount! (v. articles in *The Banker* of September, October and December 1947).

⁵ The current deficit of the rest of the world with the U.S., which in 1934-38 had averaged only \$359 millions, had by 1947 risen to \$11.5 billions — a figure thirty-two times as large.

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⁶ This deficit was balanced by a slightly smaller surplus with the rest of the world, giving an overall deficit of £26 millions. But the surplus with other countries was of course not convertible into dollars.

⁷ E.C.E., 1949, p. 126.

⁸ E.C.E., 1948, p. 107.

⁹ E.C.E., 1950, p. 20.

¹⁰ All pre-war figures in this Section are calculated from Table 34 in *The Sterling Area* (E.C.A., op. cit.).

¹¹ The increase was mainly on the part of India and Pakistan ($4\frac{1}{2}$ times the pre-war volume), South Africa (3 times), Ceylon (10 times) and Malaya ($3\frac{1}{2}$ times).

¹² Exactly the same considerations apply to the present (1952-53) apparent dollar equilibrium, which is also based on import restrictions which may not prove lasting—in Britain because they involve a running-down of stocks which must soon be reversed, especially if production picks up from its low 1952 level, and in the R.S.A. because (to judge from past experience) they never do last.

PART TWO
THE FUTURE

IV

THE FIRST PROBLEM: WORLD SHORTAGES

IT is evident from the narrative in Part One that men have underestimated the long-run deterioration in Britain's foreign exchange position. Successive crises were attributed to specific causes, thought to be transient — the effects of the war, or world rearmament. But the failure to achieve a stable balance, despite an immense and disciplined national effort and the attainment of export targets which made ample allowance for war-time losses, showed that the maladjustment had some deeper cause than the war; while those politicians who blamed the later crises solely on post-Korean rearmament were also guilty of myopia. Britain's difficulties are of a much more fundamental and persistent nature, and would obtrude themselves even had there been no war and no rearmament. Unless this is widely understood, the nation will not apply itself to sufficiently radical remedies.

The British economy, being so little self-sufficient, is naturally vulnerable. It has become a platitude to speak of 50 million people crowded on a small island, relying precariously for their food and raw materials on the vagaries of world exchange. But it is none the less true for being so often the subject of peroration. Our only indigenous resources are coal, iron ore, and the soil, and for the bulk of our primary needs we must rely on imports. The value of British foreign trade amounted in 1950 to more than 30 per cent of the national income, compared with only 5 per cent for the United States and Russia, and 14 per cent and 11 per cent respectively even for Western Germany and Japan, countries at first sight in the same position as ourselves. Thus the British standard of living is to a quite exceptional degree

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dependent on external conditions wholly outside the control of Her Majesty's Government.

For long periods at a time the consequences of this may not be serious, because world conditions are favourable to the procurement of the necessary imports. When food and materials are in copious supply, when competition from other exporting nations is not severe, when the price of gold is high in terms of goods — at such periods affairs can be managed very comfortably. But the present decade shows no signs of being such a period; on the contrary, world economic trends are developing in a manner alarmingly adverse to British interests.

Three major problems are already in the foreground, and compel attention.

- (1) The world shortage of food and raw materials.
- (2) The disequilibrium between the dollar and non-dollar worlds.
- (3) The instability of the American economy.

These may be labelled as the structural overall problem, the structural dollar problem, and the cyclical problem.

The complicating factor is that these three difficulties, although all serious and certain to present themselves, cannot co-exist at the same time, but rather will appear in series. When, for example, the materials shortage becomes really grave, the dollar problem will be automatically solved, and even the consequences of instability much diminished. Thus Britain is not faced with one simple set of problems having common characteristics and pointing to a single solution, but with a trio of distinct ones whose relative importance varies according to the time-perspective taken. Policy must therefore be quickly adapted as one succeeds another, and this will require great mental agility in governing circles.

In this book the three problems are treated in the order of what appears to be their basic structural significance. The rest of this chapter and the next are devoted to the overall

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structural problem; the dollar disequilibrium and the problem of stability are discussed in later chapters.

II

After a surprising and abnormal interlude, world affairs now appear to be reverting to what was the regular nineteenth century pattern from the moment when the industrial revolution touched off an unparalleled expansion in world output and population, namely of unbalance between primary and secondary production, and great pressure on natural resources. For some decades, especially in the inter-war period, this pattern was overlaid by a different and in the long run misleading one — of primary surpluses, and cheap food and materials. An unusual combination of factors was responsible for this break in the trend: first, an exceptionally deflationary atmosphere in the major industrial countries, with a consequent slowing-down in the rate of increase of demand for raw materials; secondly, a falling-off in population growth in those countries which formed a predominant part of total world demand; and thirdly a sensational rise in world primary production as new virgin lands were opened up, and settlers advanced to the extensive frontier of cultivation with very abundant results.

But the second half of the twentieth century seems likely to witness a reversion to the trend which frightened the nineteenth century from Malthus onwards, of a rate of demand for the earth's natural products which is always tending to outstrip their supply. The main reason for the change is to be found on the side of demand. After the relative stagnation of the inter-war decades, a period of rapid economic expansion appears to be in prospect. World population is increasing at a significantly faster rate than before the war. Industrial activity in the advanced countries will be held at higher levels by the progressive equalization

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of incomes, which sustains consumer demand, by the insistence on rising standards of social investment, and by the general ideology of full employment with the consequent pressure on governments to take action against depressions. In the less advanced countries, the growing political consciousness of the masses exerts a steady upward influence on consumption standards both in respect of food and manufactured goods, while industrialization proceeds apace. All these factors are expansionary in their effects, and point to higher average levels of employment, output and incomes, and therefore a much enhanced demand for food and raw materials. The next two decades are likely to be as strongly biased towards inflation as the inter-war decades were biased towards deflation.

Such is the general reason for expecting a renewed pressure on natural resources. But food and materials present distinct problems, and need to be examined separately in more detail. In the case of food, the dominant influence on demand is naturally the trend of world population, and this seems certain to rise more rapidly in the future than in the recent past. In the under-developed countries, mortality rates are falling as standards of health and hygiene improve, while fertility rates remain unchanged; the population in all these countries is therefore expected to grow appreciably faster in the decade 1950-60 than in the inter-war period.¹ In the advanced industrial countries also a change has taken place. The pre-war infertility, which gave rise to so many gloomy prophecies of stationary or declining populations, is no longer in evidence. The age of marriage is earlier, and the average size of family larger, than a generation ago, and it appears that 'the United States and the Western European countries have now settled down to a rate of natural increase of about 1·per cent per annum — a figure of the same order of magnitude as the rate of population growth in India',² and considerably higher than before the war. Taking the world as a whole, Mr. Colin Clark estimates

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that over the next two decades population will increase at a rate of about $1\frac{1}{4}$ per cent per annum — compared with a figure of under 1 per cent from 1850 to 1913.³

Naturally productivity in agriculture is also increasing. But even if it were increasing as fast as world population, a food shortage could still be safely predicted. Recent decades have witnessed a continuous decline in the agricultural labour force relative to total working population. The attractions of urban life have exerted an ever-stronger pull on rural workers, especially in the inter-war years when industry was less depressed than agriculture; many Governments, moreover, have deliberately encouraged a migration into industry in an effort to diversify their national economies and diminish their dependence on the sale of a few primary products. This declining labour force, even though its productivity be increasing, is not likely to be able to expand its output at the same rate as the rise in world population, and indeed the divergence between the two is already obvious. Taking 1913 as 100, world food output rose faster than population up to 1929, and although population then began to catch up the 1937 figures were still 125 for food output and 124 for population. But by 1950 food production at 131 had been easily overtaken by world population at 138. The gap will evidently widen with the expected acceleration in population growth

But for the manufacturing countries the outlook is even more depressing than such overall calculations would suggest, inasmuch as the food-producing countries are themselves consuming a rising proportion of their own food output. Partly this is due to rising population; but in addition many of these countries have low standards of real income, and as their incomes rise a large proportion of the increase is spent on food. This explains why countries such as India have already changed from being net exporters to net importers of food, and why the exportable food surpluses of other countries such as the Argentine are now much smaller.⁴

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This trend is wholly desirable on welfare grounds, but the fact that a diminishing proportion of world food output now enters into world trade is an additional factor creating a world food shortage, quite apart from the overall tendency of population to outstrip production.⁵

In the case of raw materials, as of food, no real menace of shortage was apparent in the inter-war period, and the problem which attracted attention was the reverse one of unsaleable surpluses. World manufacturing output was expanding at a slower rate than before the first World War, and raw material production was easily able to keep pace; taking 1913 as 100, materials output in 1937 was 176 compared with 172 for manufacturing output.

But although supply and demand were for the moment comfortably in balance, it has to be remembered that vast quantities of materials were being used up each year. The United States alone, for example, now takes out of the ground in a year of high activity $2\frac{1}{2}$ times more coal than in 1900, 3 times more copper, 4 times more zinc, and 30 times more crude oil; and whatever the current supply-demand situation these are drafts on exhaustible reserves. It has been calculated that the total quantity of most metals and materials used in the U.S. alone since the first World War exceeds the total used by the entire world in the whole of human history up to 1913.⁶

Thus a materials problem might have presented itself, owing to the progressive exhaustion of the easily accessible supplies, even if pre-war trends in manufacturing output had continued. But if, as is postulated above, the 1950s show a much more rapid increase in industrial output, the problem will become graver still. Already by 1950 the indices of manufacturing and raw materials output had begun to diverge very seriously, the former having reached 247 and the latter only 212. The Paley Commission summed the matter up when it reported to President Truman that 'the consumption of almost all materials is expanding at com-

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pound rates and is thus pressing harder and harder against resources which, whatever else they may be doing, are not similarly expanding'.

In trying to project the future demand for materials, we have the advantage in the Paley Report of the most diligent and elaborate study ever made in this field. The conclusions which emerge from the Report are disturbing. Taking first the United States (which consumes one-half the total world supply of many materials), the gross national product, on the assumption that it increases by 3 per cent a year (which is the average rate of increase over the last hundred years) will be nearly twice as high in 1975 as in 1950 (in real terms). This will entail a rise in total materials demand of 50-60 per cent (though the rise will be unevenly distributed between different materials; in metals and fuels it is put at 90 per cent, timber 10 per cent, agricultural materials 40 per cent, energy in all forms 100 per cent).

The demand of the rest of the world is expected to rise proportionately even more rapidly — to 65-75 per cent above the present level by 1975. Demand from Western Europe is put at a little under half as high again as now, from Canada, Australasia and Japan at over half, while the under-developed areas will show the largest increase of all (though the quantities involved are naturally smaller).

A rise in demand on anything approaching this scale will have the most serious consequences. It is not so much absolute shortages that are in prospect — the Paley Commission rightly regards this as a naive view — but a steadily rising level of costs as the richest and easiest resources are worked out, and as recourse is had to less accessible supplies requiring more capital and labour for their extraction. 'The supplies of the evident, the cheap, and the accessible materials (chemically and geologically) are running out. The plain fact seems to be that we have skimmed the cream of our resources.' This is the real threat to the world standard of living, that the vast increase in manufacturing

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output that is in prospect will only be possible at an ever-rising cost in terms of raw materials: or, put differently, that the need to devote an increasing proportion of resources to the extraction of materials will offset the benefit which would otherwise accrue from rising productivity in manufacturing.

Alike for food and raw materials, the prospect is thus one of scarcity and a sharp rise in prices relative to manufactured goods, both because demand is rising faster than supply and because costs are tending to increase. The terms of trade will move against the industrial nations, which will be able to adapt themselves only with difficulty to this changed world of dear food and scarce materials.

III

It is, of course, possible to argue that the picture is over-painted. All predictions of this sort contain a large element of guesswork, and a plausible case can be made out on the other side. It can be said, for example, that these prognostications take too little account of the endless ingenuity of the scientist and the industrial chemist: that just as synthetic rubber has been found an efficient substitute for natural rubber, and synthetic fibres for silk, so plastics may increasingly take the place of metals; in this and similar ways a continuous process of substitution might remove anxiety. Perhaps, again, the world is on the verge of a revolutionary growth in agricultural productivity. 'There is abundant testimony that, by using carefully selected seeds, by the universal adoption of fertilizers, and by further provision of water, the yield per acre of agriculture might be increased by fully 50 per cent within two decades or less.'⁸ If this were to happen, much of the worry over food supplies would disappear.

It can also be argued that not only are supply potentialities and the possibilities of substitution under-estimated, but the

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likely increase in demand is over-estimated. The Paley Commission's projection of the U.S. national product is based on the average rate of growth over the last 100 years. But the rate of growth from 1929 to 1950 was a good deal less than this average, and most of the industrial nations showed a similar deceleration during the whole post-1918 era. Many economists in the 1930s (notably Professor Hansen and the so-called Stagnationist School) thought that this was a natural and inevitable concomitant of economic maturity. They held that as a country becomes industrially advanced, that very fact must necessarily militate against high employment and rapid growth. Savings, being an increasing function of income, rise more than proportionately to the growth in wealth, while at the same time investment-outlets gradually vanish as the country becomes sated with capital. The consequent unbalance between potential savings and investment must lead, they held, to persistent under-employment and a marked slowing-down in the rate of growth.

Furthermore, not only might the declining rate of economic growth persist, but the demand for primary products must fall relative to the rise in incomes and output. In the case of food, demand does not, after a certain level of food consumption is reached, grow proportionately with incomes, and the rate of increase in the per capita demand for food in the advanced countries will therefore slow down still further. In the case of materials, history shows a steady tendency to economy with the spread of more efficient utilization, and moreover as income grows an increased proportion is spent on services which consume no raw materials.

These are the soothing reflections which are offered on the other side. But we should do well not to be too easily comforted. Reasons were given above for doubting the stagnationist thesis, and for expecting that the next twenty years will show a faster rate of growth than the inter-war period. (The eight years since 1945 have already shown a much

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diminished tendency towards depression as compared with the corresponding post-1918 period.)

That the ratio of the growth of primary demand to economic growth shows a tendency to decline should also not excite too much optimism. In the case of food, the effects of the levelling-off of per capita consumption in the advanced countries are swamped by the striking up-turn in their rate of population growth; the U.S. population is expected to grow from 151 millions in 1950 to 193 millions in 1975, the Canadian population to rise by one-quarter in the next decade, while even Western Europe shows a sharp change in trend since before the war. If one adds to this the increasing pressure on food resources from the impoverished and growing millions in Asia, Africa and South America, the prophecies of scarcity seem very firmly based.

The case of materials is perhaps more open to doubt. But the findings of the Paley Commission, even if its estimate of the growth in American output is on the high side (which is far from certain), do appear to establish that the demand from the developed nations must inevitably be such as to put a great strain on supplies; and it has always to be remembered that the steady industrialization of the under-developed countries both sustains the demand for materials and increases the supply of manufactured goods, thus further depressing the price of the latter in terms of the former.

It is impossible to dogmatize. The history of the industrial era has been punctuated, from Malthus to the great scare of 1951, by periodic alarms about dwindling natural resources; and each time the fears have proved groundless. This might be the case again, and there may be some hyperbole in the current alarmist estimates, especially in respect of raw materials. But whether there is or not, the weight of the evidence, indecisive though it must necessarily be, is definitely on the side of those who expect high primary prices and scarcities, to such an extent that only a very rash person would act on the opposite assumption.

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I V

There is, of course, much that can be done to mitigate these expected hardships. The supply of primary products is not a fixed quantity, but to a high degree elastic. Nor is their demand immutable; it can be greatly varied by the application of inventive skill. The layman can say little useful on the technological point, except to insist that economical utilization be given a much higher priority than heretofore by government and industry.*

On the side of supply, it is known that large reserves of materials exist in the under-developed areas of South America, Africa, South-East Asia and the Middle East, and that the yield per acre in agriculture can be greatly increased. But the exploitation of these potentialities demands, among other things, a large volume of international investment by the wealthier countries. The Paley Report estimates that to satisfy the world's need for copper alone will require an annual investment of \$100 millions for 25 years; and this sort of figure is not untypical. The U.N. *Report on the Under-Developed Areas* recommended an annual capital inflow into these areas of \$10 billion, compared with a current inflow of 1-1½ billion; and while it is true that this recommendation was directed primarily to increasing per capita income and not to raising the supply of primary products, in practice the two things must go hand in hand.

This is a very large sum. But it cannot be said to be wholly beyond the capacity of the developed countries. It is equal to 2½ per cent of the combined national incomes of North America, Western Europe and Australasia. Admittedly international investment was on a much lower scale than this in the 1920s, and dried up altogether in the 1930s; but by comparison with the pre-1913 era (when for many years Britain, for example, exported capital to the extent of 7 per cent of its national income) the figure cannot be considered impossible. Since 1945 the U.S.A. has lent abroad (though

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mainly to Europe, and not to the under-developed countries) to the extent of 3 per cent of its national income.

The investment would have to come largely from government, not private sources. There is no sign that private investors will summon up enough courage to take the lending risk involved, while on the receiving side the under-developed countries hold strong and natural objections to an over-large participation by foreign private capital in their economies. Even if lenders and borrowers were not thus reluctant, private investment suffers from the overwhelming drawback of being highly volatile in character, and its cyclical ebb and flow has in the past been one of the main destabilizing influences on world trade.

The International Bank and the U.S. Export-Import Bank have shown the way. But their limited resources and obligatory conditions prevent their lending on anything approaching the scale required, and the U.N. experts have therefore proposed an International Development Authority to administer world grants-in-aid (on the lines of the Marshall Plan) amounting to 3 billion dollars annually, or 1 per cent of the national incomes of North America, Western Europe and Australasia. Measured by ideal requirements, this is a comparatively modest proposal, which for most of these countries would involve the sacrifice, once and for all, of a mere six months' improvement in their standard of life. Unfortunately the prospects even for this proposal are not bright; the major contribution would naturally come from the United States, and Republican Administrations are apt not to be very amiably disposed to international action of this type. But whether or not the necessary investment can be internationally concerted, the British Government should certainly aim at a large export of productive capital. Quite apart from the humanitarian considerations involved, it would constitute a fruitful investment in the future standard of living of the British people.

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V

But even if these desirable measures were to be taken, they would only alleviate and not completely solve the problem. The relative scarcity of primary products would still remain the predominant influence on economic affairs, and its consequences for Great Britain must therefore be examined.

Two stand out in particular, and one, by a curious irony, is partly favourable. The United States will become easily the world's largest importer of primary products, instead of a major exporter. The transition is already visible. In 1900 the U.S.A. produced 15 per cent more raw materials than it consumed, and exported the surplus; but in the 1940s it shifted from being a raw materials surplus to a raw materials deficit nation, and by 1950 was producing 10 per cent less materials than it consumed.¹⁰

On the basis of the Paley Commission's estimate of future needs, it has been calculated that U.S. imports by 1975 might reach a figure of \$18-19 billions annually at 1950 prices.¹¹ This is \$10 billions higher than the actual figure of imports in 1950, which was itself much higher than the 1948-1949 levels. For comparison, the U.S. current account surplus was some \$6½ billions in 1948 and 1949, \$2 billions in 1950, and \$3 billions in 1951. In other words, if the rest of the world will show a reasonable restraint in respect of dollar purchases, the present enormous surpluses on the U.S. foreign account will give way to balance, if not actually to deficit, and the world's dollar problem will disappear. As so often, the emergence of a new problem does at least permit the solution of an old.

Britain, not being a primary-producing nation, will naturally not gain directly from this change — indeed American competition for limited supplies of materials will in some ways intensify our economic problem. But even for Britain the structural dollar problem, now so stubborn, will

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largely disappear. The overseas Sterling Area will be a substantial beneficiary (though to a lesser extent than Canada and South America), and even if the Sterling Area were not to exist, overseas markets in general will be sufficiently saturated with dollars to make it comparatively easy for Britain to earn enough to cover her own deficit with the North American countries.

But although Britons will no doubt be grateful for this mercy, they will be hard put to it to cope with the other major consequence of primary shortages, namely the inevitable movement in the terms of exchange against manufactured goods. This must bear especially onerously on Britain, which relies more than any other major country on importing food and materials in exchange for manufactures; the deterioration as compared with pre-war will be particularly sharp, since conversely Britain gained most from the low primary prices then ruling.

The U.K. terms of trade improved steadily from 1918 onwards; taking 1913 as 100, in the 1920s they were 127,¹³ in the 1930s they rose still further to 138, and in one year (1933) they reached 145. As previous chapters showed, the reversal has already gone a considerable way. In 1947, at 118, they were already worse than in the 1920s, in 1950 they were 109, and in 1951 at 96 they finally showed a figure worse than 1913; in the worst month of 1951 they were lower than at any period since the 1880s, and almost as low as the worst point reached during the nineteenth century. Thus a large part of the inevitable deterioration has already occurred and taken its toll of the British standard of life.¹³

What level are they likely to reach in the future? Mr. Colin Clark, gloomiest of all the seers, has suggested a figure of 71 for 1960, with stability at that level until 1970.¹⁴ But the worst point reached during the great commodity inflation of 1951 was 91. This showed the effect of the quite abnormal post-Korean stock-piling boom, and therefore cannot be regarded as a normal 'trend' figure. It dated,

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secondly, from a brief period which was bound to be transient — after commodity prices had reached their peak, but before they had imparted the inevitable secondary price inflation to manufactured goods; a corrective movement was certain as manufactured costs absorbed the higher material prices, and wages reacted to the rise in food prices. Thirdly, commodity prices did in fact decline, and the terms of trade improve, as U.S. demand fell back to a more normal level and primary supplies increased in response to the high profits engendered by the boom. Lastly, history shows (for what it is worth) that a permanent movement in the terms of trade of 50 per cent over so short a period as 13 years, which is what would be involved if the figure of 91 were to persist, is without parallel since the Industrial Revolution began.

It is therefore most unlikely, on the basis of present trends, that the figure will even revert to the mid-1951 low point, or fall much below its present level (105), over the next three years. But in fact present trends are not likely to continue. The United States is likely to drift into a recession in 1954-55 as arms expenditure falls off, and however slight it proves to be, and whatever remedial action is taken, commodity prices will fall still further and the terms of trade (though not, of course, the balance of trade) show a corresponding improvement for the manufacturing nations.

Thereafter, as the world economy moves once again into an expansionary phase, the pressure on primary resources will recommence, and by 1960 all the alarming developments discussed above may be in full swing. The terms of trade must then deteriorate far below their 1954-55 depression level, well below their present level, and some way below the worst 1951 level. But perhaps even then they will not reach the extreme figure suggested by Mr. Clark. Quite apart from the possible element of exaggeration in some of the current prognoses, Mr. Clark's own prediction¹⁵ rests on two main assumptions, one of which (a continued rapid

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growth of output per head in the U.S.) will certainly be fulfilled, but the other of which (the rapid industrialization of China, and its emergence as an exporter of manufactured goods and an importer of primary produce) is clearly more doubtful. And even if primary prices do reach the astronomical heights which Mr. Clark and others expect, there are two points on the other side which are often forgotten. First, although the terms of trade may turn against manufactured goods in general, they will not move equally against all types of manufactured goods. The relative prices of consumer goods such as textiles, pottery, and even cars will, without doubt, be depressed, but the demand for specialized machinery and capital goods will probably show a sustained rise for many years ahead as the less advanced economies carry through their ambitious development plans. The terms of exchange will then move much less severely against such developmental goods than against manufactured goods in general; and if the British economy is flexible enough to take advantage of this changing trend in world demand, a part at least of the rise in primary prices may be counteracted.

Secondly, many of the prophets of soaring primary prices fail to draw the correct conclusions as regards the terms of trade, because they ignore the secondary effects of the rise on the price level of manufactured goods. The more dependent a country on primary imports, the more responsive are its export prices to the behaviour of import prices. British exports contain a significant imported material content, and British wages react rather sensitively to changes in food prices. In addition, a high level of employment in the industrial countries (and many of the gloomy prophecies predicate this) will tend to exert an independent upward pressure on costs and prices. Manufactured exports will therefore show their own upward price trend, even though it lags behind the rise in import prices.

It may be, therefore, that Mr. Clark's 1960 figure is too

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pessimistic. It is dangerous for the non-statistician to bandy precise figures with the expert. But a reasonable guess would perhaps be that the level will be well above the 1951 low of 91 for the next five years, but that thereafter it will fall steadily below it as economic expansion accelerates; perhaps over the whole decade 1953-63 it will average roughly this figure (= about 150 on the post-war series). Any British Government which assumed a better figure would show itself extremely reckless, and no one could be criticized who assumed a somewhat worse one.

NOTES

¹ See *Measures for the Economic Development of Under-Developed Countries* (United Nations, May 1951), p. 45, for details.

² COLIN CLARK, *Lloyds Bank Review*, April 1952.

³ Loc. cit.

⁴ Argentine production of beef is about 15 per cent higher than pre-war; but consumption per head has risen by one-fifth, and exports are little more than half pre-war. Taking the world as a whole, the annual output of beef has increased by 3 million tons since 1938, yet world exports have fallen from 1.5 million tons to under 1 million in 1951. It is small wonder that British consumption of beef per head of population in 1951 was only three-fifths of the 1938 level.

⁵ Another specific development which has cut into the food supplies available to the free world is that Russia now takes the agricultural export surplus of Eastern Europe which formerly helped to feed industrial Western Europe.

⁶ *Resources for Freedom* (A Report to the President by the President's Materials Policy Commission, Washington, June 1952). This is referred to as the Paley Report.

⁷ Op. cit., p. 5.

⁸ United Nations, op. cit., p. 78.

⁹ In Britain, the very wasteful use of limited fuel resources offers the greatest challenge. Governments will have to be much

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less timid in their approach to consumers if the present waste is to be reduced.

¹⁰ For example, the U.S. is now a huge importer of copper and zinc (where once it was the world's largest exporter), and a rapidly growing importer of crude oil and iron ore. For details, see the Paley Report, vol. II.

¹¹ AUGUST MAFFRY, late Chief of the International Economics and Statistics Unit of the U.S. Department of Commerce, in *Lloyds Bank Review*, October 1952.

¹² The pre-war figures are collated from ARTHUR LEWIS, *Economic Survey 1919-1939* (George Allen and Unwin, 1949), Table XV: the *Economist*, August 30th, 1947, p. 351: and *British Overseas Trade from 1700 to the 1930s* by WERNER SCHLOTE (Blackwell, 1952). I am grateful to the Statistical Division of the House of Commons Library for help in preparing them.

Unfortunately all series which are calculated back to the nineteenth century define the terms of trade as the index of export prices divided by the index of import prices, so that a rise indicates a change to the benefit of the U.K. But all official post-war series use the opposite definition of the ratio of import prices to export prices, so that a rise represents a worsening from the U.K. point of view. In this chapter alone the former series are used, as the only ones available. In all the other chapters the conventional post-war notation is adopted, and reference is always to the *L.C.E.S.* series on a 1938 base. For convenience, the worst month of 1951 shows a figure of 91 on the basis used in this chapter, and 151 on the basis used elsewhere in the book.

¹³ *v.* Part I, chapter II.

¹⁴ Calculated from *The Economics of 1960* (Macmillan, 1942), p. 52.

¹⁵ *Loc. cit.*

V

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THE British people will feel two effects from this revolution in world trading relationships: first, the general effect on the standard of life, and secondly the need for major adaptations in the economic structure to meet the new situation.

We have already had a sharp foretaste since 1945 of the implications for British living standards of world primary shortages. Rising food prices, the prolongation of rationing, and the argument over subsidies all mark the change from the 1930s, when home consumption standards were buoyed up, despite mass unemployment, by the very favourable terms at which manufactured exports exchanged for food and raw materials. British real incomes were then maintained at the expense of low prices and miserable poverty in the primary-producing countries. Now that the inevitable change has come, it brings with it a world redistribution of income. British workers suffer, but the less developed countries gain, and the movement in the terms of trade has, to a limited extent, the same result as a continuing world plan for mutual aid. Certainly no socialist should cavil at the fact that the primary-producing countries can now afford a far more generous purchase of imports, even though the obverse is high prices and reduced imports in some of the wealthier countries.

But the quantitative effects of this change are sometimes exaggerated. There is loose talk of a steady *decline* in British standards of life being inevitable. This is to get the matter out of perspective, and to forget the large annual rise in productivity of which a healthy industrial system is capable. The American gross national product has risen over the last 100 years at an average rate of 3 per cent per

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annum, and there is no reason why the British economy, now purged of the abnormal deflationary influences of the inter-war period, should not show a similar rate of expansion.

A 3 per cent rise in the national product would give (at current prices) an increase in the output of goods and services of £400 millions, which would amply offset a 10 per cent deterioration in the terms of trade. To anticipate the argument of this chapter, if the terms of trade average 150 (on a 1938 base) for the next 10 years, if imports are at their 1951 volume, and if the current account shows a surplus of £300 millions,¹ then exports would need to be higher by some £850 millions than in 1951 — the equivalent of two years' rise in the national income, or one-fifth of the rise that might be expected over a decade. Even on the assumption of a 2 per cent annual rise, only three years' increase in output would be lost.

There is thus no reason to anticipate a decline in consumption, nor even complete stagnation, *provided the necessary changes are made at home*. Rising productivity will leave a good deal to spare. It may be that the increment should all go into higher home investment, and that living standards should be screwed down to make this possible. This may indeed be desirable for a period. But there is no reason for a steady *fall* in consumption on account of the terms of trade alone, and if this should occur the public should blame not harsh economic necessity, but deficient national leadership. Nevertheless, any amelioration must proceed more slowly than would otherwise have been the case, and these reflections should act as a brake upon the promises of politicians.

II

The necessary changes will require great dexterity on the part of Britain's rulers. All might be easy if resources were

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completely mobile, and if foreign buyers were so amiable as to take any British goods offered them. But with an imperfect economy at home, and highly selective buyers abroad, very obstinate problems will be encountered.

What total volume of exports will be needed? Here a *caveat* must be entered. The next two or three years may go against the long-term trend. A post-rearmament recession in America might engender a fall in commodity prices, and the tendencies discussed in the last chapter will not yet have gathered full momentum. People may then be misled into thinking that Britain's export requirements are not, after all, very much larger than now; and the balance attained in 1952 will be quoted in evidence. But this will be only a passing phase, and all long-term planning must be based on the assumption that the trend towards primary shortages represents the genuine secular trend.

The volume of exports required will then depend on the magnitudes given to four variables: the size of the surplus to be aimed at, the level of invisible earnings, the volume of imports, and the terms of trade.

A substantial surplus is needed on several counts: first and most urgently, to build up the exiguous gold reserves, and secondly to cover amortization payments, notably on the U.S. and Canadian Loans. Thirdly, Britain must be ready to contribute to an International Development Authority, should one ever be set up, the sum proposed by the U.N. experts, namely 1 per cent of the national income. Fourthly, Britain's position in a world of primary shortages is so precarious that she will wish to invest in food and raw materials production a further sum on top of this, more particularly within the Sterling Area. Lastly, a large surplus is helpful to the development of a large export trade; countries which are encouraged to buy British goods by the provision of loans will acquire the habit of buying British, and an export connection thus built up can be exploited and strengthened. These are all economic reasons, but even were they wholly

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absent humanitarian sentiment would point to the same conclusion. A country with as high an income as Great Britain must be held to be under a strong moral obligation to help raise living standards in the impoverished backward areas, and a large export surplus would be needed for this purpose alone.

Perhaps a surplus of £300 millions on the average of years should be the aim. This would be roughly equal to $2\frac{1}{2}$ per cent of the present national income, which was the proportion suggested by the U.N. experts as reasonable for the wealthier countries (though it is true that in the British case a small part of this would go elsewhere than to the under-developed countries). It is high by recent historical standards, contrasting with a large deficit or bare balance for most of the post-war years, and with a small deficit in the 1930s; allowing for the change in prices, it was not exceeded even during the brief period of renewed large-scale investment in the late 1920s. The much wealthier U.S.A. has only lent abroad 3 per cent of its national income since 1945, large though its operations during those years have appeared. If a bigger surplus proves possible, well and good; but to average £300 millions over good years and bad will require a great effort from the nation the worst hit of all by the adverse movement in the terms of trade.^a

Invisible earnings have recently been the most unpredictable item in the foreign accounts. Even in official publications a large part of them remains anonymous and unidentified under the baffling heading 'Other (net)'; and it is particularly hard to read future prospects. In 1950 net earnings were £400 millions, in 1951 they fell to £300 millions, largely due to payments on the dollar loans. The two largest credit items are shipping and the earnings of British oil companies overseas, and it is reasonable to hope that these will expand by sufficient to cover the amounts required for servicing the loans. It is therefore assumed that the invisible surplus will average its 1950 figure.

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III

What of the level of imports? The post-war years belied all the early assumptions by proving that imports need not increase *pari passu* with the rise in population and national income. Indeed they remained until 1951 well below pre-war, despite a 6 per cent rise in population and a 50 per cent increase in industrial output.

This was made possible partly by stern restrictions on consumers' choice; many imported goods and services which the public was accustomed to enjoy before the war, from American cars to foreign travel, were partially or wholly denied it. Deliberate efforts to replace imports by additional home production also helped, notably in the case of agriculture and oil-refining.⁸ Above all, industry found it possible, by showing greater ingenuity in utilization and by using substitutes, to expand its total output without a proportionate increase in its consumption of imported raw materials.

But although it proved possible, to an extent unforeseen at the end of the war, to reduce the ratio of imports to home-produced national income, there is clearly a limit to this process. The fall in the ratio since 1938 is not a safe guide to what can be achieved in the future, since it included a large once-for-all element in the shape of the virtual elimination of inessential manufactured imports. There is not much left to be squeezed here, and the import bill is now dominated by the two essential groups of food and raw materials. In the latter case at least, even though the ratio of imported materials to total output may continue to decline, each large rise in the national income will henceforth require *some* absolute rise in imports.

The events of 1950-51 were a portent. Although imports had risen from 67 per cent of pre-war in 1946 to 86 per cent in 1950, they then proved, in a year of very high activity, too low relative to the national income, and were only held down by drawing on stocks. When in 1951 stocks came to be re-

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built, and in addition limited measures of trade liberalization within Europe were accepted, imports were quickly hoisted upwards by 12 per cent, and this helped to give rise to a severe exchange crisis. Probably there was some 'fat' in the 1951 volume (though not so much as might be thought from the ease with which the 1952 cuts were effected — it has to be remembered that 1952 was a year of declining output); but the sequence of events showed the impossibility of restricting imports below a certain point.

It is not easy to decide exactly where this point lies. Obviously every effort must be made, in the light of our future difficulties, to set it as low as possible. We shall have to go slow on all suggestions for further liberalization of trade, and maintain strict quantitative restrictions into the indefinite future. This does not follow from any autarchic desire to cut Britain off from trade with the rest of the world, or to diminish the volume of international exchange. It follows merely from a sad realization that in the face of highly unfavourable terms of trade we cannot afford a free flow of imports. If all the predictions turn out to be false, and the world climate alters in a manner favourable to the manufacturing nations, then by all means let us relax, and set our imports free. But it is not helpful for those who accept the coming shortage of food and materials at the same time to criticize the view that Britain must cut her coat according to the cloth, and that the cut must be of a severely utility pattern.

The sector which seems to offer the most obvious scope for import-saving is agriculture. Economists in the past have been opposed to the protection and expansion of home agriculture, and this was natural when food prices were much lower abroad than at home. But today, as we move into the era of dear food, the position is different. Even on a strict economic calculation the argument for expanding home food output will grow stronger year by year, and it will be firmly clinched if, as seems quite likely, food imports not

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merely cost us dear, but are in some cases actually unprocurable. When there are meatless days in the Argentine, it is high time to give up traditional notions.

Food imports are now only 80 per cent of their pre-war volume. But home agricultural output is higher by 40 per cent than pre-war, and this expansion has been sufficient to restore *per capita* food consumption (as measured in calories, though not of course for all individual foods) to the pre-war level, despite the rise in population.

The immediate outlook, however, is not encouraging. Home production has remained virtually static since 1948, despite the injection of a good deal more capital, and the present Government is content to set the industry the deplorably low target of 160 per cent of pre-war. Fortunately many experts are agreed that a larger rise than this is technically possible — £200 millions over quite a short period,⁴ and looking further ahead some optimists speak of an output 40 per cent higher than now, which would be double pre-war.⁵

But how much import-saving would even this allow? The Royal Commission on Population suggested that population might grow by between 3 and 5 per cent during the 1950s. The national income will also expand, and some part of the increment would normally be spent on food. And even today, before these changes, the continuance of rationing shows that demand at current prices exceeds supply — though the abolition of the food subsidies may soon restore a purely market equilibrium by redistributing total consumption against the poor and in favour of the rich.

On a conservative estimate of income growth, and taking the Royal Commission's figure for population, Sir James Turner (President of the National Farmers' Union) puts the effective demand for food in the early 1960s at £275-£330 millions higher than now (at current prices).⁶ But the larger of these two figures exactly equals the 40 per cent increase in home output that is the maximum thought

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possible, and therefore leaves no margin for reducing imports. Import-saving will only be possible, in other words, if consumption is held down below this level either by continued rationing or by a distribution of income sufficiently unequal to render nugatory some part of the demand from poorer people. Perhaps the first of these courses will be necessary, so grave is the future trading outlook; but even if it is adopted, and *per capita* consumption is only allowed a rather small increase, it is inconceivable that more than £250 millions at current prices could be saved from imports (and quite possible that none can be saved). This would represent a cut of 20 per cent on 1951 food imports, and 7 per cent on total imports. This is evidently a point on which there is much wishful thinking.

Raw material imports must rise with the expansion in industrial output, though not, as has been shown, proportionately. The Paley Commission estimates that for the United States any given percentage increase in the gross national product induces a percentage increase in raw materials demand of something over half. If this ratio is applied to Britain, and if the national product rises by 2-3 per cent per annum, then raw materials demand in ten years time will be higher than now by anything between 15 per cent and 30 per cent.⁷ At 1951 prices, this would mean additional imports costing between £250 millions and £500 millions. The higher figures in this range would thus easily cancel out the maximum possible saving in food imports.

Some pruning is no doubt possible in respect of manufactured goods, but on balance it seems unlikely that Britain can sustain a renewed expansion in industrial output without soon reaching the 1951 import volume. Even this is only the same volume as pre-war, and to hold imports at that level over the next decade, in view of the very large rise in the national income that will have taken place since 1938, would represent a major structural change in the British economy.

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The terms of trade are assumed, as already explained, to average 150 over the next decade.

The required increase in exports can now be calculated. The import volume will be the same as in 1951, but price movements will increase the cost by £200 millions. Invisibles will improve by £100 millions compared with 1951. A surplus of £300 millions is to be aimed at instead of the 1951 deficit of £450 millions. The required increase in exports over 1951 is then $£200 - 100 + 750 = £850$ millions, or 31 per cent in volume, i.e. nearly 240 per cent of pre-war instead of 179 per cent. To such an extent must sights be raised compared with the estimates made at the end of the war;^a though it must be borne in mind that this figure will not be required for some years, since neither imports nor the terms of trade will quickly reach these higher levels.

IV

But it is not enough merely to give an overall figure for the required increase, since there is little chance of an equal expansion in all directions. We must look mainly to those types of goods which satisfy three conditions. First, they must form an expanding and not a diminishing share of total world trade. Secondly, Britain must have a comparative cost advantage in their manufacture, which means, since labour and land in Britain are relatively scarce but capital and technical skill are relatively plentiful, that they must embody a high ratio of capital and managerial to total costs. Thirdly, they must have a high raw material conversion ratio, i.e. the cost of imported materials must form a low proportion of total value; if the import content is high, then the net exchange receipts from the export will be low.^a

The application of these three criteria soon sifts the hopeful from the hopeless amongst our present exports. The superb high-quality consumer goods for which we are

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renowned — the Rolls-Royce, the quality clothes and shoes, the famous pottery, Scotch whisky — cannot be relied upon for much expansion. They fail at once on the first condition. Their sales were always confined to small upper classes, wealthy enough to indulge their whims for the highest luxuries; but today, with the world-wide spread of egalitarian tendencies, this market is declining. Given the vast export volume required, the only important markets are mass markets; the hand-tailored goods for the *deux cents familles*, though they may continue, and rightly, to uphold British prestige for craftsmanship, are no longer a serious factor in the balance of payments.

Turning to the goods with mass appeal, we find that even in the post-war years textiles have constituted one-fifth of total exports. Unfortunately for the future, they offend against all three criteria. World trade in textiles has been declining steadily for forty years with the development of domestic industries; in cotton goods, for example, world trade in 1950 was only three-quarters of the 1937 level, though world output was higher. The ratio of labour to total costs is high, and that of capital and managerial costs is low, so that Britain is at a comparative disadvantage *vis-à-vis* more backward countries amply endowed with cheap supplies of labour, but lacking capital and skill. And, lastly, the import content is high.

After the war, textile exports were sustained for some time by the exceptional buyers' market, and later by speculative buying for stock after Korea. But they fell sharply in 1951-1952, and it is doubtful if the post-war level can be regained. On a long view, there are too many bearish factors — the emergence of India, previously a substantial net importer of cotton goods, as a large and growing net exporter: the recovery of Japan: the appearance of the U.S. as a major exporter:¹⁰ and the development of native textile industries in South America.¹¹

There is therefore no expansion to be looked for here, and

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possibly a further fall; the next decade will witness a continuation of the trend which has already reduced the share of textiles in total U.K. exports from 38 per cent in 1913 to 26 per cent in 1937 and 19 per cent in 1951.

The other 'traditional' consumer goods exports (pottery, footwear, etc.) are in the same case as textiles — victims of the growing economic nationalism abroad which has made it instinctive with developing countries to encourage, often behind high tariff walls, the growth of all secondary industries which are not too complicated in character. An industrializing world no longer needs large quantities of simple consumer goods from Britain.

But there is next a miscellaneous group of 'heavy' exports which can certainly contribute more than now. Foreign demand for coal might absorb 30-50 million tons per annum¹² in a few years' time (*provided they can be supplied*), compared with 7 million tons in 1951, and this would increase foreign exchange receipts compared with 1951 by £100-180 millions (1951 prices). Steel exports should rise by 2 million tons to almost double the 1951 volume, which would bring in an extra £140 millions. Chemical exports in 1951 were in volume $2\frac{1}{2}$ times as high as pre-war; the rapid expansion in world demand is certain to continue, and British exports might rise in volume by at least three-quarters in the years ahead; this would increase their value by £100 millions.

From these three staple exports, taken together, there might thus accrue (at 1951 prices) an additional £350-400 millions of foreign exchange compared with 1951. This would represent a volume increase of 15 per cent in total exports, or nearly one-half the required amount.

But allowing for a possible decline in textile exports, there is still a large gap to be filled, and it is evident that the main burden must fall on metal and engineering exports. These have already expanded their share of the total from 30 per cent in 1935 to 45 per cent today, and they offer the main hope for the future.¹³ They fulfil all three criteria. In the

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present phase of world expansion and development, demand for engineering goods is rapidly on the increase; the less developed countries, with ample labour but little capital or inherited technique, can easily build their textile mills, but they cannot carry through their industrial development programmes without importing the bulk of the capital goods required, nor their agricultural development programmes without importing tractors and heavy commercial vehicles. These goods, moreover, have a high conversion ratio; the raw material content in general is low, and the imported content lower still.

It is not true, of course, that metal and engineering exports consist wholly of capital goods. The largest individual category is motor vehicles, within which passenger cars have shown the most rapid export expansion of any commodity — to more than six-fold the pre-war volume. Other encouraging increases have been recorded by such technically-complicated consumer goods as washing-machines, refrigerators, vacuum-cleaners, television sets, radios, etc.

What is true, however, is that the consumer component in this group is the more vulnerable to the intensification of autarchic nationalism abroad. Already Australia, hitherto by far the largest market for British cars, is building an all-Australian car, and radio-sets are beginning to come off the assembly-lines in South American countries. More and more, over the whole field of exports, we shall have to concentrate on heavy investment goods for the producer: textiles will cede to textile machinery, cars to commercial vehicles, radio sets to electronic equipment, bicycles to jet aircraft.

There has already been a very large expansion in metal and engineering exports; by 1951 they were treble their pre-war volume. But even for present needs the expansion has not been fast enough. Delivery dates have been long throughout the post-war period, and there has remained a large unsatisfied demand. This was particularly evident after devaluation, when British engineering exports rose by

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proportionately less than those of other devaluing countries, and opportunities of capturing new markets were lost. The reason was that although the capacity of these industries had risen as compared with pre-war, it had not risen fast enough. Taking 1938 as 100, U.K. output of engineering goods was 164 by 1949 and 182 by 1950, compared with a European average of 133 in the latter year. Yet even after this expansion, capacity was insufficient to meet the export demand as well as the demands from home industry for re-equipment and, from 1951, the needs of rearmament.

There was a dangerous tendency to under-estimate the task facing these industries; the Long-Term Programme of 1948, for example, put the requirements of engineering exports at only 230 per cent of pre-war — a figure very little in excess of that already attained. Fortunately this was quickly and easily left behind. But if these industries are to shoulder the main burden of reaching the new export figure, a further large expansion will be needed. Allowing for a fall in textile exports, but a substantial rise in coal, steel, and chemicals, it seems that metal and engineering goods may have to provide well over £500 millions of the total required increase of £850 millions.¹⁴

This will mean a level of exports higher by one-half than the 1950-51 volume, and nearly five times as high as pre-war. This alone might entail an increase of one-fifth in the total output of the engineering industries, and if home capital investment is also to be expanded, as it should be, the increase in output might very easily be of the order of two-fifths — a formidable redeployment of our economic resources.

V

Recent experience shows that the output of engineering goods is very elastic, given a sufficient supply of materials, in particular steel. Labour is not in general a great problem, as

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engineering wages for most grades of labour are well above the average; between 1935 and 1946 the metal goods industries gained a million workers — almost the whole of the increase in the industrial labour force during this period — and they have increased their labour force by a further 20 per cent since then. As a result the output of metal goods had by 1951 about doubled since 1935, and was half as high again as in 1946. It is clear that these industries are capable of a very large and rapid expansion, given the requisite materials. Nevertheless, steel remained a limiting factor on output, most notably in 1951, and the required increase of two-fifths in production will demand very large additional steel supplies.

The central importance of steel is, it is true, sometimes exaggerated. Some of the most promising exports in this field use very little raw material, and their output depends rather on supplies of skilled labour and factory space. Jet aircraft are a good example. They have a higher conversion ratio than any article save for precision watches — twenty times as high as motor cars, for example. They also offer scope for a sensational export expansion. About £1000 millions will be spent over the next 5-10 years on replacing the 3000 airliners now operating on the world's air routes, and a further large sum must be added for spare engines and components. These figures are based on today's air fleets and traffic. But we are surely on the threshold of a further revolutionary expansion of air traffic. It multiplied about 9 times between 1937 and 1947, and from 1947 to 1951 nearly doubled again. Comparable increases are likely in the future, and the sums that will be spent on new aircraft, added to the £1000 millions on replacement, will bring the total to an astronomical figure.

Britain, with its current lead in jet design, is wonderfully placed to exploit this expanding market. Aircraft exports in 1951 brought in £40 millions (mainly from light military machines). If this figure cannot be quintupled in five years'

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time, it will be shocking proof that Britain has lost the resilience and initiative to be a leading nation in the world.

Despite a few exceptions, however, it is true that metal and engineering output does depend largely on steel supplies, and the future size of the steel industry must therefore be considered.

Post-war expansion plans were much too unambitious even in relation to current needs, let alone future requirements. The industry's development plan envisaged an increase in production to 15 million tons a year from a capacity of 16 million tons, compared with a pre-war peak output of 13.4 millions. This was based on an assumed export figure of 3 million tons and a home demand of 13 million tons, compared with an actual home use in 1935-38 of 10½ million tons. This was a ludicrously inadequate forecast, considering the urgent need for higher exports and capital investment. Fortunately it was soon overtaken by events, and output was well over 16 million tons in 1950 from a capacity of 16½ million tons. Already by 1949 home use of steel was higher than the level assumed in the plan for the 1950s; in 1949-51 it was running at about 14½ million tons, with exports at 2-2½ million tons. But even this was less than was needed, as the events of 1951 demonstrated.

It is not easy to estimate at all precisely the future demand for steel. Post-war arguments on this subject were characterized by large discrepancies between the estimates of different experts. It is, however, a virtual certainty that private steel industrialists will underestimate the need. Owing to the high capital cost of building new capacity and the heavy overhead charges involved in its operation, they have a congenital terror of under-utilization, and this imparts a strong sub-conscious bias to their estimates of future needs. They instinctively prefer a shortage of capacity in a boom to an excess during a slump, and so tend always to play safe. This affords a very strong argument for nationalization if the necessary expansion is to be assured.

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Events have already proved the post-war plan to be quite inadequate, and even the new plan for 20 million tons in 5 years may be too over-cautious.

Many considerations suggest that we are on the verge of a period of rapidly-expanding demand for steel. Even a mere continuance of the pre-war secular trend would point to a substantial enlargement of capacity. From the boom period 1926-30 to the boom period 1936-40 home deliveries rose by one-half, and the same rate of increase over 1949-51 would give an additional home demand of nearly 3 million tons in 5 years (requiring a total output of 19 million tons), and over 7 million tons in 10 years (requiring an output of 23 million tons).

But of course this would be a quite inadequate rate of increase in view of the more rapid rise in the national income that is to be expected. During the post-war years consumption of steel was already rising faster than before the war — it rose by 33 per cent between 1946 and 1951, and this rate of increase would give a requirement of an extra 4 million tons by 1958, or 20 million tons in all.

But even post-war rates of expansion may prove inadequate once present restrictions on certain uses of steel (e.g. direct steel exports and home investment) are lifted, and in view of the required shift towards the metal-using industries. It has to be remembered that this shift of emphasis is much more likely to be accomplished if plenty of steel is made available, inasmuch as with steel, unlike other commodities, demand is very flexible and to some extent actually depends on the supplies.¹⁵ It should be the aim to make sufficient steel available for the re-deployment believed to be necessary, which is then more likely to occur. A projection of future demand based on past rates of increase is therefore not sufficient; it must instead be based on the assumption, not only that total output will expand faster than before the war, but also that the metal-using industries will increase their share in output more rapidly than in recent years.

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The three-fold increase in metal and engineering exports since before the war has required an additional $2\frac{1}{2}$ million tons of steel; at current prices, £100 millions of metal-using exports requires 350,000 ingot tons of steel.¹⁶ Thus if these exports are to rise by one-half in volume over their present level, this alone will require nearly 2 million extra tons of steel. On top of this, steel imports have been running at over half a million tons since the end of the war, while steel exports have been held below the level of foreign demand at $2\text{-}2\frac{1}{2}$ million tons — barely above the depression figure of the 1930s, and below the figure of the 1920s. In view of the large expansion in world industrial output that is in prospect, British steel exports could surely be raised by another 2 million tons per annum; even this would not bring them to a figure very much larger than the average of the period 1900 to 1930.

The export requirement alone thus involves an expansion in supplies of over 4 million tons, or an output of over 20 million tons. But in addition home investment, which absorbs three-fifths of the total output of the steel industry, must be enlarged as quickly as possible if this country is to achieve a rapid rise in productivity, while home consumption of steel must also be expected to rise as increases in income are taken out less and less in the form of food, drink, tobacco and textiles, and more and more in durable consumers' goods from the metal-using industries. Adding this additional home demand on to the increase in export needs, it seems that we shall need a total output in a few years' time of nearer 25 than 20 million tons.

These *ad hoc* considerations are reinforced by a comparison of steel consumption in different countries. In 1950 American *per capita* consumption of steel amounted to 1237 ingot pounds, compared with a British figure of 628 pounds.¹⁷ More serious, the gap shows signs of widening. The American figure has nearly doubled since before the war (as has the

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Canadian); but the British figure has only risen by 25 per cent. This suggests a very large potential increase in demand if British productivity and standards of life are to reach anything approaching the American levels.

This widening gap in consumption reflects the disparate rate of growth of production. U.S. output rose from 56 million tons in the best year of the 1930s to 93 million tons in 1951, compared with a British increase from 13 million tons to 16 million tons.¹⁸ If British output had expanded in the same proportion, it would already have reached 22 million tons by 1951. It is true that British output expanded faster between the 1920s and 1930s than American output, but making every allowance it is clear from the figures of consumption and production that we are still being left behind in the race. (Soviet output also rose by more than British compared with pre-war — from 18 million tons in 1939 to 34 in 1952.)

These international comparisons suggest that the long-run target should be set even higher than is suggested by a study of specific needs. We might fulfil the metal-using export target, and permit a moderate rise in capital investment, with a steel output of something approaching 25 million tons. But if we really wish to narrow the present gap between British and American standards of life, we shall clearly need to think in terms of 30 million tons before many years have passed.

V I

The other essential raw material is coal. Britain does not, like France and Switzerland, possess large hydro-electric sources of power nor, like the United States, abundant supplies of oil and natural gas; coal provides 90 per cent of the heat and power used. But since plentiful reserves of coal exist within our borders, this should not in theory constitute a disadvantage.

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Nevertheless, a persistent shortage of coal has bedevilled the national effort. Output in 1952, despite an 18 per cent rise since 1946, was still below the best pre-war year. But meanwhile industrial consumption had risen from 70 million to 90 million tons, and this additional demand could only be satisfied by severe restrictions on consumer supplies — which fell from 45 million tons in 1938 to 32 million tons in 1951 — and (much more serious) by reducing exports well below pre-war and far below the level of foreign demand. In 1929 British exports (including bunkers) were 61 million tons, and even in the 1930s they averaged 42 million tons; but the average of the post-war years was under 9 million tons, and British industrial output was only maintained at the cost of empty grates in every city in Europe.

The steady decline in British coal exports between the first and second World Wars was mainly due to the increasing development abroad of alternative sources of energy; total world exports of coal were declining during this period. But the low post-1945 figures were of course due not to a continuation of this trend of falling foreign demand, but solely to an inability to supply. The Ridley Committee estimated that 1951 exports fell short of demand by some 10 to 15 million tons; and since in addition domestic consumption would have been 5 million tons higher had supplies been available, the total supply deficiency at current prices was 15-20 million tons.¹⁹ This is an exceedingly conservative estimate.

The consequences of this export failure were most serious, especially in Europe, which for decades had relied on British coal. There is no measure of the loss of welfare caused by the resulting shortage of heat and power, but there is a direct measure of the economic loss in the expenditure of precious dollars on coal imports from the U.S. In 1947 36 million tons of American coal were shipped to the O.E.E.C. countries at a cost of \$337 millions, in 1948 25 million tons (\$275 m.), and in 1951, after an interlude of self-sufficiency, 25 million tons again. Besides aggravating

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the European dollar problem, the exiguous level of British exports naturally also worsened the U.K. balance of payments. If the pre-war figure of 40 million tons had been maintained, earnings of foreign exchange would have been higher by some £110 millions to £120 millions annually.

European demand for British coal should increase over the next decade. Polish exports are likely to be more and more attracted towards the industrializing countries of Eastern Europe and the Soviet Union, and the rise in European industrial production may outstrip the rise in continental coal output. The E.C.E. estimates²⁰ that the gap between supply and demand in Western Europe in 1956 might be wider than in 1951 by 20 million tons or, if Polish exports disappeared, 30 million tons. This would involve a large increase in imports of American coal up to a figure of 45 to 55 million tons annually.

This seems, it is true, a rather exaggerated calculation. It is based on the official plans of the O.E.E.C. Governments for a 25 per cent rise in their gross national products between 1951 and 1956 — a rate of $4\frac{1}{2}$ per cent per annum. This is just plain silly. The first two years of the quinquennium have passed with hardly any rise at all, and Europe will be extremely lucky if even half the proposed rise is achieved by 1956. The E.C.E. calculation assumes, moreover, a relationship between rising output and coal consumption signally at variance with that suggested by either the Paley Commission or the Ridley Committee.

But even if the figures of the likely gap are halved, there is still a large scope for increasing British exports to the Continent. To fill the gap and replace 1951 imports of U.S. coal might require an additional 35-40 million tons, and if Britain were able to seize this opportunity coal exports might rise to 40 or 50 million tons a year. It is therefore disturbing to find that the National Coal Board allows for a level of exports of only 25-35 million tons annually in the 1960s²¹ — a figure below that achieved even in the 1930s.

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The N.C.B.'s projection of internal demand, which puts it in the early 1960s at only 205-215 million tons, is even more curious. Already by 1951 inland consumption (at 207 million tons) was above the lower figure of the estimate, despite the restrictions on deliveries to the domestic consumer. And not only are there still unsatisfied demands today, but a further sustained rise in demand is certain. Higher real incomes will bring higher standards of comfort in the home, and so an increased domestic consumption; and, still more important, the required rise in industrial output will demand a much increased supply of coal — indeed the latter is a necessary condition of the former.

The Ridley Committee puts inland demand in 1959-63 at 232 million tons; the Federation of British Industries takes a more buoyant view, and sets it at 263 millions.²² Both bodies accept the Coal Board's mean figure of 30 million tons for export demand, and their projections of total demand are therefore respectively 262 million and 293 million tons, compared with the Coal Board's 230-250 million tons.

The Coal Board's figure thus shows a large deficiency even on the Ridley Committee's estimate.²³ But if it is accepted that exports might, if supplies were available, reach 40-50 million tons instead of 25-35 millions, the deficiency becomes enormous. All the indications are that demand will be much nearer to 300 million tons than to 240 million tons. Whether it is possible even to approach this figure of output without an exorbitant rise in costs is doubtful. In any event, the most drastic enforcement of fuel economy will be needed to free the necessary quantities for export, and a major re-orientation of thought and planning methods to secure a large transfer of resources into the industry.²⁴

VII

If the materials base can be thus broadened, the conditions exist for a rapid build-up of metal and engineering output.

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Coal and steel are the essential prerequisites. Without them, nothing can be done; with them, as the last few years have shown, a large expansion is possible.²⁵ The British economy, instead of relying, as now, too heavily on the older consumer industries which are obsolescent from an export point of view, would then be firmly based on the expanding metal-using industries with which the trading future so obviously lies.

Naturally there are risks in this policy, and if we have wrongly read the crystal we might find ourselves tiresomely saddled with costly excess capacity. The whole thesis of an imminent world scarcity of food and raw materials might turn out to be mistaken. Or sensational advances in agricultural productivity, combined with rapid technological progress in raw material utilization, might make the country much more self-sufficient, and so moderate the export target.²⁶ Or again, even if the suggested export expansion is required, it might come mainly from products whose material content is low; jet aircraft are an obvious example.

Some expert predictions, moreover, suggest rather lower requirements than those given here. The Paley Commission estimates that British demand for steel will only rise by 45 per cent over 25 years, which would give much more modest figures for the output required in 5 or 10 years' time. Again, it expects little further rise in Western European coal consumption, believing that the whole increase in energy requirements will be satisfied by oil supplies from the Middle East; and although this takes into account neither the foreign exchange difficulty nor the price-relationship between coal and oil, it is clearly a possible alternative.

All this raises serious doubts, and throws into relief the hazards of any ambitious long-term planning. But a careful weighing of the pros and cons has convinced the author that the risks must be taken. It was argued in the last chapter that although the evidence cannot in the nature of things be conclusive, and although the next three years may see

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primary commodities once again on offer cheaply, the weight of evidence does point in the long run to an accelerated rate of world industrial expansion, a shortage of primary products, and therefore the need for very high British exports of the advanced and complicated goods which alone will command a sufficient market. And quite apart from this, it is surely essential, in order to satisfy the strong and very proper pressure for rapidly improving living standards, to narrow the gap between British and American levels of production; and this alone would call for additional coal and steel in very large amounts.

Recent experience has shown, furthermore, that the tendency to underestimate future increases in output and consumption is far more common than the reverse. The annual *Economic Surveys* have pretty consistently underestimated the rise in production for the coming year. The steel industry's 1946 projection of future steel demand was outmoded within three years of publication. The Heyworth Committee²⁷ predicted a 20 per cent increase in gas sales by 1955; in fact there was a 23 per cent increase already by 1950. These examples suggest that the buoyancy and vitality of an economy working under conditions of full employment and not, as for so long in the past, of under-employment, are still not fully appreciated. This inveterate post-war tendency to underrate the possibilities of growth should be called to mind by those inclined to react sceptically to ambitious proposals.

But the finally conclusive argument is that the risks involved in not expanding the materials base are infinitely greater. Suppose we make the effort and achieve these large increases in capacity, and then the demand does not materialize, the result is merely surplus capacity in coal and steel — an additional cost, perhaps, but not a disaster. But suppose we do not expand capacity, and the need *does* materialize, the result is then disaster. The production will physically not be there, nor the required exports forthcoming, and we shall then be faced with the certainty of what we

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have so often barely avoided in the post-war years — insufficient imports to maintain full employment and adequate food supplies. The penalty of over-expansion is merely surplus capacity, the penalty of under-expansion is unemployment and impoverishment.

Even the risk of over-capacity is, in fact, not great. Both the coal and steel industries are at present operating very high-cost production units in order to satisfy current demand. If the heavy investment here proposed is made, but demand proves insufficient to absorb the extra output, then the less economic pits and steel-plants can be closed down, and the new investment will permit production at a lower average cost than now.

VIII

But suppose sufficient metal goods can be produced, can they be sold? Until recently all discussions of the export problem have concentrated on questions of supply. The limiting factor on exports from 1945-51 was for the most part insufficient output, and the characteristic market situation was one in which we could have sold more goods had more been available. But the trading climate has now changed, and the complaint is everywhere of intensified competition and a buyers' market. The question is therefore whether we can possibly sell these great additional quantities of goods.

What causes most anxiety is the recent resurgence of Germany. The revival of Japan is also disturbing, but relevant more to those types of goods (notably textiles) for which world demand is assumed in any event to be declining; Japanese competition can therefore be taken as having been partially discounted in the analysis of the nature of the export problem.

Before the war German and British exports of manufac-

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tures were roughly equal in value, and in many markets and many commodities Germany was Britain's most dangerous competitor. But for several years after the war German exports were virtually non-existent, and this wonderfully eased the British task of expanding exports by three-quarters. Since 1948, however, German recovery has proceeded at a spectacular pace, and German competition is now severe.

There is, it is true, a common tendency to exaggerate the extent of German recovery. Graphs of output and exports show such sensational rises since 1948 that people are inclined to forget the abysmally low figure from which they start. Even in 1951 West German industrial production was only 13 per cent higher than in 1938, British production 55 per cent higher; engineering production 19 per cent higher, British 87 per cent; chemical output 28 per cent, British 147 per cent. The volume of exports was barely above pre-war, British exports 79 per cent above; and their value was less than half that of British exports. Britain is still exporting five times as many cars as Germany. German oil-refining capacity is only one-quarter of U.K. capacity, and steel production, which before the war was higher than in Britain, is now lower. Britain thus still has an appreciable lead.

Nevertheless there is cause for anxiety. In the first place, an important fraction of Germany's pre-war trade went east to Central and Eastern Europe, where it was non-competitive with British goods; now that these markets are closed, there is a correspondingly greater pressure on the remaining markets. (The same applies to Japan and the Chinese market.) Thus what semblance there was of a pre-war division of markets has now disappeared.

Secondly, the commodity composition of German exports is more favourable than that of British exports from the point of view of future world demand. In 1951 metal and engineering goods accounted for 63 per cent of West German exports, but only 47 per cent of British, whereas the share of textiles was only 6 per cent for Germany and 20 per cent for Britain.

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Britain thus enjoys a less favourable structure for the development of engineering exports, and a greater transfer of resources will be needed.

Thirdly, however, and as a direct result of this, each favourable shift in the composition of British exports brings an additional *tranche* into competition with German goods, and the degree of commodity specialization between the two countries is gradually diminishing. The decline in British textile exports and the rise in chemical, metal and engineering exports has already brought a large additional range into the directly competitive field; indeed the whole expansion of U.K. exports since before the war has been in spheres in which Germany already specialized. This encroachment by Britain on the traditional specialities of her main competitor will make future rivalry continuously more intense.

If the same world trading conditions were to persist in the future as in the inter-war decades, there would be little hope, in the light of these considerations, of ever selling the additional quantities of goods. From 1913 to 1937 world output of manufactures doubled, but world trade in manufactures failed to rise. If this decline in the ratio of trade to output were to persist, it would be impossible to raise British exports to two-and-a-half times pre-war. To do so might mean capturing as much as one-quarter of the pre-war volume of world trade in manufactures, or more than the total of pre-war German exports.²⁸ This is not, of course, a serious proposition, and Britain's export task is hopeless unless the pre-war ratio of trade to output is at least maintained, if not enlarged, so that the expansion in U.K. exports need not make large inroads into the markets of our main competitors.

Fortunately the omens are not all unfavourable. There is strong evidence²⁹ that the relative fall in world trade between the wars was not part of a normal historical trend, but due to the unusual relationship then existing between primary and secondary prices. The temporary over-supply of

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primary-products, and the consequent fall in their prices, compelled the primary-producing countries to curtail their imports of manufactures to an unnaturally low level.

But if the future brings the sustained rise in primary relative to secondary prices that is suggested, the position will be reversed. The primary-producing countries will be rich in terms of foreign exchange, and their demand for manufactures will be high. Under these circumstances we are likely to see a large rise in the volume of trade in manufactures, and market conditions may be surprisingly favourable for both German and British exports — provided always that the necessary adjustments on the supply side are made, and that British exporters are as robust and energetic as their foreign competitors, both of which are far from certain.³⁰

There may be a further indirect effect of high primary prices, also favourable to the prospects for manufactured exports. One of the reasons why Britain's exports fell between the wars was the industrialization of many of her best customers. Attempts are often made by those with a hopeful bent of mind to argue that industrialization abroad does no damage to British exports — that it merely shifts the demand from consumers' goods to capital goods. There is some truth in this. But the substitution is not by any means complete, and on balance it is better for Britain that the less developed countries should not hasten on with industrial development too eagerly. A somewhat slower rate of industrialization would both sustain primary production by slowing down the trek from the countryside into the towns, and improve the prospects for British manufactured exports by maintaining a high degree of world specialization.

In the inter-war years the less developed countries were under strong temptation to industrialize by reason of the poor outlook for primary commodities. But the high primary prices of the future will pull things in the opposite direction, and governments concerned with acquiring the maximum foreign exchange incomes may go slow on indus-

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trialization, and concentrate instead on expanding food and raw materials output. In this way one persistent threat to British exports may be lessened.

There is plenty of evidence from British experience for the belief that exports of manufactured goods fluctuate with the prices obtained by primary-producing countries for their goods. It was found between the wars that a rise in primary prices and incomes, involving worsened terms of trade, invariably improved the ratio of U.K. export to import volumes; foreign demand for U.K. exports, which were (and are) mainly capital goods and high-standard-of-living consumer goods, showed a higher degree of income-elasticity than the British demand for imports (in which foodstuffs play a predominant part).³¹ This experience has been repeated since 1945. The only periods when British exports have fallen have been when prices and incomes in primary-producing countries were falling, and the U.K. terms of trade improving — during the U.S. recession of 1949 and the period of falling commodity prices in 1951-52. In all other periods, which have been characterized by deteriorating terms of trade, British exports have been faced with a lively sellers' market and have shown a steady upward rise.³²

This pattern is likely to persist. Nothing can alter the effects of worsening terms of trade on the standard of living, nor obviate the need for a painful transfer of resources out of treasured old favourites amongst industries into newer expanding ones. But if the conduct of affairs proves skilful enough to effect this transfer neatly, we may find the problem of selling the goods less formidable than some now think.

I X

But it is all a matter of conjecture. No one can foresee world trends at all exactly, and it might prove to be an

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absurd idea to think that we could sell so large a quantity of goods. If this were because the terms of trade did not deteriorate as here suggested, so that world trade in manufactures failed to rise, the result might not be too disastrous, since the need for such huge exports would then be less.

But if the terms of trade should deteriorate, and still we could not raise our exports — because the primary producing countries persisted in intensive industrialization, or foreign competition proved too fierce, or we failed to adapt our own economy successfully — then the only alternative would be a ruthless and permanent cut in imports. This would prove more disruptive, and more damaging to living standards, than the attempt to succeed by higher exports. Uncertain though the future is, it is surely better to *try* the export solution, and make the necessary changes for it, and only fall back on rigid autarky if the better solution fails.

NOTES

¹ For the reasoning behind these assumptions, *v.i.*

² The supply of developmental goods to the under-developed areas will not, of course, be necessarily confined to what this sum can buy. These countries will earn large exchange incomes from the high prices of their primary products, and with many of them, moreover, Britain must maintain a surplus in order to earn the gold needed to cover her dollar deficit. Thus in the ordinary course of international trade they will be able, if they so choose, to import investment goods from Britain on a very substantial scale, quite apart from what is provided by British overseas investment.

³ The ambitious refinery-building programme was particularly successful. The quantity of crude oil refined in Britain has increased ten-fold since 1945, with the result that we now refine a good deal more than we consume at home, compared with only 20 per cent of our home requirements in 1947.

⁴ Special articles in *The Times*, November 10th-11th, 1952.

⁵ 'Re-Thinking our Future' (*Observer* pamphlet, 1952), and

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'Survey of British Agriculture' (*Financial Times* Supplement, December 1st, 1952).

⁶ *Financial Times* Survey, op. cit.

⁷ The rise will not be even. Demand for aluminium, for instance, is expected to be twice as high in 1960 as in 1950, and the whole additional supply must come from imports (Cmd. 8702).

⁸ Even on the much more favourable assumption that the terms of trade revert to their 1950 level, the figure would still be nearly 210 per cent.

⁹ An excellent discussion of these points is to be found in an article by Austen Albu M.P. in the *Listener*, July 17th, 1952.

¹⁰ In Canada, for example, the U.S. has increased its share in Canadian imports of cotton piece goods from one-third before the war to three-quarters today, while the British share has fallen from one-half to 6 per cent.

¹¹ U.K. exports of cotton goods to the Argentine fell from 127 million sq. yards in 1937 to 3 million in 1950.

¹² For the reasoning on which this figure is based, *v.i.*

¹³ Within this group, vehicles (motor vehicles, ships, aircraft) contributed in 1951 20 per cent of total exports, machinery 15 per cent, electrical goods 4 per cent.

¹⁴ The generic notion of metal and engineering goods is here used, despite the known diversity of these industries in respect of market prospects, because space prevents a separate analysis of each sub-sector. For a brief such analysis, *v. AUSTEN ALBU, Fabian Journal*, March 1953.

¹⁵ I am indebted to Mr. Kaldor for suggesting this point to me.

¹⁶ British Iron and Steel Federation, *Monthly Statistical Bulletin*, March 1952.

¹⁷ B.I.S.F. *Bulletin*, December 1951.

¹⁸ B.I.S.F. *Bulletin*, February 1953.

¹⁹ *Report of the Committee on National Policy for the Use of Fuel and Power Resources*, September 1952 (Cmd. 8647), p. 3.

²⁰ E.C.E., 1951, chap. vi.

²¹ *Plan for Coal* (National Coal Board, 1950).

²² In its evidence to the Ridley Committee.

²³ In fact almost the whole increase in output envisaged by the N.C.B. would, if the development plans of the British Electricity Authority were to be fulfilled, be absorbed by new generating

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stations, leaving nothing extra to sustain the growth in industrial output, nothing for the housewife, nothing for export. This points to a sad lack of co-ordination between nationalized industries.

²⁴ The current position as regards investment in the coal industry does not suggest that a good start is being made. The Coal Board's plans for capital expenditure (*Plan for Coal*) were criticized at the time as too unambitious. Yet allowing for the rise in prices, investment in 1951 and 1952 appears to have been only two-thirds of the planned figure. It also appears to have been proportionately much smaller than that of the French coal industry (E.C.E., 1951, Table 75).

²⁵ There are, of course, other possible bottlenecks, but coal and steel look to be the most probable ones.

²⁶ Or the advance might come in the use of coal and steel themselves. An expansion in the output of the metal-using industries is even now accomplished with a less than proportionate increase in steel consumption; between 1946 and 1952 the output of these industries rose by about 65 per cent, but steel consumption only by 34 per cent (B.I.S.F. *Bulletin*, December 1952). This ratio might be further reduced in the future. In the case of coal there is enormous scope for economy if known methods of raising fuel efficiency are generally applied.

²⁷ Cmd. 6699.

²⁸ G. D. A. MACDOUGALL, 'Britain's Foreign Trade Problem', *E.J.*, March 1947, p. 91.

²⁹ It has been excellently marshalled by PROFESSOR ARTHUR LEWIS, op. cit., chapters XI and XII.

³⁰ v. Part II, chapter IX.

³¹ v. TSE CHUN CHANG, 'The British Balance of Payments, 1924-1938', *E.J.*, December 1947.

³² A striking illustration of this tendency is provided by the fluctuations of British exports to Australia during 1951-52. These showed a very exact correlation, allowing for time-lags, with movements in the price of wool.

VI

THE SECOND PROBLEM: DOLLAR SCARCITY

ALTHOUGH it is the 'structural overall' problem of the terms of trade that will cause most concern over the next two decades, it is for the moment, and will be for some time, overshadowed by the 'structural dollar' problem. As the first problem advances, the second will recede, since the U.S. will need to eject an ever-larger flow of dollars into world trade as she outruns her own material supplies and pursues the search elsewhere.¹ But for the moment, for Britain as for most countries, the central issue is the dollar shortage. An overall balance can, with an effort, be achieved, and was achieved in four out of the five years 1948-52. But dollar solvency eludes our grasp; and the events of 1949 showed that an overall balance is no guarantee against a catastrophic dollar crisis.

From 1945 to 1951 the world ran a current account deficit with the U.S. of between \$5 billions and \$8 billions annually, except for 1947 (when it rose to \$11½ billions) and 1950 (when it fell to \$2 billions). This world 'dollar gap' has been predominantly financed by American governmental aid (the British loan, U.N.R.R.A., the Marshall Plan, defence aid), which has varied between \$4½ and \$6½ billions annually. There is no sign that the gap is steadily diminishing — it was larger in the first half of 1952 than in 1950 or 1951. The expectations which underlay all the early post-war plans (the U.K. Loan Agreement, the I.M.F., the I.T.O., etc.) were of a brief transitional period of dollar scarcity, deriving from the contrasting war experiences of the unscathed Western and the devastated Eastern Hemisphere, to be followed by a stable equilibrium in which no currency would be exceptionally scarce, and very liberal trading policies

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could safely be pursued. This belief that the dollar scarcity was essentially a short-term problem, certain to disappear as post-war recovery proceeded, explains the various 'transitional periods' that were written in to the post-war international agreements. But the years set for the return to normal came and went, as did the Loan and Marshall Aid, with no sign of a closing gap or stable equilibrium, and today it is everywhere recognized that the dollar shortage is not a temporary and adventitious consequence of war, but a lasting and intractable structural problem.

II

There was not an enormous dollar gap before the war: in the 1930s the U.S. current account surplus averaged less than \$ $\frac{1}{2}$ billion. There was, it is true, a painful drain of gold across the Atlantic, but this was caused by movements of capital funds from an exposed and nervous Europe to the comparative (political) safety of Wall Street.

The growth of the surplus to \$5-8 billions post-war is to be explained by changes in the volumes of visible trade. The terms of trade are not responsible — indeed the U.S. terms of trade are now less favourable than before the war.² Nor are invisibles the cause; the change here is a mere \$ $\frac{1}{2}$ billion. But whereas U.S. imports have risen in volume since before the war by only one-quarter to one-third, exports have been higher by anything from 80 per cent (1950) to 160 per cent (1947); 1951, showing imports 26 per cent but exports 125 per cent higher, was a fairly typical year.

This gives the clue to the real nature of the problem. It has its fundamental origin in the natural creditor status of a country which constitutes overwhelmingly the world's largest producing unit, and which is therefore far less dependent on the world outside for imports than the world outside is dependent on her. The U.S. now produces more than 40

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per cent of the world's manufactures, yet at the same time can largely feed herself and (as yet) provide herself with raw materials. The natural propensity to import is therefore low, the capacity to supply a world still hungry for goods exceedingly high.

The tendency to self-sufficiency was already noticeable in the inter-war decades, and from the 1920s onwards there was a definite decrease in the relative dependence of the U.S. on imported commodities. The Western Hemisphere as a whole increased its share in world production of most of the important primary commodities — amongst others, cotton, rubber, copper, zinc, tin, coal, wheat, sugar and maize;³ and American imports, as a proportion of gross national product, declined from 4.2 per cent in 1925-29 to 2.8 per cent in 1935-39.

But the economic dominance of the U.S.A. has become much greater in the last fifteen years. Continued large increases in U.S. output, combined with less rapid increases elsewhere (and in some cases actual declines), have still further increased the American share in world output not only of industrial but also of primary commodities. The U.S. is now even more (relatively) self-sufficient, and the rest of the world even more dependent on U.S. supplies, so that although the total supply of dollars is higher, the U.S. surplus has risen by far more. The greater self-sufficiency is measured by the fact that although the national income has doubled imports are higher only by 25-30 per cent, and as a proportion of gross national product have now fallen to 2.6 per cent.

It was the declining ratio of imports to national income which was the most obvious cause of surplus before the war, and which even now attracts the most discussion. But in fact the larger influence accounting for the growth in the surplus since pre-war has been the rise in world demand for American exports.⁴ This has been rather neglected. It arises generally for the reason, mentioned above, that U.S. output

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constitutes a very large proportion of world output, so that the rest of the world finds it hard to maintain high levels of consumption and production without large dollar purchases. American prices are often low and quality high, and, above all, supplies are much more elastic than elsewhere, since in most cases U.S. exports constitute only a fractional share of total U.S. production. Not only, therefore, are American goods of competitive price and quality at all times available to a world that badly needs them, but any sudden rise in world demand for goods is concentrated on the U.S., where alone the additional supplies can be obtained. This was a world-wide phenomenon in 1951, when the main cause of the dollar crisis was not any large fall in U.S. imports, but a huge rise in U.S. exports. Persistent examples of this tendency have been the European demand for coal, and the British demand for steel; in each case marginal supplies, when needed, have been procurable only from America.⁶

The combined availability and attractiveness of U.S. goods make a permanent solution of the dollar problem particularly difficult. When the world supply of dollars becomes plentiful after a period of large American purchases, what should happen is that the extra dollars go directly to strengthen currency reserves. What actually happens, so strong is the attraction of American goods, is that they are at once spent on higher dollar imports, and all the gains are dissipated. This happened in both 1949 and 1951, when periods of comparative dollar plenty set off a rush for American goods, and the improvement was all undone; indeed the last position was worse than the first, since by the time American exports had risen in response, imports, always unstable, had fallen again, and the deficit was larger than before.

The other change from pre-war relates to the means of payment. In the 1930s, the unbalanced character of merchandize trade was offset by American payments of investment income to the rest of the world, and by transfers of

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gold, the commodity purchasing power of which was, by historical standards, at that time high. But since then, as the unbalance has grown, so the means of settling it have shrunk. A large part of the world's dollar investment income has gone for ever, and gold has a much reduced value in terms of dollar goods. The post-war pattern of trade could thus be sustained only by large subventions of dollar aid.

III

The question is whether there are any possible methods of closing the dollar gap other than by a large reduction in the world's purchases of American goods.

First, U.S. imports. Two-thirds of these consist of raw and semi-manufactured materials, which in the short run depend overwhelmingly on the level of the national income. But over a longer period a secular trend towards greater independence of foreign supplies is noticeable; the ratio of the value of imported materials to the total value of U.S. manufactures has fallen from 7-8 per cent two decades ago to 3-4 per cent today.⁶ In ten years' time the influences described by the Paley Commission will no doubt be operating to reverse this trend, but over the next five years no large increase in imports is in prospect. The national income is not likely, in a period which may cover a pronounced recession, to show a very big expansion, while certain developments in the synthetic field (notably natural fibres) may in the short run further reduce the ratio of imports to industrial output.

As with materials, so with food, a steady trend towards self-sufficiency can be noted. Twenty years ago 4-5 per cent of total food supplies were imported; today the figure is 3 per cent, and in addition much larger quantities of food are sent abroad. In the long run, again, the expected acceleration in population growth may turn even the U.S. into a major

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food-importing country, but there is no sign that this is due to happen soon.

Great hopes are sometimes pinned on large increases in manufactured imports, if only tariff barriers could be lowered. This is a doubtful prospect. Such imports are largely confined to traditional high-quality consumer goods appealing to a Europeanized upper class on the Eastern seaboard (Scotch whisky, Jaguars, European-style clothes and shoes, Swiss watches, Gorgonzola, etc.). But each egalitarian twist to the distribution of incomes, and each further shift in the centre of economic gravity away from the East, threatens even existing markets, and although most creditable victories have been scored in new directions,⁷ they have all been on a limited scale. Indeed it must always be an uphill struggle to break into American manufacturing markets in view of the tendency for American industrial efficiency continuously to outstrip European.

A further reduction in tariffs would make little difference. Only \$1 billion of imports out of a total of \$7.9 billions is now subject to duty. Since 1937 tariffs have been reduced by an average of 60 per cent without any very spectacular result. In the words of an authoritative American commentator, 'the actual increase in U.S. imports which can be attributed to reductions in the American tariff and other trade barriers during the past two decades is certainly small in relation to the cyclical and secular increases during the same period. So also is the potential increase which might result from further reductions in these barriers'.⁸

In any event, the outlook for further reductions is not bright. American industries have recently been applying in increasing numbers to the U.S. Tariff Commission for the revocation of duty reductions already granted, and with a Republican Congress in the saddle, and a widespread fear of recession, there is no likelihood of a sudden surge of liberal opinion in the direction of free trade.

Of course the non-dollar world has the right to reiterate,

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especially when pressed by Americans to make risky concessions to liberal trading notions, that protectionism, whether in the form of tariffs or other devices,^{*} should be held inconsistent with a creditor position in world trade; and suggestions for dismantling trade controls, when they come from protectionist Republican quarters, may very properly, and even resentfully, be thrown back. But the tariff issue is really more important as a bargaining counter than as a major factor in the world dollar situation (although naturally individual industries can be found which have a very strong interest in the matter; and Britain in particular has much more to gain from duty reductions than most other countries).

Some increase in the American national income will occur over the next five years, though probably a less rapid one than in the succeeding five years. A small absolute rise in imports is therefore a reasonable hope. But it cannot possibly be large enough to cure the world dollar shortage, and in any case it is far from being a certainty. Imports have been held up in recent years by a level of business activity that only once (briefly in 1949) fell below a conventional definition of full employment, and over a large part of the period was clearly inflationary in character. It may be that the secular rise in the national income will be offset in the immediate future by the effects of recession, in which case the world would have to wait some years before witnessing any rise in American imports at all.

The next item to be considered is the invisible account. *Hôteliers*, Tourist Association officials, and the late Lord Keynes have all painted very optimistic pictures of a flood of American tourists lavishly spending the U.S. out of surplus into deficit. These hopes are much exaggerated. Apart from the fact that most American tourists go across the border to Canada or Mexico, the sums involved are small; in 1951 net American tourist expenditure was \$150 millions, so that even a doubling would make only a fractional difference to the total gap. Not much can be expected from shipping

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earnings, since the American merchant marine is heavily protected and subsidized against too much competition from foreign fleets. Expenditures by American armed forces stationed abroad are much more important than either tourism or shipping, but they cannot be relied on for a very large increase from their present high 'Cold War' level.

An increase in the price of gold is a perennial hope, especially in the breast of Mr. Havenga and (presumably) the Soviet Minister of Finance. It is a consummation strongly to be desired, despite the politically rather awkward distribution of the ensuing gain. There can be no two opinions about the quantitative significance of the matter. Had the price of gold risen since 1938 by as much as U.S. commodity prices, the Sterling Area would have had a dollar surplus in each post-war year except 1947 and 1951, and the gold reserves would now be 3-4 times higher than they are. But the American Government is adamant against an increase, and although no harm can come from continued agitation and vociferation on the subject, this is more likely to maintain morale than to convince the U.S. Treasury.

A more hopeful development lies in the strengthening of N.A.T.O. Large sums of defence aid are already paid to Europe, and some of these are spent on off-shore purchases (e.g. British aircraft for France and Belgium), the dollar payments for which are equivalent to an ordinary increase in dollar exports by the supplying countries. If the Atlantic mood were to strengthen, and a centralized N.A.T.O. purchasing organization were to be set up, the supply of off-shore dollars to the more efficient European economies might show an important increase. But again there is no assurance, with an economy-minded U.S. Congress, that either the necessary funds or a wider discretion to spend off-shore will in fact be conceded.

Lastly, American foreign investment might fill the gap. This would, after all, be the classical solution. As American material supplies contract, it may be applied. The strongest

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inducement to foreign investment has always been the need to replace dwindling (or non-existent) indigenous supplies of primary products by new supplies elsewhere. It is not surprising that the American oil companies accounted for the largest share in post-1945 U.S. private investment abroad, or that much of the remainder was directed to the exploitation, mainly in Canada and South America, of new discoveries of raw materials.

But the prospects of a large expansion are not good. The inducement is not yet strong enough, whereas memories of the painful experiences of the 1920s still persist. The American private investor, like his counterpart elsewhere, is nervous of venturing into a world of growing nationalism in which restrictions on dividends and even the expropriation of capital are real risks. Dr. Moussadeq was not exactly a bullish factor in the foreign capital markets of the world, and he is unlikely to be the last in the long line of nationalist leaders who have found that attacks on foreign capital are the quickest way to mass support. Under these circumstances there is no reason to expect American private investment abroad to rise much above its average post-war figure of $1-1\frac{1}{2}$ billion dollars.¹⁰

More can be expected of Governmental investment. Many ambitious and enlightened plans for a large flow of dollar aid to the under-developed countries have been proposed by the Americans themselves (the Point Four Programme), by international bodies, and most of all by benevolent British observers. Such a flow would be wholly desirable, quite apart from considerations of the dollar gap, on humanitarian grounds and for expanding raw materials supplies. Indeed nothing effective can be done about the under-developed territories, from either a welfare or an economic point of view, without American funds — a fact which should be remembered by those who think that a humanitarian concern with the backward peoples is quite consistent with a strongly-developed anti-Americanism.

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But whether Point Four investment will actually materialize on a sufficient scale to close the gap is still uncertain. Undoubtedly the idea has aroused strong idealistic sentiments amongst the American people, and these are reinforced by more hard-headed considerations of anti-Communist politics. On the other hand, a Republican Congress may not be disposed to vote larger appropriations for foreign aid, so that even if grants to the under-developed countries do increase they may do no more than offset a fall in aid to Europe. The outcome will depend mainly on political factors, and prophecy is really a matter of political guesswork. But clearly the outlook is too uncertain to warrant the assumption that here lies an easy cure for the dollar problem which requires no effort by the other nations.

The conclusion is that nowhere can developments be detected which of themselves will close the gap. The supply of dollars will not, over the next five years, show any large increase, and the world must therefore accommodate itself to the existing supply, and restrict its purchases of American goods accordingly.

I V

Already restrictions on dollar expenditure are widespread. But that they have been too mild is shown by the persistent tendency to unbalance, and in particular by periodic sharp increases in dollar imports which never fail to cause a crisis. No one who cannot rebut the case presented here, against expecting a rise in the supply of dollars, can avoid the corollary that the adjustment must come from the side of demand, i.e. by further restricting dollar purchases until a balance is reached. All suggestions for the contrary policy of relaxing restrictions, and so releasing additional demand, must be countered by asking where the additional dollars are expected to come from. If no good answer is forthcoming, they must be rejected.

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It is, after all, only simple prudence for the rest of the world to lessen its dependence on the U.S.A. Since the fundamental disequilibrium is due to the predominant American share in world output, the only way of restoring equilibrium is to raise output elsewhere, and then to switch purchases from the old dollar sources of supply to the new non-dollar sources.

The essential condition of durable equilibrium — short of large-scale U.S. investment of which there is no sign, and in the intervening period before the exhaustion of her own material resources forcibly diminishes her share in world primary output and directs her purchases abroad — is thus a large rise in world production outside the U.S. (both primary and secondary — Rhodesian tobacco and British engineering goods are equally relevant), combined with an agreement amongst the non-dollar countries to buy each other's increments of output in preference to dollar goods (i.e. an agreement to discriminate). Only thus will the world's dependence on dollar goods be diminished in the critical interval before America's dependence on non-dollar goods begins to grow.

v

The structural dollar problem is distinguished from the cyclical problem raised by the trade cycle.¹¹ But without bringing American booms and slumps into the picture, there is still a problem of stability to be considered. American imports are liable to large and sudden fluctuations even while business activity remains at a virtually 'full employment' level. This is because so large a part of them is on the margin of consumption. The consumer goods element consists largely of specialized luxury goods for which the demand falls off very rapidly in the event of a small decline in income. The greater part consists of raw materials, but

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here also they are normally marginal supplies, and so fluctuate more than proportionately in response to any change in the level of industrial activity. This fact of an unusually high marginal propensity to import imparts a high degree of instability to the total world supply of dollars, and the rest of the world needs both large reserves and exceptional self-restraint in the face of it.

Furthermore, the fluctuations are exaggerated by the sensitivity of inventories to small changes in activity, which means that the trend of current demand is often swamped by changes in inventory policy, as in 1950-51; and again by the fact that for many primary products U.S. demand is so large a part of world demand that small changes in it have serious effects on the prices of imported commodities as well as on their volume.

It has been calculated that a fall of 4 per cent in consumption and 6 per cent in the gross national product induces on the average a 24 per cent fall in the value of imports.¹² This calculation takes mainly pre-war experience into account, but there is no sign that the post-war relationship is significantly different. Comparing 1949 with 1948, a mere 1 per cent fall in the national product, with no fall in consumption, led to a 7 per cent decline in imports. The following fluctuations all occurred within a 3-year period:

TABLE 7

PERCENTAGE CHANGES IN VALUE AND VOLUME OF U.S. IMPORTS

	<i>Volume</i>	<i>Value</i>
From 4th Qr. 1948 to 3rd Qr. 1949	-13 %	-21 %
„ 3rd Qr. 1949 to 3rd Qr. 1950	+36 %	+40 %
„ 1st Qr. 1951 to 4th Qr. 1951	-19 %	-19 %

(Source: E.C.E. Annual Surveys.)

These are the sort of swings that the world must learn to live with. They are certain to continue into the indefinite future, since they reflect changes in the level of activity that

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fall far short of a major slump¹⁸ and are probably unavoidable in a productive system of that gigantic size.

VI

The dollar shortage is of so fundamental a character that it is likely to persist (at least in the sense that restrictions on dollar purchases are required) at almost any level of business activity in the U.S.A. The only exception would be if a condition of violent inflation were to exist. If U.S. monetary demand consistently exceeded the value of current home-produced output, so that queues and waiting-lists were general, it would spill heavily over into imports, and moreover only negligible supplies would be available for export; an upward movement of wages and prices would no doubt reinforce this tendency, and a dollar balance might conceivably result. British cars, for example, enjoyed impressive American sales in 1948 when the U.S. motor industry still had not cleared off its post-war waiting lists; and the inflation of winter 1950-51 raised the volume of U.S. imports by one-third over the level of a year before (though stock-piling also played a part in this).

But of course it is absurd to expect America to endure a degree of inflationary pressure quite incompatible with price stability in order to solve the world's dollar shortage. It is equally absurd to ask the non-dollar world to seek a cure by deflation. Naturally there must be some level of income at which people would have to forego dollar goods to the extent of giving a dollar balance. But the fall in incomes, to be effective in cutting out less essential dollar imports, might need to go to the point where it would involve starvation in India and mass unemployment in Britain. A deep-seated structural disequilibrium of this kind defies solution by means of textbook changes in income (or prices, for the same argument can be applied to exchange-rate movements), since to

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be effective the changes would involve a degree of inflation in the surplus country and deflation in the deficit countries that both would rightly consider unbearable. Changes that were tolerable and in themselves desirable (i.e. the mere absence of deflation in the creditor country and inflation in the debtor countries) would not, on the other hand, as the last few years have shown, be effective.

But although there is no tolerable level of U.S. internal demand which of itself will close the gap, nevertheless the actual level of demand will largely determine, through its influence on the volume of imports, how wide the gap is to be. With a high average level of U.S. employment the problem is, with an effort, soluble; with a low average level, the dollar stringency will be so intense as to compel restrictions on dollar purchases quite inconsistent with the maintenance of present living standards in the non-dollar world. So far it has been tacitly assumed that the secular tendency in America was towards a high average level of employment, so that apart from actual depression years the level of imports would be at least maintained. This assumption must now be examined.

V I I

It is always dangerous to prophesy about the future of the American economy; no kind of prophecy has a more regular history of unredeemed error. Most economists seem to have taken warning from the long parade of penitents amongst their colleagues who successively came to grief by predicting a post-war slump which never came; and statements about the future are now noticeably more tentative. But some general notion of future trends is a necessary condition of intelligent policy-making.

If one were to judge by opinion in America itself, the outlook would seem almost desperate. Ever since 1945, despite

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record employment, output and incomes, the one conviction that has united workers and capitalists, Democrats and Republicans, laymen and economists, has been the conviction that a major depression was just around the corner. The entire American public appears to be suffering from the most painful hangover from the Great Depression of the 1930s. 'Measured by its continuing imprint on actions and attitudes, the depression clearly stands with the Civil War as one of the two most important events since the Revolution. For the great majority of Americans World War II, by contrast, was an almost casual and pleasant experience.'¹⁴ The consequence of this traumatic experience is that the present generation of Americans suffers from a neurotic disbelief in the economic prospects of the system for which it outwardly evangelizes most eagerly.

Yet a dispassionate survey of the evidence suggests a more hopeful view. There is no sign, it is true, that the U.S. economy is wholly purged of cyclical influences; its very size, its decentralization of economic decisions, and the fact that the decisions are made primarily in response to profit-expectations, are all a guarantee that booms and slumps will recur. There is evidence, however, that the fluctuations will take place round a higher average level of employment than between the wars, and that the typical situation will be a good deal less deflationary.

(1) Despite the universal expectation of a post-war slump, the U.S. has now enjoyed eight years of full employment, interrupted only by a brief and minor recession in 1949 when unemployment rose for a month or two from 1½ million to 4 millions (compared with 12 millions in 1932-33). Most significant was the strength and assurance of the recovery from this recession — a recovery, it must be remembered, which owed nothing to Korea or rearmament. The whole performance was appreciably better than in the corresponding years after 1918.

(2) The very fact of eight years' stability is itself an

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influence making for future stability. The obstinately difficult feature of the trade cycle is the expectation of a *cumulative* increase or decrease in prices, incomes and sales; it is this which leads to the bunching of investment-decisions in the upswing, and their total collapse in the downswing. But if such a movement is not expected, but only a change which peters out in a short time, then the main de-stabilizing influence is removed. When recent experience has been of a markedly cyclical character, then expectations, being coloured by the immediately prior cumulative movement, themselves have this cumulative quality. But if the prior period has been one not of cyclical swings but of stability, it is much less likely that they will have this character. There will have been no violent movement in one direction leading men to expect an equal and opposite movement; nor will there have been a period either of abnormally high or of zero investment creating pressures (through capital satiation or scarcity) for a sweeping change in the reverse direction.

The unusually prolonged stability must already have gone some way to weaken the cyclical element in business expectations; and if a really deep slump can now be avoided, the cyclical imprint need never again be quite so strong. Although causes of instability still remain, future fluctuations should therefore be more moderate in character, and not reach all the way from textbook 'floor' to textbook 'ceiling'.

(3) The rate of population growth is now faster than in the inter-war years, and this tends to be a bullish factor.

(4) The distribution of incomes is now more equal. In 1929 the top 5 per cent of income-recipients took 34 per cent of the total post-tax incomes of individuals, in 1939 27 per cent, and in 1946 18 per cent. This must create a steadier and higher level of consumption demand.

(5) There are now in addition certain specific stabilizing influences on consumer demand. First, the increase in social

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security benefits, notably unemployment payments, places a floor under a considerable part of consumption expenditures. Secondly, and more important, the price-support programme guarantees farmers an assured income in the event of a fall in prices, so that government expenditure on farm products rises automatically as private expenditure falls off. Thirdly, income-tax, which now plays a much larger part in government finance, acts as an automatic stabilizer inasmuch as tax-payments fall more, and available income less, than proportionately in the event of a fall in income. There is thus a degree of 'built-in' stability which did not exist in the 1930s.

(6) There has been, as a result of the New and Fair Deals, a pronounced shift in the balance of power towards the two groups traditionally the worst hit by a depression — the workers and the farmers. A Republican administration may do something to restore the old balance, but that its field of action is very restricted is shown by the fact that Mr. Eisenhower found it necessary to outbid the Democrats in his promises to the farmers, and to appoint as his Secretary for Labour a Democratic Trade Unionist. The greater electoral power of these two especially vulnerable groups will ensure a very heavy pressure on any government to take measures against a slump.

(7) More generally, public opinion has greatly hardened on the subject of full employment, and no longer passively accepts the view that nothing can be done. It may be that the climate in Washington is now less favourable. But it has to be remembered that the Republicans found it necessary to place a full employment pledge in the forefront of their election campaign, and that as a party hitherto associated in the public mind with depression both they, and the business community which has contributed so large a part of the present Cabinet, are under heavy obligation to prevent a slump, since they know full well that their chances of winning a second election are small if they confirm by their actions

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(or lack of actions) that they are still the party of depression. Moreover public professions of rugged individualism are no evidence in America, as the farmers have shown, that their authors will not demand state action of the most interventionist character if economic self-interest should require it.

(8) The techniques of anti-depression policy are now much better understood, and action when it came would be more effective than the gallant but inchoate efforts of the Roosevelt New Deal. A vast literature on compensatory fiscal policy now exists, and has influenced official thinking. Monetary policy has already been used in recent years to influence the level of business activity, and control over consumer credit to raise or lower consumption expenditures. State and Federal public works projects are accepted as part of the normal order of things. A Republican administration may delay action for a few months longer than otherwise, but there is no reason to doubt that the action, when it comes, will be crudely effective. (And the U.S. is fantastically far in advance of Britain in its knowledge of economic trends; information about proposed consumer spending and capital outlays by business is such that the danger signals will be visible well in advance.)

(9) The size of the Federal Budget is now much higher, relative to gross national product, than in the 1930s, even at the height of New Deal spending. This is perhaps the most important change of all. Whatever Republican propagandists may say at election times, a large part of this expenditure is inviolable; social security payments cannot be cut, and so long as the cold war persists there is a high limit to the reductions which can be made in foreign aid.

All these changes from the 1930s point to a significantly different pattern of behaviour in the future. Of course one must not exaggerate them. The fact that the whole of the quite abnormal post-war demands — first the pent-up demand from consumers and businesses for goods unobtainable for five years past, later the very high appropriations for

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Marshall Aid, and last the rearmament programme — could be accommodated without a runaway inflation shows what an enormous volume of aggregate demand is necessary to keep resources fully employed. The present level of investment, moreover, is probably higher than is required by the long-run needs of population and technological advance.¹⁵

The U.S. economy therefore still possesses a slight bias towards deflation, and the 'normal autonomous' level of activity, if one may use a crude concept, may still not suffice to give continuous full employment. Moreover cyclical influences have not been finally eliminated, and it is more than likely that a recession will occur at the end of rearmament.

But the deflationary bias is weaker: the techniques for counteracting it are more efficient: the public pressure for using them is stronger: and post-1945 experience proves that the bias can in fact be corrected by government expenditures. It is a fair conclusion that future fluctuations in employment will themselves be less severe, and will take place round a higher average norm, than in past decades; 1937, not 1929, may be the typical depression. One may quote a recent judgment by an American economist. 'Speaking with all the caution which broad generalization requires, the experience of recent years suggests that there are no problems on the side of depression or deflation with which the American economy and polity cannot, if it must, contend.'¹⁶

NOTES

¹ *v.* p. 87.

² Though they have improved with the Sterling Area.

³ For details, *v.* E.C.E., 1949, Table 87, p. 165.

⁴ As was to be expected, the rise in U.S. exports has been least obvious in the case of raw materials. In 1949, the total volume of exports was 242 (1934-38 = 100), within which crude raw materials were 125, foodstuffs 559, and manufactured goods 285. (Source: E.C.A., *op. cit.*, Table 32.) It is striking how far the

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post-war dependence on American supplies has been due to world food shortages.

⁵ There are, of course, some important exceptions to the statement that American exports are marginal in relation to home deliveries, notably wheat, cotton and tobacco.

⁶ The figures in this paragraph and the next are taken from the *Economist* Special Supplement, 'Living With the Dollar', November 22nd, 1952.

⁷ e.g. civilian jet aircraft, sports cars, motor cycles, and even on occasions heavy electrical equipment.

⁸ DR. AUGUST MAFFRY, *Lloyds Bank Review*, October 1952.

⁹ Such as the Buy America Act applying to Federal public works contracts: import quotas laid down under the Defence Production Act: the deliberately intricate customs procedure: the subsidies to the Merchant Marine: and the stipulation that at least half of foreign aid shipments should be carried in American bottoms.

¹⁰ Nor indeed would this be a desirable way of filling the dollar gap; there are both political and economic objections to relying too heavily on private capital investment.

¹¹ *v.* Part II, chapter VIII.

¹² E.C.A., *op. cit.*, p. 43.

¹³ During the 1929-33 slump, the value of imports fell by 70 per cent.

¹⁴ J. K. GALBRAITH, *American Capitalism: An Analysis of U.S. Economy* (Hamish Hamilton, 1952), p. 69.

¹⁵ The main reason why the minor recession of 1948-49 did not develop into something more serious, despite the very heavy fall in inventories, was the unruffled behaviour of fixed investment, which showed scarcely any fall at all. This was decisive in sustaining total demand in the dangerous early days of the downturn. But eventually fixed investment must fall from its present high levels, and then matters will be graver.

¹⁶ GALBRAITH, *op. cit.*, p. 193.

VII

CONSEQUENCES FOR THE STERLING AREA

BRITAIN is, and has been, worse hit than other countries by the dollar shortage. The central part which foreign trade plays in the national life makes her unusually vulnerable to any adverse influence from abroad. She always had a trading deficit with the dollar area, but the means of settling this deficit have now been largely destroyed — by the forced sale of dollar investments, the lower purchasing power of gold, and the lessened possibility of earning dollars in trade with third countries. There is the further complication of the Sterling Area dollar pool, which means that movements in the reserves are a function of the behaviour of other (largely uncontrollable) countries as well as of her own.

The serious effect on the U.K. of the weakening of the multilateral system of payments has been rather neglected. Britain, far more than most countries, has always run large surpluses with some trading areas and large deficits with others. This is inevitable, and in normal times desirable, for a country that relies on so large and varied a volume of foreign trade. But it carries with it a high degree of dependence on the existence of multilateral settlement, on the possibility, that is, of using the proceeds of the surpluses to cover the deficits.

Since the war, however, multilateral settlements have not been possible on a large scale, owing to the general non-convertibility of currencies (other than the dollar), and the existence of large quantities of accumulated sterling available to the world for financing deficits with Britain. British deficits with the dollar area have therefore required to be settled in dollars, but surpluses with other areas have not

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earned dollars or currencies convertible into dollars. In 1948 and 1949, years in which the U.K. current account was in approximate balance, Britain had gross surpluses and deficits each amounting to some 1200 million dollars. Yet only 40 (in 1948) and 400 (in 1949) million dollars of the proceeds of the gross surplus were 'compensable', i.e. could be used multilaterally to offset the gross deficit.¹

This general inconvertibility arose, of course, from the fact that one major trading nation was consistently in a creditor position, so that the circle of multilateral payments could never be closed. Its consequence for Britain is that even if the overall account is in balance there is still a dollar drain amounting to some very large fraction of the sum of deficits.

For all these reasons it proved impossible, as Part I, chapter III has shown, to achieve permanent dollar viability in the post-war world. It is true that a Sterling Area balance could be attained for short periods, given exceptionally favourable conditions. But such periods always proved too good to last, and the characteristic situation was one of deficit. Important changes in policy are evidently required for a durable equilibrium.

II

Nobody supposes that the United Kingdom can ever again enjoy the luxury of as large a dollar trading deficit as before the war. The means of covering it are largely destroyed, and the overseas Commonwealth, with more urgent needs relative to its dollar income, cannot contribute an offsetting surplus (counting gold) of the pre-war magnitude. A large measure of adjustment to these reduced circumstances has already been made; dollar imports are much lower than pre-war, and dollar exports higher.

But clearly a further reduction in the direct U.K. deficit

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is still required. A big effort must be made on the side of dollar imports. These are fairly equally divided between raw materials, food, and manufactured goods.² Some direct import-substitution may be possible over the years as the oil-refinery programme is completed, as the output of wheat from British farms expands, and more particularly as a larger and more varied production of engineering goods enables us to dispense with the still considerable machinery imports. But the main hope lies in the further development of alternative sources of supply in the Commonwealth, and the gradual switching of purchases to them: Rhodesian tobacco and copper, aluminium on the Volta River, bauxite in India. No amount of discouragement or political misrepresentation over the groundnuts scheme must be allowed to interfere with essential dollar-saving colonial investment; and British Governments will have to be adamant in preserving the right to discriminate, for as far ahead as one can see, in favour of new sterling sources of supply.

But cuts in imports, after the immense efforts already made in this direction, will be neither easy nor swift to take effect, and it would be quite wrong to look to them for the whole adjustment. Exports must also be expanded. The public mind is much confused on this. Great pessimism is expressed, much of it justified, about the possibilities of exports to the U.S.A. But it is not necessary to balance our trade with the U.S.A. in order greatly to reduce the total dollar deficit. As we have seen, two-thirds of Britain's dollar payments are not made to the U.S. at all, but to third countries — Canada (which accounts for one-third), certain South and Central American countries, and (periodically) Europe.

Now there is no reason why the deficit with these other hard-currency areas should not be greatly reduced. The Western Hemisphere nations all fall into the category of developing countries, with a high demand for engineering goods. This applies particularly to the most important

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market, Canada, which is evidently on the threshold of a period of sensational expansion. Her population is likely to increase by anything up to 25 per cent over the next decade, and income per head is rising rapidly with the development of industry and the exploitation of exceptionally rich mineral resources. No market in the world offers greater possibilities, and Britain will be held guilty if she cannot seize them. Her share in Canadian imports has fallen since 1938 from 20 per cent of the total to 12 per cent, while that of the U.S. has grown from 60 per cent to 70 per cent; American exports of machinery to Canada are 16 times as high as similar British exports. Thus there is much lost ground to be made up. The Gilpin Mission has already reported, what even the uninstructed newspaper reader can perceive, that the prospects for British engineering goods are excellent, and this is a further and immediately urgent argument for the policies outlined in Part II, chapter v.

Latin America, which contains several 'American Account' (i.e. dollar) countries, also offers a challenge. The British share in Latin American imports has fallen from 25 per cent in 1910 to 12 per cent in 1938 and 7 per cent in 1951. The U.S. now supplies one-half of the total, and markets have recently been lost also to Germany. Considering the rate at which this Continent is developing, an expansion of British exports is certainly possible. But there is no sign that either government or industry is making the required sales effort, and complaints about the passive attitude of British exporters, as compared with their American and German counterparts, are much too common.³

The aim should be to reduce to a very low figure the deficit with these third hard-currency markets, so that net dollar disbursements are mainly confined to covering the deficit with the U.S., which, after a further reduction in British imports, should normally be of a modest character. This is not an impossible task — after all, in 1950 Britain was all but in balance with Canada — provided that the

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right internal policies are adopted and that exports can be prevented from going in too large a quantity to soft markets.

This new pattern of trade will not everywhere be popular. It involves, for example, not running so large a deficit with Western Europe that gold payments are involved. This is a break with the traditional pattern of trade whereby Western Europe financed a large part of its gold requirements from Great Britain, which in turn secured the gold from the overseas dependencies. But now that this gold is coming in much-reduced amounts, Britain can no longer afford to pass any of it on to the Continent, and trade in Europe will never revert to the pre-war pattern.

III

But however vigorously Britain tackles her own dollar account, she cannot be made responsible for eliminating the whole of the Sterling Area's dollar gap. Judged by the changes from pre-war, she has already done more than her share, and her dollar accounts now show a greater improvement, allowing for price-changes, than those of the R.S.A.⁴ The latter group must therefore bear some of the onus of adjustment.

A consideration of the basic structural factors suggests the same conclusion. The dollar area is both a large primary-producing and a large manufacturing area; Britain by contrast is predominantly a manufacturing nation, relying on imports for her primary supplies. It is thus almost certain that she will need more goods from the dollar area than are demanded from her in return, and a deficit, even though a smaller one than before the war, is a natural condition of affairs. By contrast, the R.S.A., being a large primary-producing area containing not only rich supplies of gold but many raw materials in which the U.S. is deficient, and having in addition advantageous access to British supplies of

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manufactured goods, might be expected to earn a dollar surplus, though again a smaller one than before.

On both counts, therefore, the aim should be a return to the pre-war triangular pattern of payments (even though the magnitudes will be smaller): an R.S.A. surplus of dollars and gold accruing to Britain in payment for a deficit with the U.K., and then available for financing the British dollar deficit.

The post-war developments in R.S.A. dollar trade, which were summarized in Part I, chapter III, are set out in more detail in the table on the next page.

It will be seen that the contribution of the whole R.S.A. to the central reserves, even counting in gold, has been very small (column 4). For the first four post-war years there was a net drain, and it was only with world rearmament that a surplus appeared. Over the whole period the net contribution was a mere £234 millions — an annual rate of about £35 millions, which is vastly smaller than the average pre-war contribution if gold is taken into account.

The colonies cannot be blamed for this. They have consistently earned a surplus, comparing in most years very favourably with the 150 million dollars earned in 1934-38.

But the Independent Sterling Area countries (hereafter referred to as the I.S.A.) — Australia, New Zealand, India, Pakistan, Ceylon, Southern Rhodesia and Eire — have had a dollar deficit throughout, except for the quite abnormal period of U.S. inflation and stock-piling in 1950. This deficit has been on a scale far larger than the 1934-38 average deficit of under 100 million dollars, despite the fact that American employment and imports were higher than in the 1930s. Except for the two years dominated by rearmament, the deficit of the Dominions^{*} far exceeded the colonial surplus, so that the R.S.A. as a whole showed a negative trading balance.

This situation would not have mattered if, as in the 1930s, current gold output had been sufficient not only to cover the

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TABLE 8
R.S.A. ACCOUNTS 1946 TO MID-1952
(£ million)

	1946	1947	1948	1949	1950	1951	1st Half 1952 (annual rate)
Gold and Dollar Transactions:							
Current balance with dollar area of:							
1. Dependent Overseas Territories	+28	+2	+41	+43	+131	+160	+136
2. Independent Sterling Area	-92	-268	-118	-125	+21	-67	-218
3. Gold Sales to U.K.	+82	+84	+55	+68	+100	+78	+104
4. Total R.S.A. surplus or deficit (1+2+3)	+18	-182	-22	-14	+252	+171	+22
R.S.A. Transactions with non-Dollar World:							
Current balance with:							
5. United Kingdom	+39	-102	-232	-268	-245	-270	-536
6. Rest of World	-32	-78	+76	-6	+200	-5	-24
Total Transactions:							
7. Current balance with whole world	+25	-362	-178	-288	+207	-104	-538
8. Government Transactions*	-2	-7	+97	+26	+17	+8	-
9. Total drain on (-) or contribution to (+) U.K.	+23	-369	-81	-262	+224	-96	-538
Financed by:							
10. Capital outflow from U.K. (= -)†	+60	-240	-149	-250	-155	-153	-70
11. Drain on Sterling Balances (repayment by U.K. = -)	-37	-129	+68	-12	+379	+57	-468
Total financing	+23	-369	-81	-262	+224	-96	-538

* E.R.P. receipts by Eire, net drawings on I.M.F., South African loan.

† Australian and New Zealand gifts subtracted from capital outflow (=£46 m.).

(Source: U.K. Balance of Payments White Papers)

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I.S.A. deficit, but also to allow very large gold sales to Britain, so that despite the trading deficit the Dominions were still a net contributor to the central reserves. But a comparison of columns 2 and 3 shows that this has not been the case. Whereas before the war newly-mined gold (\$500m. annually) was easily sufficient to cover the whole U.K. deficit (\$320m.) on top of the small Dominion deficit, it has not been sufficient since 1945 (except in 1950 and 1951) to cover even the Dominion deficit, let alone contribute to the British one. The Dominions have thus exerted a cumulative net drain on the central reserves, amounting to £239 millions between January 1946 and July 1952.*

But in fact to attribute gold sales to the whole I.S.A. is misleading. By far the greater part of the gold comes from South Africa, a non-participant in the dollar pool. Her dollar deficit does not appear in column 2; gold sales to Britain are strictly in payment for essential imports, and reflect a current account deficit with the U.K. Column 2 therefore represents the true dollar burden of the I.S.A. (less South Africa); and the total in this column for the period is £758 millions.

It can now be seen how large a part of American Aid was not enjoyed by Britain, but passed on to the Dominions. From 1948 (when Marshall Aid began) to mid-1952 the American Government disbursed to Britain in the form of Marshall or Defence Aid some £900 millions; in addition £225 millions of other governmental dollar aid was received by the U.K. (e.g. the Canadian credit, the South African gold loan, I.M.F. drawings, etc.), making a total of over £1100 millions. Furthermore, gold to the value of £350 millions was bought from South Africa in payment for exports, and the colonial dollar surplus amounted to £450 millions. A total of £1900 millions in gold and dollars was thus available to the British Government.

Yet over the same period the U.K. dollar deficit was only £1200 millions, and U.K. payments of gold to non-dollar

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areas (notably E.P.U.) may have added another £100 millions. Receipts would thus have been amply sufficient to cover this deficit, and to allow large accretions to the gold reserves, had Britain and the colonies stood alone. As it was, however, £400 millions of these receipts was paid out to the I.S.A. to cover its dollar deficit, and a further sum to cover its gold payments to non-dollar countries. Thus nearly one-half of American aid was passed straight on to certain Dominions in the R.S.A., the loss only being made good by the colonial surplus and by gold earned from South Africa. Or one may say that total British receipts of aid were all but sufficient to cover the U.K. dollar deficit, but that the whole surplus of the colonies was impounded to cover the deficit of the Dominions: the colonies lent dollars to Britain which Britain at once re-lent to the I.S.A.

Of course the total drain on Britain was much larger than any calculations merely in terms of dollars would suggest. Throughout the post-war period the volume of British exports to the R.S.A. has been very much higher than before the war, and growing from year to year. Column 5 in Table 8 shows the annual R.S.A. deficit with the U.K., and column 6 shows that there was in addition frequently a deficit with the non-dollar non-sterling world as well. The larger deficit with the dollar area cannot therefore be traced to any lack of goods elsewhere, or set off against a corresponding improvement in the R.S.A. balance with Britain or the rest of the world.

The extent of the total drain on British productive resources is given in column 9, which adds the R.S.A. net dollar drain, its deficit with the U.K., and its deficit with the rest of the world (financed out of sterling from London). These figures show that in every post-war year except 1946 (when the balance either way was insignificant) and the exceptional year 1950, Britain was lending (or repaying) very large sums to the R.S.A. The total figure comes to nearly £850 millions: such was the value of the unrequited

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exports that the British people, hard-pressed as they were by their own burdens, sent out to the R.S.A. during this period — and the largest amounts were in periods (1947-49 and 1951-1952) when Britain's own difficulties were greatest.

Indeed the whole pattern of Sterling Area borrowing and lending in the period 1946 to mid-1952 will come as a surprise to many citizens. Britain received foreign funds (dollar and non-dollar), in the form of loans or grants, to the value of £1800 millions, and in addition sold £150 millions of capital assets. But of this total of £1950 millions, only £1100 millions was required to cover the overall current account deficit, and £850 millions went in financial assistance to the R.S.A.

The R.S.A. ran a much larger overall deficit of £1425 millions. Of this, £450 millions was covered by its own borrowing from the non-sterling world (mainly from the U.S.), and £125 millions by the sale of assets. But the remaining £850 millions was covered only by the receipt of capital funds (either loans or repayment of debt) from Britain.'

Thus almost half the foreign funds received by Britain have been passed on to the overseas Sterling Area, and swallowed up by its current deficit — a fact which should be recalled by those on the Right who like to imply that all the foreign aid received by Britain has been squandered on the home consumer. Certainly there is no foundation for the common accusation that Britain has lived on the backs of the Commonwealth peoples — on the contrary, the R.S.A. has lived on the back of the long-suffering British public.

The movement of capital from Britain to the R.S.A., which so largely financed the R.S.A.'s huge deficit, has often been thought to consist mainly of the repayment of the large sterling balances which had been built up during the war. These British debts to the R.S.A. amounted at the beginning of 1946 to £2454 millions.

Yet the total of these balances rose during the period (column 11). The cause of this surprising development was

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that there occurred a large and sustained outflow of new capital from Britain amounting to over £920 millions (column 10); and this was sufficient not only to finance a large part of the current account deficit of the R.S.A., but also to allow a rise in their sterling balances of nearly £100 millions. This movement of new funds was largely responsible for the strain exerted by the R.S.A. on the British economy, since without it the sterling balances would quickly have been depleted to a point where a much stricter prudence in respect of imports would have been enforced.

IV

A study of the fortunes of individual countries shows a great diversity of experience. First the dollar accounts must be examined. The colonies, as has been shown, have behaved irreproachably (though not of course as free agents so far as their native populations were concerned), and their surplus has largely financed the I.S.A. deficit.

Of the I.S.A. countries, Australia and New Zealand have both run dollar deficits (Australia of between \$60m. and \$200m., New Zealand \$40m. to \$80m.),^s and drawn on the central reserves, save during the period of the post-Korean boom in wool prices. The volume of their exports was much larger than pre-war, and for some time their dollar imports were held below pre-war; but both in 1949 and 1951 there was a sudden and extravagant rise in dollar purchases. It is true that both these countries were in dollar deficit in the 1930s, but it is doubtful if Britain can continue to finance their deficit in her present state, shorn of so much of her pre-war wealth. It is not unreasonable to say that they should restrict their deficit to what can be covered by their own gold output, by drawings on the I.M.F., and by borrowing from the U.S.A. They would then not draw on the central reserves — at least on the average of years; fluctua-

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tions in wool prices may involve unavoidable changes in their dollar accounts, and so alternating periods of withdrawals from, and contributions to, the dollar pool.

India and Pakistan, despite a large increase in exports (mainly due to jute), have exchanged a pre-war dollar surplus for a deficit (except again for the Korean period) varying between \$20 millions and \$150 millions, the change being due to an enormous rise in dollar imports. Some of this rise consisted of wheat, which no one would grudge them, considering the poverty of their population and the rate at which it is increasing. But not all the extra imports were so essential, and some pruning is permanently possible from the highest levels reached — e.g. in 1948, when the volume was $4\frac{1}{2}$ times pre-war. It is not reasonable to expect these countries to revert to a position of surplus — a dollar deficit is an essential part of any plan to aid the under-developed areas. But the drain on the reserves will certainly have to be less than it was in several of the last few years.

The greatest change has been in the position of South Africa, whose dollar deficit, before the war \$60 millions, has varied from \$100 millions to \$450 millions. (South Africa even achieved the lone distinction of a deficit in 1950.) This has not meant a direct drain on the central reserves, since South Africa has since 1948 been responsible for her own dollar deficit. But indirectly the effects are equally serious, since a higher proportion of current gold output is attracted to the dollar area, and a smaller proportion is available for sale to Britain. This has been one of the main reasons for the post-war difficulties. However, as South Africa is not a member of the dollar pool, there is neither a moral case nor the bargaining power for demanding a reduction in her dollar deficit; this can only be achieved by directing a sufficient volume of British exports to the South African market.

The other Independent Sterling Area countries are not involved for large amounts.

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The solution would thus appear to be that Australia and New Zealand should be responsible for their own dollar deficits: that India and Pakistan should adjust their deficits to a more manageable figure, and that commercial relations with South Africa should be so managed as to attract a higher proportion of her gold output to Britain. The colonies will continue to earn a dollar surplus, and the desideratum is thus that the I.S.A. countries, other than India and Pakistan, should be on balance self-supporting, and that the colonial surplus and South African gold should be available, in return for British exports, to cover the dollar deficits of India, Pakistan and Great Britain.

So much for the dollar account. But overall balances and the movement of capital are also relevant, since they determine the total strain on, or contribution to, British resources coming from each R.S.A. country.

Again it is clear that the colonies have been of great assistance. Their sterling balances rose by more (nearly £600m.) than their contributions to the dollar pool (£470m.). It is true that a certain outflow of British capital to the colonies has also taken place; and this is partially responsible for the rise in sterling balances. But Britain has borrowed virtually the whole colonial dollar surplus in exchange for a rise in balances; this surplus was not, in other words, offset by an equivalent deficit with the U.K., and the colonies were lending, not goods direct, but large amounts of gold with which goods could be bought. This is the reverse of what should happen. The colonies ought to be running their balances down, not building them up. It is certainly desirable, and reasonable, that they should continue to earn dollars by selling their primary products to the Western Hemisphere, but not merely should their contribution to the dollar pool be balanced by a flow of goods from Britain, but there should be a further flow on top of this as part of a long-term plan of development.

The trouble lies again with the Independent Sterling Area

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countries. It has been calculated that of the total capital outflow of £645 millions (not counting changes in sterling balances) during the years 1947-49, under £300 millions represented genuine investment in new projects.⁹ Some £350 millions represented merely 'hot money' movements — the flow of private capital abroad, induced partly by a dislike of the political or fiscal policies of the Labour Government at home, partly by motives of currency speculation. These funds went mainly to Australia and South Africa. In the case of Australia they helped to finance an enormous volume of unrequited exports (not to mention a large deficit with the rest of the world)¹⁰, happily purchased without any of the self-restraint which falling London balances would soon have induced; in the case of South Africa the receipt of fresh supplies of sterling made it less likely that the deficit with Britain would be settled in precious gold.¹¹

An equally large outflow of capital went to India, Ceylon and Pakistan. These three countries between them, though they were not the recipients of any private funds, ran down their sterling balances by £340 millions¹² during the years 1947-49 — an annual rate of British repayment of debt of £121 millions. Again this involved a large volume of unrequited exports, and there is no doubt that this rate of repayment, considering the difficulties of the British economy during those years, was more than we could afford, though it was a creditably generous policy.

It is clear from all this that future policy must consider not only the dollar payments situation of each R.S.A. country, but also its lending-borrowing relationship with Britain. This is not now mainly a problem of the war-time sterling balances. It is true that the hopeful post-war expectations of what would happen to these balances have not been realized. Ambitious schemes were proposed during the U.S. Loan negotiations for cancelling one-third of them, funding one-third and repaying one-third over a period of years. Such hopes were dashed when the creditors refused to forgo

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their full claims. Nor has the more modest hope been fulfilled that the traditional British surplus with the countries concerned would steadily diminish the balances. In some cases a very rapid repayment was made (notably to South-East Asia and the Middle East); and Britain has had a surplus in her trade with almost all the countries most concerned. Nevertheless the total balances, which were £3700 millions in 1946, had only fallen by £300 millions in mid-1952, while the Sterling Area balances were actually higher by £100 millions. The reason, as we have shown, was that despite the U.K. surplus they were constantly replenished by the outflow of fresh capital; and moreover they rose automatically as the colonial surplus of dollars was purchased by the U.K. against pounds.

But although the total is little lower, there has been a very big transfer as between different categories of holders. Non-sterling countries have reduced their balances from £1200 millions to £800 millions, the main reduction being in the South American group, whose excess balances have now almost disappeared (the sale of the Argentine railways being partly responsible). India, Pakistan and Ceylon, as a result of the large releases to them, have seen their balances fall by over one-third; and the Middle Eastern countries (notably Egypt, Palestine and Iraq), which were also allowed very liberal rates of drawing, have had their balances halved.

As against these large declines, there have been offsetting rises in the balances of the Sterling Area Dominions (Australia, New Zealand, South Africa and Eire) — an increase of perhaps £150 millions¹⁸ — and still more in those of the colonies, which have risen by £600 millions.

This redistribution has two consequences. First, it means that the existing balances cannot be identified with the war-time balances whose correct disposal was such a lively moral and political issue after the war. The latter have been repaid in large amounts, and the present funds are mainly a reflec-

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tion of post-war trading and capital relationships. Secondly, without being too invidious one may say that the balances are now in more reliable hands. A higher proportion is held within the Sterling Area, and within the Sterling Area holdings a higher proportion is credited to countries (notably the colonies) whose economic behaviour is reasonably predictable.

To this extent the problem is therefore eased. Nor should the failure of the balances to decline in nominal value cause too much alarm. The world price level has risen sharply since 1946; the real burden of debt which they represent is therefore lighter, and a higher proportion of them must be immobilized by the countries concerned as a minimum foreign exchange reserve. Many of these countries, moreover, look upon their London balances as a backing for their internal currency, and, since these currencies have been greatly inflated since the end of the war, correspondingly larger amounts of the balances are required as banking reserves. It has been estimated¹⁴ that some £2000 millions out of total balances of £3400 millions are now required as minimum external reserves and backing for internal note issues; and it is probable that the Australian, New Zealand, South African, Middle Eastern and South American balances have now all reached this minimum level.

Of the sums in excess of this, a very large part is credited to the colonies, and so comes under effective London control; while a further large sum belongs to India, Pakistan and Ceylon. But these latter countries are covered by the Colombo Plan, under which the rate of repayment is both systematized and reduced; the rate is to be £45 millions annually over the six years beginning 1952, by the end of which period these balances also will be down to a minimum working level. The problem of the sterling balances as such can therefore be considered a matter of past history, and the question of capital movements can be examined *de novo*.

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V

So much for the diagnosis. What of the cure? There is no mystery about what is required. The I.S.A. must come into dollar balance, save for the South-East Asian dominions, and even they must reduce their deficit; and the capital position must be placed on a more secure and satisfactory footing. But is the main change to come on the side of dollar exports or dollar imports?¹⁵

Dollar exports from the overseas Sterling Area consist almost entirely of raw materials; indeed over half their value in 1949-50 derived from four materials — wool, rubber, jute and tin.¹⁶ Their volume (and price) therefore depend in the short run on business conditions and inventory policy in the U.S.A. They are thus determined from outside, and there is little that the Sterling Area can unilaterally do to affect the situation. But quite apart from temporary fluctuations in American demand, the immediate prospects for any considerable expansion are not encouraging. The U.S. is already notably less dependent than before on certain important R.S.A. materials, in particular rubber and tin. Before the war 75 per cent of U.S. imports of rubber came from sterling sources, but by 1949-50 only 53 per cent; domestic production of synthetic rubber was a further damaging influence, and in consequence the price of rubber rose by much less than other commodity prices, and the volume of dollar exports was slightly lower than before the war. In the case of tin, before the war the R.S.A. supplied 87 per cent of U.S. import requirements, but in 1949-50 under half, and the volume of exports was barely above pre-war. Jute also suffered, not from the development of alternative sources of supply, but from a steady process of substitution, and both the volume and value of dollar exports were down on pre-war.

There are, it is true, compensations. Exports of raw wool to the U.S. were $3\frac{1}{2}$ times the pre-war volume (and wool

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had jumped from 6th to top place amongst R.S.A. dollar-earnings), and cocoa and diamonds also showed very large gains (the former due to a sevenfold increase in volume, the latter to an exceptionally large rise in price).

But there are more changes for the worse in store. All the four main dollar-earners are menaced by substitutes, and the threat is not far distant. Wool is threatened by natural fibres, and although a slow secular rise in U.S. demand is expected, it will be negligible in the immediate future; rubber, tin and jute may all show a declining trend before many years have passed.

Admittedly on a long view, as the U.S. eats away its indigenous material resources and turns its gaze abroad, there are grounds for comfort. The Paley Commission gives the following estimated increases in American imports of certain commodities which the R.S.A. produces: copper 130 per cent, lead 120 per cent, zinc 110 per cent, bauxite 300 per cent, cobalt 340 per cent, manganese 50 per cent, wool 30 per cent. In all these materials the R.S.A. is well placed. It already produces one-fifth of the free world's non-U.S. output of copper and lead; it could substantially increase its exports of zinc; it owns half the free world's known reserves of bauxite, and rich deposits of cobalt; and it produces nearly the whole world output of manganese. Moreover, although wool exports will increase by less than the average, the livestock-rearing countries (Australia, New Zealand, Eire) will have very profitable openings for expanding food exports, provided the necessary surpluses can be secured; U.S. imports of dairy produce are expected to rise by 400 per cent, and of meat by 30-50 per cent.

(The Sterling Area is not, admittedly, as fortunate even on a long view as some other primary-producing areas, since it now relies heavily on two of the very few materials of which U.S. imports are expected to decline: rubber (by 80 per cent), tin (23 per cent); nor is any rise in jute imports anticipated. On this basis certain pessimistic calculations

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have been made purporting to show that the losses will outweigh the gains, and that R.S.A. exports to the U.S. will actually be lower in 1975 than now. But this is beside the point. Even though American imports of tin and rubber fall, demand from the rest of the world is expected to show an enormous rise — for tin by 60 per cent, natural rubber by 200 per cent; for all the other materials, moreover, a large increase in non-U.S. demand is superimposed on the rise in U.S. demand. Some considerable part of this new demand from outside the U.S. will earn gold and dollars for the R.S.A., and it is silly to judge the prospective dollar position merely on the basis of trade with the U.S. itself.)

But all this lies in the distant future. Over the next quinquennium the development of substitutes for wool, rubber, tin and jute may proceed faster than the growth in demand for the other materials. The U.S. national income, as was argued in the last chapter, may not over this period show any very large increase, and it would therefore be most unwise to expect that R.S.A. dollar exports will quickly expand much beyond their present level.

V I

The main burden of adjustment must therefore fall on imports. These must be restricted for some years ahead to the volumes at which they were briefly held after the Commonwealth Conferences of 1949 and 1952, and well below the volumes (of anything up to double pre-war) at which they were running for most of the period.

This may involve less hardship than is sometimes supposed. Casual people easily get the impression that most R.S.A. imports from America consist of essential foodstuffs unobtainable elsewhere — wheat, for example, to stave off famine in India. This is not the case. In 1949-50 only 2 per cent of such imports consisted of wheat, and the greater

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part by far consisted of heavy industrial goods. Machinery, steel products and chemicals between them accounted for nearly 40 per cent, automobiles and oil for a further 14 per cent; and certain consumers' goods also figured prominently, e.g. textiles (6 per cent) and tobacco (5 per cent).¹⁷ Nor do the changes from pre-war suggest that the higher post-war volumes can be explained simply on grounds of genuine hardship. Textiles in 1949-50 were ten times their pre-war volume, steel and chemicals four times, machinery double.¹⁸

It must not be thought that the large increase in imports of dollar capital goods is traceable to any failure on the part of Britain to supply these goods in the pre-war quantities. On the contrary, R.S.A. imports of machinery and iron and steel products from Britain have also been two to three times as high as pre-war.

The increases are fairly evenly distributed amongst Australia, New Zealand, South Africa, India and Pakistan. They have their origin in the programmes of industrialization with which these countries have been pressing on fast in recent years. All of them have wished to develop secondary industries, and to lessen their dependence on a few primary products with (it was thought) very uncertain market prospects. It was natural before the war, with primary prices so depressed and the terms of trade moving in favour of manufactured goods, that men's minds should turn in this direction. But if the argument of Part II, chapter IV is accepted, there is a good deal less rational justification for this attitude today. In the future it is primary producers who will gain, and manufacturing producers who will lose; and any country which can supply the food and materials for which the world is clamouring will earn far larger supplies of manufactures by international exchange than it could possibly produce at home by a hot-house encouragement of new industries. This is a situation in which world specialization really has some meaning; and it must be in the interests of the primary-producing countries themselves to arrest the

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drift of resources into secondary industry, and to concentrate on raising their output of food and raw materials.

These considerations apply with particular force to the Sterling Area. World demand, and especially U.S. demand, is growing very rapidly for two types of product in which the Commonwealth is potentially rich — minerals and livestock products. The Paley Report opens up an encouraging vista of long-run dollar solvency if only the R.S.A. will concentrate its attention and resources on producing those goods in most demand: livestock output in Australia, Eire and New Zealand, and mineral output in all those countries — which in fact means almost every important country in the R.S.A. — possessing rich metal and mineral deposits. But some part of the resources needed for the new development must be found internally, and this will require a retardation of plans for further industrialization. Nobody wants to deprive the Australians of their all-Australian car, or the Indians of their brand new steel-mills. But if cars and steel can be obtained from Britain, while American demand for Australian dairy produce may rise by 400 per cent and for Indian bauxite by 300 per cent, it hardly seems sensible to devote too large an investment to the former, and too little to the latter.¹⁹

If this shift of emphasis is accepted, the import of heavy manufactured goods into the R.S.A. may be somewhat abated; and considering the large fraction of dollar imports which these goods account for, it is reasonable to hope that dollar expenditures will bear the brunt of the cut.

But more is needed than this. Even if the pace of industrialization slows down, some will still continue; and the new investment in food and raw materials will demand large supplies of certain kinds of capital goods. Thus although imports of heavy engineering goods may be reduced, they will still continue high. It is therefore further essential that within this total there should be a switching from American to British supplies. Discrimination, in other words, must

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continue and even be intensified. Here a large responsibility rests on Britain, to make available, at competitive prices and quick delivery dates, the goods foregone from dollar sources. This heavily underlines the need, already outlined in Part II, chapter v, for a greatly expanded output of metal and engineering goods in Britain, where an equally pronounced shift of resources will be required. The whole Sterling Area system would then become much more complementary than it is today, and both sectors of it would be devoting their main attention to goods for which world demand is rising — Britain on engineering goods, the overseas area on food and raw materials.

It may be that certain categories of dollar imports into the R.S.A. cannot be prevented from rising as population and incomes grow. But if expenditure on dollar machinery can be restrained, there is some hope that for the next few years dollar imports can be held down at least to the relatively modest figures of 1949-50 and 1952. (Even this is much higher than pre-war, in marked contrast to the British case.) At this level, a reasonable dollar equilibrium is possible.

V I I

This policy involves a continuing, and even a growing, U.K. surplus with the R.S.A. A surplus is in any case demanded on humanitarian grounds, especially with the colonies; it is wrong that colonial dollar earnings should be reflected merely in rising sterling balances, and not in higher supplies of British goods. But the surplus with the colonies must extend also to the independent countries if the required new investment in primary output is to be encouraged by suitable supplies of capital goods. This raises a danger. There is always a risk that a free trade area like the Sterling Area, with its smaller hazards and difficulties, will encourage too high a volume of trade within it at the expense of trade

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with the outside world. Many have argued that the easy trading conditions within the R.S.A. have already attracted British goods which could and should have gone to dollar markets, and to aim deliberately at a still larger sterling surplus might exacerbate this tendency. There is no simple formula here for right conduct. A surplus with the R.S.A. there must be, for new development and to ensure that the R.S.A. restricts its dollar purchases; yet British exporters must not become too enmeshed in sterling markets.

This raises the whole question of how the surplus is to be financed. If the investment is to have the desired results, it must be organized and directed so that it reaches the right destinations in the form of the right supplies of goods. If not so organized, the recipients may be the least deserving ones, and the goods may be the wrong ones.

During the last few years a large part of the surplus has been financed by an unorganized outflow of private funds, directed not at all to urgent economic needs, but solely to currency speculation or the avoidance of taxation. This form of capital flight does nothing but harm. First, it attracts additional supplies of British goods to the particular recipient countries. Since there is a limit to the foreign lending which Britain can afford, this has the effect of sequestering a part of the available surplus, and thus making it more difficult to afford genuine overseas investment in other (and perhaps more deserving) areas. The typical effect is to divert the surplus to Australia and South Africa away from the colonies.

Secondly, some of the additional exports to the recipient countries may be attracted away from dollar markets.

Thirdly, where the capital outflow serves to replenish existing sterling balances, these may rise to the limit which the Governments concerned are willing to hold. There is then a tendency to use the balances to increase imports from other countries; and if an excessively liberal import policy develops in this way, it is inevitable that part of the excess

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demand should spill over into dollar goods, thus aggravating the drain on the central reserves.

Fourthly, since exchange control in some of the recipient countries is less efficient than in Britain, there is a danger of an illegal movement of funds outside the Sterling Area altogether, with a consequent loss of gold.

Fifthly, in certain cases (notably South Africa in the Sterling Area, but a number of other countries outside), the provision of fresh supplies of sterling makes it less likely that a U.K. surplus will be settled in gold.

Such are the dangers attendant upon a large outflow of flight capital. In certain directions, of course, the problem does not arise. Investment in the colonies, whether by public or private bodies, will no doubt continue to be genuinely directed to economic capital projects. In the case of India, Pakistan and Ceylon, there is no attraction for flight capital, and the surplus will be financed by drawing down their balances at a rate now regularized under the Colombo Plan. Even with the Southern Dominions, which have been the main recipients of flight capital in the past, the problem is for the moment not urgent. Speculative motives are not driving British funds abroad, South Africa seems politically less secure than Britain, and Mr. Butler's fiscal policies are less repellent to wealthy men than Mr. Gaitskell's. For the present, therefore, overseas investment is properly canalized, through public and reputable private organizations, into productive capital ventures. But should the flow of hot money again show signs of mounting, the British Government must reserve the right to raise the whole question of exchange control over capital movements within the Sterling Area. The present freedom of movement has beneficial consequences, and no one wishes to restrict it. But it might be too high a price to pay if it meant that the fruits of British overseas investment were wasted and its purposes frustrated.

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VIII

In addition to the problem of long-run equilibrium, there is the further danger of instability to be considered. This arises from the fact that the R.S.A. relies for its dollar earnings on the sale of certain raw materials which are particularly sensitive to changes in American demand. It is not only the quantities sold that are affected by these changes, but also the price; and three materials whose price is unusually volatile (wool, rubber, tin) account for 40 per cent of R.S.A. dollar receipts. During 1950 to 1952, the price of rubber rose from 22½d. a lb. to 74 d., and then fell to 28d.; tin moved from £591 per ton to £1615 and back to £964; wool from 145d. per lb. to 323d. and down to 116d. The value of American imports of these three commodities showed the following fluctuations:

MILLIONS OF CURRENT DOLLARS AT HALF YEARLY RATES

1st half 1950	428
2nd „ „	660
1st „ 1951	990
3rd Qr. 1951	786

(Source: E.C.E., 1951, p. 5)

These fluctuations have an especially damaging effect because of the small size of the reserves, any considerable fall in which immediately causes an exchange crisis. The moral is clear. There must be an agreement about import policies — specifically, that at times of American boom demand some large proportion of the higher earnings, instead of being at once dissipated in higher dollar imports, should go instead into the central reserves, which so badly need this fortification; and, secondly, that when prices and earnings begin to fall, cuts in dollar imports should be made at once, instead of being postponed until a large drain on the reserves has pre-

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precipitated a crisis of confidence which threatens the value of the pound.

The events of both 1949 and 1951 showed the urgent need for co-ordination along these lines. In both years there was an unjustified relaxation of import restrictions just as commodity prices were beginning to recede and it was becoming clear that dollar earnings must soon decline; and hasty action had to be taken, far too late, by a full conference of Commonwealth Finance Ministers. In 1950-51 a glorious opportunity was lost; if all the exceptional earnings of the commodity boom had been put into reserve, and not been 'blown' on a wild buying spree in dollar markets, the resulting rise in the reserves would have done much to secure the whole future of the Sterling Area.

If the necessary co-ordination cannot be achieved by concerted and automatic voluntary action, there appears to be an overwhelming case for some central body of more significance than the mere statistical secretariat that now exists, or perhaps for a twice-yearly meeting of Finance Ministers or their deputies. After all, the problems here are not unlike those that face the European Payments Union; and the E.P.U. has the whole machinery of the O.E.E.C. to look after it. Experience shows that the O.E.E.C., with its permanent Council of high-ranking Government representatives and its frequent meetings on the Ministerial level, acts efficiently and is capable of quick decisions to meet a changing situation. Some permanent body of this nature may be needed for the Sterling Area unless its members begin to show a greater degree of self-discipline.

But it is not the gold reserves alone which show the effects of this instability. It is imparted also to the employment situation in Britain. When commodity earnings rise, the London balances of R.S.A. countries rise in response. Import policies are then relaxed, and a sudden expansion of demand is experienced in British export centres. New labour is taken on, output is stepped up. But in a few months the

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additional balances have all been spent, import restrictions are again applied, and the extra demand for British exports disappears as quickly as it came, leaving behind it broken contracts and even unemployment. Lancashire and the Midlands were both victims of this experience in 1951-52, and disturbances such as these make it particularly difficult to maintain stable employment in British industries.²⁰

Nobody blames the overseas countries for these fluctuations in earnings. They originate in America, not in Australia or New Zealand; and they could only be prevented by international action for commodity stabilization. But when the relative advantages derived from the Sterling Area system are under discussion, the disadvantage to Britain of having overseas price instability communicated to the home employment situation must be borne in mind.

I X

The cohesive political unit which the British Commonwealth represents is a factor for great good and stability in the world. The Sterling Area is the economic reflection, for a large part of the Commonwealth, of this political unity; and no one would willingly suggest anything that might endanger its future. Nevertheless the strain which it has recently exerted on Great Britain is not such as can be borne in a world without large-scale American aid.

Any changes should naturally come by agreement if that is at all possible. The outlines of what is required have now been sketched. The independent members of the area must come into dollar balance, apart from the legitimate deficits of India and Pakistan, and even these must be restrained; some agreement may be needed about the outflow of capital from Britain; discrimination against dollar goods must be intensified; and a more restrained and co-ordinated

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behaviour must be adopted in the face of U.S. fluctuations. Such an agreement would reduce the strain on British resources to more manageable dimensions, would improve the position of the colonies, and would enable the reserves to be gradually built up.

But what if such an agreement proves impossible? The consequences of this must be faced and frankly discussed. There is no virtue in lurching from crisis to crisis in gentlemanly silence. These changes must come, and if they do not come by agreement they will come by hard compulsion.

Two things would be involved. First, the I.S.A. countries (less South-East Asia) would have to be rationed in their drawings on the dollar pool; out-payments in bad years would have to be restricted to the amounts paid in during good years, so that no net drain occurred. Secondly, under certain circumstances the free flow of capital would have to be restricted by exchange-control. This would, of course, be described as the break-up of the Sterling Area. What would be the reality behind this facile phrase?

India, Pakistan and Ceylon would not be very much affected, since their command over British resources has been settled by agreement under the Colombo Plan, and their drawings on the dollar pool are tending already to become a matter for inter-Governmental agreement. Nor would South Africa be much concerned; she is already responsible for her own dollar deficit, and control over flight capital would make little difference, since Dr. Malan has already largely cured that difficulty. The colonies would lose nothing, and the smaller I.S.A. countries (except Eire) would hardly be disturbed.

The only countries seriously affected would be Australia and New Zealand, who would be restricted in their drawings on the central reserves and deprived of some part of their command over sterling resources. They would partly lose two of the essential advantages of the Sterling Area system — free access to the dollar pool and free movement of capital.

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Britain, on the other hand, would be relieved of a drain on the reserves, and would be forced to send out fewer unrequited exports.

But might there be compensating disadvantages from the British point of view, such as an abrogation of Imperial Preference? Might it then be harder, if British exports fell in consequence, to secure the present share of the foodstuffs and raw materials which are these countries' staple exports — might these instead be violently orientated elsewhere?

There is little to fear from an abrogation of imperial preference. This now plays an insignificant part in determining the direction of trade. Non-sterling imports into these countries are subject to exchange-control, and all imports to quantitative controls; it is Government policy in respect of these restrictions, and not imperial preference, which determines the source of imports. Imperial preference did not prevent very burdensome restrictions being laid by Australia on British goods in the spring of 1952, any more than it prevented sudden increases in non-sterling imports at other periods. The share of Britain in these markets, in these days of licensed trade, does not depend on the Ottawa preferences. The Sterling Area could exist without imperial preference, just as before the war imperial preference existed without the other features of the present Sterling Area system.

Why else should British trade with these countries fall? Many incentives to large-scale trade would still exist. Traditional consumer preferences will not disappear merely because the nature of the Sterling Area alters, and they will give a powerful advantage to British goods. Even if flight capital is restrained, Britain will still be willing to lend in an organized and business-like manner, both to encourage investment in primary production and to ease the flow of British exports; and it is not certain that these countries would obtain borrowing facilities so easily elsewhere. The central gold reserves might still be made available to them,

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even though their drawings had to be balanced over a period with their contributions; and if they chose to use the pool they would still gain from not having to start, with great difficulty, to build adequate reserves of their own from scratch. For some of the produce of these countries, moreover (meat from Australia, dairy produce from New Zealand), it is a great advantage to have assured markets of the sort that are now provided by British long-term contracts; other governments might not be so willing to offer guaranteed markets for entire exportable surpluses, and continued British willingness to do so would be a strong factor in securing the supplies.

It is not clear to what other markets these countries would orientate their sales even if they were so tempted. The dollar market would naturally attract them most, but they already sell as much for dollars as they can. Western Europe (Germany in particular) is a possible competitor; but provided British goods are properly competitive, and in view of the British advantages discussed above, it is hard to see why Europe should greatly increase her share in Australasian trade. There are not many European countries which can offer these advantages, and still fulfil the essential conditions that Britain fulfils — of being a safe market for large amounts of primary produce, and at the same time a source of supply for a virtually complete range of manufactured goods.

One cannot pretend that there is no risk involved in imposing these suggested limitations on the Sterling Area organism. But the risk is a very limited one: that Australia and New Zealand might buy rather fewer British goods if deprived of free access to the dollar pool, and of limitless supplies of 'hot money' capital: and that Britain in consequence might earn a smaller share of their output of primary produce. The arguments adduced above do not suggest that the risk is very great — whereas the recent burden on Britain from the present uncontrolled arrangements is quite beyond dispute. And even if the risk had to

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be taken, most features of the sterling system would continue much as now. Trade within it would be fully multilateral. The pound would be no less convertible than now, save that dollar convertibility would be somewhat restricted for these two Dominions (as it already is for some other countries in the R.S.A.). Far more freedom of capital movement would still exist within than without the system, even if occasional controls on the flow of funds to Australasia were imposed. Relations with the colonies and South Africa would be unaltered, with no diminution in the flow of gold and dollars in exchange for British goods. Relations with India, Ceylon and Pakistan would not be much affected, nor would the position of the smaller independent countries. The modifications would thus not be either very large or very disastrous, and it is absurd to pretend that they involve the 'break-up' of the Sterling Area.

But it need hardly be said that it would be infinitely preferable that the required adjustments should come by full agreement, and no one suggests any unilateral action by Britain so long as there is any prospect of agreement. Fortunately there is a growing realization that post-war sterling relationships have not been satisfactory, and a correspondingly better hope of amicable reform.

X

The solutions outlined in this chapter, whether they come by agreement or not, will dispirit those liberal persons who still desire the early return of free conditions of trade and exchange. Why, it may be asked, is nothing said of the need for convertibility, recently so much canvassed? Why is all the talk of more, and not less, discrimination and restriction?

The answer is simple. It is that discrimination and control appear essential, given the prospective supply of dollars, to a dollar balance: that a dollar balance is a pre-requisite of

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stability in international trade: and that without stability expansion is impossible. The proposal to maintain restrictions does not mean any bias against world trade — the volume of trade has already expanded enormously over the last few years, for all the controls; on the contrary, it is seen as a necessary condition of further expansion.

Recent talk on the other side has been particularly of convertibility. By this is meant the right of non-resident holders of sterling to convert that sterling, providing it has accrued from current and not from capital transactions, into any other currency, so that world trade becomes fully multilateral.

This does not necessarily imply non-discrimination or freedom for imports; the right of foreigners to do what they like with their sterling earnings does not deprive the British Government of the right to control the volume and the source of import purchases by its own citizens.

It is suggested that to make sterling convertible would in some way assist, or even solve, the dollar problem. But detailed argument is not forthcoming. There is foolish talk in the banking magazines, wholly devoid of figures, about the increased financial earnings of the City of London; but the amounts involved are in fact quite trivial. Otherwise the supposed advantages are never detailed, and recourse is had to anthropomorphic slogans: convertibility would make for 'a more virile currency', would 'restore the old virtue to sterling', would 'enable the pound to look the dollar in the eye'. The splendid old deity seems to be in need of an aphrodisiac.

The dangers of convertibility, on the other hand, are obvious — a drain of sterling into dollars on the 1947 model. What conditions would have to be fulfilled in order to avoid this? (a) A U.K. overall balance, so that the world's current earnings of sterling did not exceed its current requirements — preferably, indeed, a surplus, so that sterling was rather scarce; (b) the convertibility of other currencies, so that the

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gross surpluses within the balance yielded, if need be, gold on the same scale as was required for settling the gross deficits;²¹ (c) effective control over any large sterling balances held outside the Sterling Area, to prevent a concealed capital drain of sterling into dollars; (d) much higher gold reserves than now; and (e) no world current shortage of dollars.

This is a formidable list. But perhaps it is even more formidable than many people realize. It is sometimes thought that the essential condition is that the British balance should be favourable. This is not so. The essential condition relates to the supply of dollars. If there is still a world dollar shortage, not necessarily even in the sense of the U.S. account being out of balance (i.e. showing a current surplus not wholly covered by loans or grants), but merely in the sense that at current price and exchange relationships world demand for dollars exceeds the supply, and is only made equal to the supply by controls and restrictions — then, even though the U.K. account be in balance, convertibility would still lead to a drain of dollars. All those countries with a strong demand for dollar goods now held back only by the lack of dollars would hasten to lay their hands on sterling as an indirect means of acquiring dollars. This they would do partly by attempting a concealed withdrawal of sterling capital funds — always possible, however strict the control — but more insidiously by cutting imports from Britain in order to acquire a surplus of current sterling for conversion into dollars. The result would be lower British exports and a fall in the reserves. Any one who doubts this has only to study the history of the 1947 experiment.

The only conditions under which this would not occur would be if British goods became so attractive relative to American goods that the entire demand for dollar imports now frustrated by inconvertibility would disappear, and be transferred to British goods. But this, of course, is equivalent to saying that the structural dollar shortage would cease to

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exist, and is a silly expectation. It ignores all the structural factors described in the last chapter. It ignores the fact that Britain cannot physically supply a large range of goods — food and materials — of which the world would now buy more from America if it had the dollars. (And it ignores, looking ahead to the future, all the additional cyclical difficulties which might be created by an American recession and the consequent intensification of dollar stringency.)

Presumably nobody doubts the existence of this pent-up demand for dollar goods. World-wide import restrictions bear witness to it, and if further evidence were needed it was provided by the experiment in 'limited convertibility' tried by the Bank of England in August 1952. The experiment was confined to E.P.U. countries, and to commodity transactions. Yet even in this limited field the desire to convert sterling into dollars for making American purchases was shown to be enormous; and the Bank, swamped by applications, had quickly to close the lists.

There is no reason to expect this situation soon to change. The world dollar shortage shows no signs of being about to disappear.²² It is most unlikely that the supply of dollars will show much rise over the next five years; it is, if anything, more likely to decline, with an American recession or a tailing-off of Governmental aid. The conditions necessary for convertibility are therefore not in sight.

The same objections apply to all the liberal panaceas. Deflation or devaluation could only bring a trading equilibrium if pushed to quite fantastic lengths, involving large scale unemployment and a severe fall in the standard of life. Proposals for a dollar stabilization loan, as backing for a return to multilateral trade, also ignore the fundamental unbalance; the loan, intended to create confidence and to remain intact in reserve, would soon be dissipated by the new wave of dollar buying released by the removal of restrictions.

More sophisticated proposals have recently been made for

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an Atlantic Payments Union:²³ a fully multilateral non-discriminatory trading system, backed by huge deposit facilities. The figures suggested for the U.S. deposit are sensibly large, and for the moment would make dollars very plentiful. But the scheme would still founder on the structural disequilibrium. Since the present precarious dollar balance is only maintained by discriminating import controls, the return to non-discrimination would inevitably unloose a larger flow of dollar purchases. The U.S. would then be steadily in surplus, and its deposit quota gradually drawn down; this spectacle would itself intensify demand for the dwindling supplies of dollars, and soon the quota would be exhausted, leaving the world no nearer equilibrium than before.²⁴

All solutions which rely on a once-for-all infusion of dollars are doomed to failure. If the problem were purely a cyclical one, so that only a revolving fund were needed, they might succeed. But since it is also a structural one, the new supply would eventually go the way of the U.S. Loan and Marshall Aid; E.P.U. has shown the weaknesses of a multilateral system characterized by persistent creditor and debtor positions. A multilateral equilibrium could be maintained only by a *regular annual* flow of dollars on a scale sufficient to equate supply with an unrestricted world demand. The implication is thus one for the U.S. balance of payments; and the decision rests in the hands of the American Government. The world has no right to criticize that government if it fails to make this large provision. But it has the right to say that in its absence the present controls must be kept on.

X I

This will all prove very annoying to the supporters, still surprisingly numerous, of the post-war plans for restoring multilateral trade. But the objection taken to the multi-

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lateral school, and to the attempts of the American Government to force these doctrines upon international conferences, was never to the glowing picture which was painted of the potentially better results that such a solution might give — that was not controverted. It was, and is, to the assumption that the conditions for such a solution actually exist in the post-war world, namely that no major currency is in short supply, and that a general trading equilibrium is in sight. (Many of the multilateralists made this an implicit assumption, without much argument; others, more rash, committed themselves to a firm assertion, such as Lord Keynes's statement in 1945 that 'the chances of the dollar becoming dangerously scarce in the course of the next five or ten years are not very high'.)²⁶

That is why, as one looks back on the post-war controversy, it seems so unhelpful. Both bilateralists and multilateralists were right on their own assumptions, and much of the argument was for this reason at cross-purposes. But the bilateralists were right in their assumptions, and the multilateralists were wrong.²⁶ The dollar has been consistently scarce, and, given the inadequacy of the world's exchange reserves and the quotas of the I.M.F., the American attempt to urge the world quickly back to full convertibility and non-discrimination was unrealistic and bound to fail. The I.M.F. has played no useful or constructive role, and has largely contracted out of the post-war problem, confining itself mainly to giving petulant and unhelpful advice at ill-chosen moments.²⁷

It is solely because the dollar remains scarce that most countries maintain discriminatory import restrictions against U.S. goods: that sterling remains inconvertible against the dollar: and that bilateral trading relationships are widespread.

Nevertheless a substantial part of world trade (more especially that part financed by sterling) is multilateral in character; the pound enjoys a wide area of convertibility,

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and the European Payments Union has recently enlarged the area in which multilateral settlements are made. Nor has any attempt been made, as proposed by the more extreme anti-multilateralists, to organize a preferential trading bloc completely independent of the dollar; the reliance of the world on dollar supplies has made any such idea quite unrealistic.

The picture is therefore a very mixed one, containing both bilateral and multilateral features. But the point to be emphasized is that the partial nature of the restoration of multilateral trade has been due not to wickedness or blind stupidity in the non-dollar world, but to the continuing scarcity of dollars. So long as this continues, any attempt to dash for freedom spells disaster.

NOTES

¹ E.C.E., 1949, Table 89.

² Imports from the U.S.A., in order of importance, are: cotton, machinery, tobacco, wheat and coarse grains, vehicles (including aircraft), oil, chemicals, copper and zinc.

³ The Government was reprehensible in 1952, for example, at a time when several Latin American countries were short of sterling and when surplus capacity existed in many British export industries, in not encouraging the market for British goods by a more extended use of barter deals, and even by the provision of credits. For comments on the performance of private industry in these markets, *v.* Part II, chapter ix.

⁴ *v.* pp. 66-8.

⁵ In all this discussion the collective term 'Dominions' is of course exclusive of Canada.

⁶ The annual drain of the I.S.A. (Columns 2+3) has been as follows: (— = net drain on central reserves):

1946	1947	1948	1949	1950	1951	First Half 1952
—10	—184	—63	—57	+121	+11	—57

⁷ For details of these calculations, *v.* article by ERNEST H. STERN, *The Banker*, November 1952.

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⁸ The figures for the balances of individual R.S.A. countries are taken either from the E.C.A. study (op. cit., Tables 36, 78, 90, 98, 141), or from CONAN (op. cit.).

⁹ *The Banker*, January 1951. CONAN (op. cit., pp. 125-8) gives even higher figures for the flight capital.

¹⁰ Out of the total R.S.A. current account deficit between 1946 and mid-1952 of £1425 millions, South Africa was responsible for £670 millions, Australia £423 millions, India £480 millions; no other countries (save Eire) reached three figures (STERN, loc. cit.). This shows clearly how narrowly confined to a trio of countries the R.S.A. problem is.

¹¹ Though this danger was partly mitigated by various agreements with the South African Government to ensure a minimum flow of gold. But it is certainly the case that this inflow of sterling was a general encouragement to import extravagance.

¹² Cmd. 8080.

¹³ Many people became anxious about these Dominion balances during the post-Korean commodity boom, when they rose to great heights; but they fell equally rapidly after the break in commodity prices to a level not very much higher than their 1945 starting-point. E.g. the Australian balances, which were £200 millions in 1946, rose to £700 millions in mid-1951, only to collapse to £300 millions in mid-1952.

¹⁴ CONAN, op. cit., pp. 138-9.

¹⁵ Nothing more is said here on the price of gold, the importance of which has already been made clear in an earlier chapter. In view of present American attitudes, a concession would be a purely windfall gain, and there is no reason to expect it.

¹⁶ R.S.A. exports to the U.S. in 1949-50 were as follows in order of importance: wool, rubber, jute, tin, diamonds, cocoa, hides and skins, crude oil, tea, furs. (E.C.A., op. cit., Table 5.)

¹⁷ E.C.A., op. cit., Table 8.

¹⁸ These increases understate the typical post-war situation; R.S.A. dollar imports were much lower in 1949-50 than in 1947, 1948 or 1951.

¹⁹ Of course those countries with large amounts of surplus labour in the countryside (e.g. India) have much less choice in the matter than countries such as Australia. Industrialization is for them a matter of necessity to help solve the employment

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problem (unless, by irrigation and flood-control, they can greatly increase the area of cultivable land). But they still have *some* choice. Recent developments in India suggest that the high price of rice is already exerting an influence in the right direction.

²⁰ Some measure of the strain may be gathered from the fact that the I.S.A. countries, with one or two others, together ran down sterling balances by £750 millions between mid-1951 and mid-1952, Australia being mainly responsible.

²¹ In normal times this condition would be superfluous if (e) were fulfilled, since no motive for inconvertibility would exist. But in a transitional period, even if dollars were not currently scarce, countries might still wish to hoard them in order to build up large reserves.

²² *v.* Part II, chapter VI.

²³ *v.* *Economist*, November 22nd, 1952.

²⁴ Any scheme which entails non-discrimination as well as convertibility naturally requires an even more exacting interpretation of the condition that dollars should be plentiful.

²⁵ *E.J.*, December 1946.

²⁶ In this connection the writings of Dr. Balogh must receive special notice. Although his practical solutions were always not feasible, he was foremost in insisting on the permanence of the dollar problem as against the majority who saw it as purely transitional.

²⁷ Such as its advice to a number of countries in the winter of 1950-51 to lift restrictions on dollar imports — just a few months before a most severe dollar crisis.

VIII

THE THIRD PROBLEM: AMERICAN RECESSION

THE third payments problem which Britain has to face is the cyclical problem — in effect, the danger of periodic American slumps. It has already been seen that American import fluctuations, occurring even without significant changes in the level of employment, may transmit to the rest of the world an exasperating degree of instability. But we are here concerned with something more serious, namely significant changes in the level of employment. These, accompanied as they will be by the usual movements in inventories and consequent price speculation, will cause even bigger fluctuations in import values, and thence in incomes and employment abroad.

What scale of fluctuations are we to expect? Reasons were given in Part II, chapter VI, for thinking that the U.S. would not again suffer a depression of the catastrophic magnitude of 1931, but that cyclical changes in employment would continue, with the recession of 1937-38 perhaps providing an approximate norm. Taking those years as an illustration of what the world may have to cope with (while recognizing that worse might easily happen), the consequences for the supply of dollars can be roughly estimated. The 4 per cent fall in employment between 1937 and 1938 was accompanied by a 35 per cent drop in the value of merchandise imports. Applying these figures to current levels of imports, and allowing also for invisible payments and capital movements, it has been calculated that a recession of this magnitude would deprive the world of \$10 billions over the whole period of recession and recovery.¹

This is the measure of the direct effect. But there are also very pervasive indirect effects. The 10-billion fall in the

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dollar receipts of those countries which export to America represents both a fall in exchange reserves and also a fall in the incomes of exporters. Naturally dollar imports must be cut, since dollars are no longer available. But imports from other countries are also reduced, partly on account of the fall in internal incomes, and partly because Governments, perceiving their reserves to drain away, have in the past clamped down quite indiscriminate import restrictions. This has the effect of transmitting the depression to countries which may themselves have been little affected by the fall in U.S. demand. They find their exports falling, so they in turn cut imports, and the whole process becomes cumulative. The disease proves contagious, and the whole world is eventually contaminated.

The Sterling Area is particularly vulnerable both to the direct and indirect effects. Its exports to the U.S. decline by more than the average — exports from the R.S.A. in 1937-38 fell by 51 per cent, compared with the average of 35 per cent; while for most Sterling Area countries the value of foreign trade is an unusually high proportion of the national income — in 1949-50 over 50 per cent for Malaya and Rhodesia, between 25 and 50 per cent for Ceylon, South Africa, New Zealand, Eire and Australia, and 18 per cent for Britain — so that their economies are very sensitive to any contraction in world trade.²

II

Past history shows that when a decline in American business activity occurs, it is principally raw material imports that are affected. Since the supply of raw materials is almost always (in the short run) very inelastic, the effect of a fall in demand is felt on price rather than on output. The initial impact is thus not widespread unemployment in industrial countries, but falling prices and incomes in primary producing countries. In both 1929-33 and 1949 nearly two-thirds

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of the fall in the value of U.S. imports was due to a fall in price and not in volume (though in 1937-38, exceptionally, the proportions were reversed). World unemployment only follows as a secondary effect, when the impoverishment of primary producers reflects itself in lower purchases of manufactured goods.

Thus if the fall in raw material prices and purchases could be prevented, the secondary fall in employment would hardly occur at all. This analysis points strongly to the need for world commodity and buffer stock agreements.

There has been too much complacent talk about these in the last few years, and too little action. Such agreements were already envisaged in the Draft Charter of the I.T.O., and have been much discussed by the F.A.O., as well as in unofficial circles. Yet only one such agreement — for wheat — has been concluded. This is deplorably slow progress. The British Government (not to mention other Governments in the Commonwealth) has been sceptical and suspicious, and therefore inactive, all along. It seems to have been actuated by the fear that such arrangements would mean a higher average price for primary products than would otherwise be the case: and that this further deterioration in the terms of trade, already unfavourable enough, would be unbearable.

This is a short-sighted view. A greater stability would, over the long run, encourage higher output, and help to ease the coming shortage of primary products. Moreover, so long as a central dollar pool exists, it must depend for its replenishment mainly on the raw material earnings of the outer Sterling Area; nobody who has attended to recent movements in the reserves can reasonably prefer low commodity prices. And if one adds the particularly stubborn employment problem presented by falling British exports, and the universal desire to strengthen the economies of the under-developed countries, the case for more stable prices and buffer-stock arrangements is surely irresistible.

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This, then, should be the first line of defence against an American slump. Certain proposals for stabilization agreements were made in a recent U.N. Report.³ It is admitted that there are grave practical difficulties about making such arrangements, but any prudent British Government will at least press actively for their study at an international governmental level.

III

But whether such arrangements will in fact be made before an American recession comes, no one can tell. At the moment it looks unlikely, and it would be wise to consider further lines of defence.

A second, though more limited, approach is to concentrate on the loss of foreign currency caused by the fall in American imports, and the consequent crisis of the reserves. The difficulty here is the inadequacy of world reserves of gold and dollars. At mid-1951 these were only one-fifth higher than in 1937, whereas imports (into countries other than the U.S.) were $2\frac{1}{2}$ times higher; reserves are therefore a far less adequate defence against fluctuations in trade than before the war, especially as the speculative pressure on any currency showing signs of weakness is much greater than was normal then.

The present level of reserves represents, on the average, about 25 per cent of the annual value of imports. A decline in American demand on the scale envisaged could easily involve a fall in export earnings by this amount; there are plenty of instances in the past, without counting 1931, where this has occurred. With reserves at their pre-war level, such a prospect could be faced with comparative equanimity, or at least without a damaging exchange crisis. With reserves at their present wretched level, it would spell catastrophe. The I.M.F. provides no help worth speaking of; its total holdings of gold and dollars amount to \$2.8 billions — a puny

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sum when compared with a possible \$10-billion fall in dollar supplies.

The ideal solution is clearly one which would enable the rest of the world, despite the loss of dollar earnings, to maintain or replenish its reserves, so that drastic import cuts might be avoided. The most detailed suggestions along these lines were made by a committee of economists set up by the United Nations in 1949.⁴ The authors of that report made two major proposals.

First, they proposed that a country whose imports had fallen as a result of a fall in internal demand should make available to other countries a supply of its own currency equal to the value by which its imports had declined (in comparison with a base-year). Britain, for example, would then receive a supply of dollars equal to the amount by which its dollar earnings had fallen as a result of the U.S. recession. These special currency supplements from the depressed country would be repayable if, in future years, when depression gave way to boom, its own reserves began to diminish, and those of other countries to increase.

Secondly, in order to avoid the fluctuations in long-term lending which historically have accompanied cyclical movements in current trade, and still further de-stabilized the international flow of currencies, each country should fix for five years ahead an annual target for total foreign investment, and if actual investment in any year fell below the target the Government concerned should make up the difference by loans to the International Bank. In this way, the flow of U.S. investment dollars would be stabilized throughout the period of American recession, instead of contracting and further restricting a supply of dollars already diminished by the fall in imports.

These two schemes, taken together, would have the effect of wholly maintaining the world supply of dollars. They would enable the world to stabilize its purchases from the U.S. without any outflow of gold, and thus would benefit

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both the U.S. (by preventing any fall in external demand for American goods, and so partially cushioning the internal deflation), and the other nations (by enabling them to hold imports at a higher level than would otherwise be possible). The balance of payments aspect of the problem would in this way be largely solved without the need for measures of trade restriction.

There is nothing in these proposals, of course, which would prevent a fall in primary prices consequent on the cessation of U.S. demand. Although dollar imports could be maintained, internal incomes would still decline, and so would earnings of non-dollar currencies. There would still be a tendency for primary producing countries to reduce imports from the manufacturing countries, and so start a secondary deflation there. Special dollar subventions are thus not a complete substitute for the international commodity schemes discussed above, which still remain the essential condition of preventing the spread of depression. Nevertheless, the greater part of the fall in the reserves would be avoided, and at least exchange considerations would not be a major factor compelling import restrictions.

But the real difficulty is political. All such proposals are meaningless except in relation to the U.S.A., which, however discreet and anonymous the language used, is the subject of every recommendation. It is action by Congress that is required. But no one who has examined the behaviour of Congress in recent years could conceivably hope for the adoption of any such scheme. Each annual programme of foreign aid has been the subject of months of debate and continuous modification as Congress jealously guarded its rights over expenditure. In the light of this experience, there really is no hope that it will commit itself, for some years ahead, to amounts of dollar aid that are neither foreseeable in advance nor under its own control. This was made quite clear by the U.S. representatives when the Report was debated at the U.N. Economic and Social Council.

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A second group of economists was therefore asked to suggest an alternative approach which might be more congenial to Governments. Their report⁵ made the more orthodox, but perhaps more practical, proposal that efforts should be concentrated on the existing international institutions. In particular, a pronounced liberalization of the rules of the I.M.F. was suggested, so that member countries might have freer and less conditional access to its resources; and above all a large increase in the total of its subscriptions, which were inadequate at the start and have since been made to appear even more paltry by the post-war rise in prices. In addition, the Fund should take power to borrow from the country experiencing the recession.

These proposals also, although they take a form which, because less rigid and automatic, stands a greater chance of acceptance, rely in the last resort on action by Congress. All suggestions for dealing with the exchange effects of a U.S. slump come down in the end to the same thing: the injection into world trade of large supplies of (repayable) dollars to replace those lost through the fall in American demand. If the U.S. is willing to make these recurrent injections, then the rest of the world, its gold reserves replenished, can largely avoid the need for import cuts. But if not, then no alternative exists but to restrict imports to the full extent that dollar receipts have fallen.

I V

If such restrictions become necessary, the non-dollar world will have to employ every device of discrimination and bilateralism to maintain trade outside the U.S., and to concentrate the restrictions on to dollar goods. In the past, a fall in dollar earnings has been followed by import cuts all round, and the deflation was transmitted to still more countries. But this secondary deflation could be partially avoided if the reductions were deliberately selective, and

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confined to imports from America, while imports from elsewhere were maintained.

There is nothing impossible about this. Take the two Sterling Area countries most affected by a U.S. slump: Australia, directly hit by the fall in U.S. demand, and Great Britain, more concerned with the secondary consequences. Australian dollar receipts from wool collapse — in the past, by over 50 per cent in the first year of recession. Naturally dollar imports must be cut. But why should imports from Britain also be cut? The obvious answer is that the fall in the price of wool means both a decline in sterling receipts from the sale of wool, with a consequent shortage of sterling, and a decline in internal incomes leading to lower imports all round.

But in the first place, if Britain preserves full employment, sterling receipts fall much less than dollar receipts: the *volume* of British wool purchases does not fall, and in the case of other Australian exports whose price is little affected by American demand, the value of British purchases is fully maintained. The reserve position should therefore encourage a heavy discrimination against dollar goods.

Secondly, since Australia now has unwanted surpluses of primary products for which U.S. demand has fallen, it is in her interest to make a bilateral arrangement with Britain to sell us these extra supplies in exchange for manufactured goods which otherwise would have to be forgone; and she would thus acquire the necessary sterling with which to maintain her British purchases.

The British interest is in exactly the same direction. Some slight unemployment will already be apparent in her export industries following the decline in American demand, and Government and manufacturers alike will be anxious to preserve their other markets abroad. Moreover, the shortage of dollars will have enforced severe reductions in dollar imports, and Britain will wish to buy alternative supplies provided that at the same time she can stabilize, or even increase, her exports to the countries concerned.

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There will thus be a very wide scope for bilateral or even barter arrangements, since the interests of all non-dollar countries will be the same — to sell elsewhere the goods they can no longer sell to America. In this situation it would be absurd to let trade languish in preference to making such agreements; nothing is sillier than the spectacle of two countries, each with export trades depressed and everything to gain from increasing mutual trade, unable to do so because they lack each other's currencies.

If the shortage of sterling were really serious, and Britain could not physically absorb any larger supplies of (e.g.) Australian wool, it would be wholly to her interest to make loans in order that the export labour force might be neither unemployed nor lost elsewhere. Nothing could be more sensible than that Britain should, at times of low commodity prices, finance a surplus with primary-producing countries by means of loans or a run-down of sterling balances, offset by an equivalent deficit at a time of U.S. boom and commodity inflation. Between them, a policy of cyclical foreign lending, the use of bilateral methods, and import discrimination against the dollar would enable countries outside the U.S. largely to maintain their purchases from each other, and at least a shortage of foreign exchange (other than dollars) would not then disseminate deflation round the world.

Some import cuts falling on non-dollar goods are unavoidable owing to the fall in primary incomes. But if all countries would act in the way described above, their extent would be enormously lessened, and the worst secondary effects of the slump would be avoided.

What is required is a prior agreement about these matters between a large number of countries. This should not be impossible. Many of the countries most concerned are in the Sterling Area, and this whole discussion underlines the need, stressed already in the last chapter, for a closer co-ordination of trading policies within the Area; the apparently non-dis-

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criminating nature of the Australian import cuts in the spring of 1952 is the reverse of what is needed. Canada, outside the Sterling Area, is intimately concerned, so close are her trade ties with the U.S.; if her exports to the U.S. fall, one may hope for more discrimination in her import cuts than before the war; British goods now compete with American goods over a much wider range, and Canadians are more aware of the possibilities of substitution. Again, the O.E.E.C. countries with their dependent overseas territories constitute an organized and central group, and here too concerted action should be possible. Nobody suggests that a firm undertaking to discriminate and substitute can be exacted from every country in the world, but given a clear British initiative very many countries might be encouraged so to act, with markedly beneficial results on the level of world employment.

V

The reduction in dollar imports might be effected in two ways, as between which there is no basic issue of principle. The one is a movement of exchange-rates, the other the use of quantitative import restrictions. Both would, of course, be used in a deliberately discriminating manner. Just as the physical restrictions would be imposed only on imports from the U.S.A. (and any other similarly depressed countries), so would exchange-rates be moved down selectively, the aim being that all other major currencies should be simultaneously devalued against only those currencies rendered scarce by reason of internal deflation.⁶ The object in view would be the same whichever weapon was chosen, namely to discourage dollar, but not non-dollar, imports, and to encourage world substitution of non-dollar for dollar goods.

The exact circumstances must determine which weapon is employed.⁷ Whereas controls operate solely on the side of imports, currency devaluation also gives a stimulus to

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exports. It therefore has an expansionist as well as a restrictionist effect on the total volume of trade, and acts as an important financial inducement to the substitution of non-dollar for dollar imports, and so the encouragement of world trade outside the U.S.A. In principle, therefore, currency adjustments may be thought preferable.⁸

But in practice many countries may find themselves in a position where a lowering of their export prices will not raise, and may reduce, their export earnings, either because limited capacity in their export industries prohibits a large rise in the physical volume of exports, or because foreign demand for their exports is inelastic. In this situation imports would in any event have to bear the burden of adjustment, and it would then be pointless to choose currency devaluation rather than import controls, since the former would bring in its train, while the latter would not, a deterioration in the terms of trade and a reduction in real incomes. If no help can be expected from higher exports at lower prices, physical restrictions are always to be preferred. On the other hand there will be countries of which this is true and which must yet choose to work through exchange-rates, merely because their administrative apparatus is not adequate to the task of manning a proper system of controls.

One cannot theorize in advance about the right technique. Governments must be free to choose whatever method seems in the circumstances most likely to be efficacious, provided only that its object is genuinely to maintain the levels of world trade and income, and not to snatch a competitive advantage at the expense of other nations in a similar plight.

VI

Everybody would prefer to avoid this outcome. Nobody likes bilateralism and discrimination for their own sakes. They have the obvious disadvantage that, by concentrating

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the import cuts on the U.S., they aggravate the depression in that country; and they involve shifts in the source of imports, and the direction of exports, which are necessarily disturbing to production. But all this is better than passively to allow a creeping paralysis to grip world trade; and it is advocated solely in the belief that the more multilateral and non-discriminatory the network of trade, the quicker a U.S. recession will spread.

Even today, with full employment in America, the world has not found it possible wholly to dispense with bilateralism and discrimination. This emphasizes just how drastic and wholesale must be the reversion to these practices if the present precarious position is further disturbed by a new and violent cause of dollar shortage in the form of a U.S. slump. It would then be quite wrong to renounce the use of any weapon for maintaining trade in the non-dollar world. If America dislikes this prospect, she has the remedy in her own hands, which is to adopt one or other of the U.N. proposals for replenishing the supply of dollars. If she chooses not to, she cannot blame the other nations for taking elementary (and, unfortunately both for them and for herself, inadequate) measures of self-protection.

VII

The severity of the employment problem in Britain will depend on the success of international measures to keep up the volume of trade. But assuming that these are at best only partially successful, there are three distinct sources of unemployment: the direct effect of the fall in exports to America, the effect of import reductions elsewhere, and the multiplier effect on internal incomes.

Of these, the first is not so serious. It is true that British exports to the U.S. fell by 40 per cent in 1937-38, and doubtless would do so again. But these exports account for under

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5 per cent of the total, so that the number of jobs affected would not be large. Moreover the effect would be very widely spread. Our exports to the U.S. are of a heterogeneous character, and there would be no painful concentration of unemployment in any one industry.⁹

The real problem comes from the import reductions elsewhere. A high proportion of British exports goes to countries particularly vulnerable to American recession, and it was their restrictions which caused a fall in the total value of British exports of 47 per cent between 1929 and 1931, and 10 per cent between 1937 and 1938. The 47 per cent figure exaggerates the employment problem, since one-third of the fall in value was due to lower prices, but the 10 per cent figure slightly understates it; export prices, rather surprisingly, rose a little between 1937 and 1938, and the fall in volume was over 12 per cent. This is the measure of what we have to fear from a comparatively slight U.S. recession, given the same international policies as prevailed before the war.

But at least it should be possible to avoid the internal 'multiplier' effect. As incomes and employment fall in the export trades, so does the labour force in those trades spend less on home-produced goods, and a further round of deflation is felt in home industries as well. The fall in employment due to reduced purchasing power in the export industries may well in the past have been as large again as the direct export unemployment.

This secondary effect can certainly be stifled. The reduced demand is spread evenly over the whole of British industry according to the current national pattern of consumption, and it is therefore susceptible of cure by general measures of monetary expansion through the Budget. No fresh theoretical problem is raised, and even though the practical application be imperfect, there is no reason why a determined Government, by the use of fiscal policy, should not reflate home demand so as to prevent this secondary depres-

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sion, and confine the unemployment to only a half of what it would otherwise have been.

But such indiscriminate methods of expanding demand are of little use for dealing with the unemployment in the export trades, since that unemployment is distributed not according to the national pattern of consumption, but according to the pattern of demand from the export markets most affected, which is a quite different thing. Suppose a fall in export demand concentrated (as is very likely) on textiles: it is of no use to increase total home consumption by an overall cut in taxation, since only 10 per cent of consumers' incomes is spent on clothing. The textile industries would gain little from the new purchasing power, 90 per cent of which would be spent on other goods. Worse still, assuming full employment elsewhere, this 90 per cent would cause a serious inflationary pressure in the rest of the economy. Something more subtle and selective is needed when the unemployment is localized and not general.

Since the recession in the U.S. is cyclical in character, and since therefore exports may be expected to pick up again as recovery starts, it is desirable as far as possible to find alternative employment in the same industries. Experience of coal and textiles after the war has shown how hard it is for such industries to recapture labour once they have lost it. That is why the ideal solution is to find alternative export markets, so that no change of employment is involved, but only a change in the direction of sales.

The possibility of finding these differs for consumer and capital goods. The former will face the worse employment problem, for, being less essential, they will bear the main brunt of the fall in world imports.¹⁰ But if there is general discrimination, they may more easily find new markets. The initial cuts in dollar imports will fall most heavily on consumer goods, and possibilities of substitution will therefore present themselves. Moreover it is easier for primary-producing countries to absorb a sudden increase in the flow of

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British consumer goods than of more specialized capital goods, whose profitable utilization may require planning long in advance. The outlets may thus be there, provided the means of payment can be found; and it will be well worth while, as suggested above, to make loans in order to divert frustrated exports to other markets. The colonies will offer a most suitable outlet; their sterling balances have grown steadily since the end of the war, and it would be to their advantage and to Britain's that they should draw on them during an American recession.

In the case of capital goods, foreign demand will decline by less, though to the extent that it does fall it may be harder to find alternative markets abroad. Development plans cannot quickly be adjusted to fit a fluctuating supply of capital goods, especially when these latter are highly specialized. But these industries produce many goods of very general utility, and in view of the large and growing world demand for engineering products it should be possible to find some absorptive markets. A high proportion of U.S. exports consists of iron and steel products, machinery, and vehicles, and the acute world dollar shortage will certainly permit some substitution here.

In so far as new export markets cannot be found, the next best thing is to find a new home market for the goods concerned, so that a transfer of labour may still be avoided. Here the case is easier with capital goods. The nationalized industries have a large and varied demand for investment goods, and the direct control which the Government exercises over them, together with its influence over private investment, can ensure a considerable increase in home orders. Consumer goods are a worse problem. The unemployment will be greater, and home demand for particular goods cannot easily be stepped up. The pent-up demand accumulated from the war, and held back by rationing and purchase-tax, has now been largely worked off, and there is no reserve of demand for individual commodities waiting to be released by

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the removal of restrictions. Some movement out of these industries is therefore unavoidable.¹¹

But what sort of movement? It is not enough for the Government to limit its responsibility to seeing that sufficient jobs are available *somewhere in the country*. Married women in Lancashire cannot be asked to move to the Midlands, and even in the case of men their natural reluctance to leave their own home districts will only prolong the period of unemployment. Nor can the problem be solved by 'public works' of the traditional kind; such projects cannot be laid on and off at will, and the labour will often be quite unsuitable.

What is required is the maximum diversification of employment in each major industrial area. There must be an end to regions solely dependent on textile mills or coal mines; the ideal is that factories drawn from different industries should jostle each other in the same locality. Unemployment is the more difficult to deal with, the more geographically concentrated are the industries concerned; and full employment requires as a necessary condition the greatest possible 'scatter' of industries. Of course some (mainly heavy) industries must be tied for economic reasons to particular areas; but more and more is it true that industry is geographically mobile in the sense that cost-differences between different regions are diminishing.

The residual problem of export unemployment, therefore, once everything has been done to find alternative sales, is essentially one of location policy, and points to the need for maintaining Government controls over the siting of new factories.

No Government faced with an American slump can guarantee full employment at the level of the last few years. But resolute action along these lines could, given a reasonable modicum of international planning, keep the resulting unemployment within bearable limits — but only if the action is resolute, and only if it is taken in time. A Government

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which adopted *laissez-faire* would soon see the unemployment figures surmount the million mark.

VIII

It is sometimes said that the real threat to full employment, in the event of an American slump, will come not so much from the fall in demand as from a shortage of raw materials. The fall in exports will cause so large a balance of payments deficit that imports will have to be cut to the point where essential supplies for industry are affected. It will then be of no use to set about expanding home demand, since employers will not have the necessary materials with which to provide the labour.

This is not good sense. Few of our essential material imports now come from America. The vast majority come from non-dollar countries which will be badly hit by the slump. Assuming the failure of international measures to stabilize commodity purchases — and otherwise the problem does not arise — these countries will have huge surpluses for which they long to find alternative markets. It is then (and only then) that Britain's bargaining position as the world's second largest market will be overwhelmingly strong, and it is ridiculous to imagine that we shall not be able to make bilateral agreements with these countries to secure our essential needs. Raw material difficulties in Britain come in periods of primary shortage, not primary surplus.

NOTES

¹ *Measures for International Economic Stability* (United Nations, 1951).

² Figures in this chapter, unless otherwise attributed, are taken from E.C.A. *The Sterling Area*, pp. 24, 42-6 and Tables 5, 7, 18; *Britain and World Trade* (P.E.P.), Appendices to Chapter IX; and L.C.E.S. *Bulletins*.

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^a United Nations, op. cit.

^b *National and International Measures for Full Employment.*

^c *Measures for International Economic Stability.*

^d That a simultaneous re-alignment of most world currencies against a few 'hard' ones is possible was shown by the events of September 1949, when the downward adjustment of sterling led precisely such a general movement.

^e For a useful discussion of the different characteristics of these alternative techniques, v. *Full Employment Objectives in relation to the Problem of European Co-operation* (Council of Europe, Strasbourg 1951), pp. 41 seq.

^f It has been the fashion recently to talk down the efficacy of devaluation, particularly on the side of exports. Reference is made to pre-war experience. It is quite true that currency adjustments in the 1930s were often ineffective, owing to subsequent competitive depreciation by countries which, being themselves in surplus, had no justification for such a move. (The classic example is the devaluation of the U.S. dollar in 1933, which was carried through in a very frivolous manner.) But where competitive depreciation was (for at least a time) avoided, results appear to have been not negligible. The depreciation of sterling in 1931 led to a sharp rise in the British share of world exports of manufactures, which fell back again after 1932 when the U.S. and other important countries all devalued in turn (v. G. D. A. MACDOUGALL, *E. J.*, March 1947). This impression is confirmed for the post-war world by the experience of the 1949 devaluations (v. Part I, chapter III), which also suggests that manufactured exports are more sensitive to relative price changes than is sometimes imagined.

Of course this sensitivity on the part of European exports presupposes no illegitimate competitive depreciation of the dollar. If the U.S. Government, in addition to failing to stabilize its own level of employment, were also deliberately to attempt to export its unemployment by an all-out trade war supported by devaluation, then indeed all would be lost, and the only salvation would lie in bilateralism and autarky at all costs. But the post-war policies of U.S. Administrations suggest that, despite occasional backsliding, they are not willing completely to jettison all their liberal ideals of a multilateral system by action of so violently

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aggressive a character. And the extent to which collective discrimination on the lines outlined above would give to the U.S. an excuse for breaking the 'rules' must not be exaggerated; Biblical sanction for discrimination can be found in the 'scarce currency clause' of the I.M.F. Charter. But perhaps one should not alarm oneself unduly about a devaluation of the dollar, since its effect on the price of gold would be both a deterrent to the U.S., and a compensating comfort to the Sterling Area, should the eventuality ever arise.

⁹ The share of different goods in total U.K. exports to the U.S. in 1949-50 was as follows: spirits 18 per cent, woollens 15 per cent, vehicles 7 per cent, machinery 5 per cent, linen goods 5 per cent, tin metal 4 per cent, leather goods 4 per cent, chemicals 3 per cent, pottery 3 per cent.

¹⁰ In the first nine months of 1952, when the recession in world commodity prices led to a decline in British exports, metal and engineering exports were actually slightly higher than a year before (except, characteristically, cars), textiles 28 per cent lower, other manufactures 5 per cent lower.

¹¹ A sensible Government would try not merely to maintain, but actually to increase, the total demand for capital and engineering goods, so as to absorb some of those unemployed in the consumer goods industries into a sector which, looking ahead, needs more labour than it now possesses.

IX

CONCLUSIONS

THE whole emphasis of this book has been on the structural nature of the economic problems facing the United Kingdom. They have their origin, not in any faulty price relationships, or excessive incomes, or unwise rates of interest, in the United Kingdom itself: but in a major revolution, of the kind that only occurs perhaps once or twice in a century, in world economic relationships. Britain has finally lost her industrial leadership to the United States, and that country now bestrides the world in so colossal a fashion that the dollar and non-dollar worlds can reach no proper balance; and Britain finds herself merely the tallest amongst the pygmies who make up the latter. At the same time she has lost the subsidy to her standard of living which for many decades she had received from primary producers the world over; and she is now the biggest victim of the growing shortage of food and raw materials.

To these problems, the orthodox discussions of the financial experts seem magnificently irrelevant. They diagnose only a little flatulence, due to excess and riotous living, and easily susceptible of cure by the knife. They take the knife to everything as consistently as Cutler Walpole to the nuciform sac, and with as much scientific justification. A few painful cuts here and there — in government expenditure, in subsidies, in the level of home consumption — and the disease will be cured. Nothing seems to have been learnt from the 1920s, when internal deflation, so far from aiding the structural adjustments that were so badly needed, positively hindered them, and froze a weakened economy into exactly the wrong shape. It is still assumed that changes in prices or incomes, to be obtained by fiddling with the Bank Rate, will somehow bring the pound and dollar into balance, and

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spirit away the problem of the terms of trade. The City experts have learnt nothing and forgotten everything, and it is one of the more tiresome features of Conservative rule that these Adullamites have not merely crept out of their caves, but have gathered respectful audiences around them.

The fashionable diagnosis of our ills thus makes a very unreal impression on the student. The talk is everywhere of living beyond our means; of inflation; of excessive consumption; and of the evils of subsidized food and rents.

This talk pays no attention to the facts. For all the last five years, save one, Britain has lived within her means, and the overall account has shown a balance. It is true that dollar borrowing was necessary owing to the general inconvertibility of currencies; but it was balanced by equivalent lending to other countries, notably within the Empire.

Great difficulties in preserving a balance still face us. But these cannot be attributed mainly to inflation when exports are so much higher, and imports so much lower, than during the depressed 1930s. Nor are they due to extravagant consumption at home. Imports, rigidly controlled below the level at which free demand would set them, are not now dependent, as they would be in a free economy, on the level of home demand; and a small cut in that demand would not affect them. A relation between home consumption and exports is more easily established. But even here consumption is not the main competitor with exports, the largest component of which is engineering goods. Where it has been an obvious competitor, it has been held back by specific restrictions (rationing, purchase-tax, or government agreement with the industry concerned). But over the most important sector of exports the main impediment has been the supply of raw materials, and in particular steel; and for these supplies the home consumer is not in general a serious rival.

The bankruptcy of the orthodox school is equally evident when it comes to prescriptions for the future. Dear money

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is all the fashion now. It may have had some minor good effects (e.g. in forcing excessively high stocks on to the market) as well as some minor bad ones. But if taken seriously as a cure, and pressed to the point where it has a decisive influence, it can only lead to a decline in badly-needed investment, and consequently a worse outlook for productivity and therefore exports. Belgium, which has enjoyed the highest rates of interest in Europe and the lowest increases in output and productivity, should be a warning. Dear money means low investment, and low investment means an unprogressive economy. No doubt a cure can eventually be achieved this way, at very low levels of trade and income. But it is not a cure that Britain, whose only hope of solvency at a high standard of living lies in high investment and rapid technical progress, can possibly afford.

It is suggested that the weight of taxation on company profits is the main evil, since it reduces corporate saving, and thereby prevents investment. But investment since the war has been held back not by a shortage of finance — indeed industry has actually been a net lender¹ — but by a shortage of physical resources. The finance has been there to pay for the whole investment programme permitted under Government planning (and often rather more). If a higher investment is thought possible, then certainly consumption must be reduced and savings increased. But this is more equitably done through a larger Budget surplus than through a rise in the retained profits of companies; the higher savings can then be translated, by the intricate operations of the financial mechanism, into funds available for borrowing by industry. (There is no justification for the view, so sedulously propounded by industrialists, that industry should be able to finance its entire capital expenditure out of undistributed profits, without recourse to borrowing or new issues.)

In the end, all the proposed remedies come down to more disinflation. The case against this was argued in detail earlier.² It will not reduce imports, which are already con-

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trolled, unless carried to the point of creating large-scale unemployment, which apparently is not proposed. It will not aid engineering exports unless it leads to a fall in home investment, which is the serious rival claimant to the output of engineering goods. If it were to do so, it would be the most recklessly shortsighted policy conceivable. The quick advantage to exports would be far more than outweighed by the long-run effects on productivity, and possibly on the provision of new capacity, especially in steel, owing to the depression of expectations of future demand and profits.

All these prescriptions lay an exaggerated stress on the market mechanism and movements in prices and incomes. No doubt the price mechanism is quite efficient when it comes to small changes at the margin. But where it is a matter of large organic changes, it either works in a very wasteful fashion (i.e. at the expense of a loss of output and falling productivity), or else it does not work at all. The great necessity is a major structural change in the pattern of British industry, and the history of the 1920s shows that this sort of change does not ensue easily or automatically on a deflationary policy.

Of course it is important to avoid inflation, and to restrain consumption so as to allow the necessary home and foreign investment. But this is a necessary, not a sufficient, condition of solvency; by itself it will not secure a higher output and export of the right goods. And, carried too far, it must have the reverse effect to that desired, and act as a drag on the very expansion that is needed.

II

Similarly in the field of foreign economic policy, the liberal solutions either will not work at all, or will only work in a quite unnecessarily wasteful and painful manner. The right conditions for convertibility are not in sight. A devaluation of the pound would only effect a cure if carried to the point

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where it involved a severe (and superfluous) fall in the standard of living (which is not to deny that at the right moment it might contribute to a cure). A relaxation of import controls would plunge us into violent deficit unless accompanied by deflation and unemployment at home. British Governments must be firm against all these *deus ex machina* solutions, which fly in the face of reason and all the facts, and derive from a purely mystical belief in the efficacy of free markets. Indeed it is incredible that they should be seriously put forward now, only a year after one of the worst periods of dollar scarcity in recent times, and perhaps only a year or two before an American recession will call for the use of every control in our armoury to ward off mass unemployment and a crisis of the reserves.

None of this is to justify rancorous abuse of the United States in week-end speeches or weekly journals. This is in any case an ungrateful response to the help which Britain derived from Marshall Aid. But it also betrays a confusion of thought. To oppose the American desire for free exchanges, and to criticize their attitude as unrealistic, is not to imply moral censure on their policies. There is much too much sanctimoniousness about America on the British Left, and a tendency to criticize her for having a trading surplus at all. But the U.S. cannot be blamed because the world chooses to buy more goods from her than she from the rest of the world; and there is no moral duty on her whatsoever to finance this surplus by large grants or loans to Europe (though there is to avoid protectionist policies at home while calling for freedom elsewhere). If we dislike the surplus, we can eliminate it by buying fewer dollar goods; we cannot ask the Americans to give away the goods we cannot pay for.

What can be said, however, is that while this surplus persists, there is no onus on us to dismantle our defences and adopt those policies which happen to find favour with the U.S. Administration. We have every right to solve the problem in our own way, just as the U.S. has every right to

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run a surplus if the rest of the world is acquiescent. Neither side has a moral case against the other, as a little thought would show, if the fanatics on both sides were not so mentally encrusted in a rock of self-righteous indignation.

III

The real requirements for solvency, as opposed to mere monetary juggling, have been described in earlier chapters. Primarily they are an expansion of output in steel, coal and engineering, and a sufficient increase in the export of such goods not merely to cover worsening terms of trade, but also to allow a surplus for foreign investment. This is partly a physical and economic problem of securing the necessary redeployment of resources, but partly also a psychological one: unless traditional attitudes are surrendered, the redeployment will not take place with the required speed and thoroughness, nor, even if it did, would the goods be sold abroad. The latter point will be dealt with first.

Although the post-war years in Britain were years of unexampled economic expansion, with output, productivity and exports all at record levels and rising fast (though one would never have guessed it to hear the speeches of Company Chairmen at their annual meetings): and although the British economy seemed to have found within itself great stores of energy and resilience which promised a more vigorous age, healthier by far than the ailing and decrepit era of the 1930s: yet there seems today a lack of zest for the task ahead.

Output and productivity have ceased their six-year rise. Governmental emphasis is again, as before the war, negative rather than positive, on cuts and not expansion. The nation seems confused about what is required of it. It no longer has the clear firm directives of Sir Stafford Cripps; and the rounded periods of Mr. Churchill are not an adequate sub-

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stitute (especially on economic matters, where they carry no message at all to those not similarly brought up on Gladstonian financial principles).

One might hope that all this was merely a pause for breath were it not for some evidence that the previous burst of energy was a symptom not of full recovery, but only of temporary improvement due to a combination of transitory factors — some adventitious, some due to Labour planning. Today a number of negative and complacent attitudes, perhaps always latent in the last few years, and sometimes overt even then, have come to the surface. There is little sign of the drive and sense of urgency which alone can secure the necessary changes. The soldiers have lost their zeal for the battle; and a middle-aged lethargy is spreading fast.

This is most evident in the field of exports, now that the sellers' market is over and great energy is needed to gain new orders. One single recent issue of *The Times*⁸ may be taken as typical. First, there appeared a dispatch from the Delhi Correspondent on trade prospects in India and Pakistan. 'During the past six months several important contracts that could have been reasonably expected to go to Britain have been lost, and there are indications that unless British manufacturers . . . are prepared to offer firmer prices and better deliveries, many further big orders for equipment will be lost to Germany and Japan . . . A recent German effort to secure a contract for communications equipment provides a good illustration of the sales enterprise German firms are practising here. On hearing that an order for new teleprinters was impending, a German firm immediately sent out four teleprinters by air, accompanied by technicians to instal and demonstrate them to Government officials, and offered to make these machines available immediately . . . British firms often only offer long-term deliveries, insist upon escape clauses in their quoted prices, have few technicians to spare to accompany their products, and show little enthusiasm to sell.'

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On the following page the comments of the U.K. Trade Mission to the Latin-American dollar markets are printed. After describing the great opportunities that lie open in these markets, the report comes down to all-too-familiar phrases: 'distribution will have to be studied and considerably improved . . . The lack of British technicians in the field was their biggest handicap. In addition, British delivery times must be shorter and British prices must be kept down. It was essential that British exporters should pay far more personal attention by visits to these countries'.

All this is very reminiscent of the pleas of the motor industry in 1947 that it could not possibly export more than 25 per cent of its output, where later events showed that when forced to by the Government it could sustain an export of 75-80 per cent year after year. There seems a dangerous tendency to underrate both the possibilities and the need for exports: to think that the proper procedure is for foreign buyers to come cap in hand begging for the goods to be sold, and that it is ungentlemanly to have to go out and chase for orders. This view is not, alas, widely held in Germany.

This lack of vitality is not confined to exports. In the same week that the above quotations appeared, the newspapers published the comments of the U.S. productivity team on the cotton industry. 'The managements of many British mills are too apathetic to establish the conditions necessary for labour to work at high productivity . . . Our impression was that large elements of both management and labour were dominated by inertia . . . Their main effort at the moment seemed to be directed towards the protection of the least efficient producers and the preservation of antiquated arrangements.'

In the same week again the President of the Board of Trade was reported as having asked the Monopolies Commission to investigate the practices of exclusive dealing and the collective boycott; and all commentators on this decision agreed

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that these restrictive practices were widely employed in industry, and acted as a serious brake on new enterprise and technical progress.

These are quotations chosen at random from a single week's news. It may be that they give a wholly false impression. No one doubts that some industries have put forth a superb effort in the last few years; one has only to think of the Comet and the Viscount, the Ferranti contract at Seattle, Jaguar sales in the U.S. and Canada, and many other instances. Nevertheless it is not easy to erase from one's mind altogether the fear that large sections of industry are not showing as much animation and dynamic as the situation demands.

In such matters the leaders of industry must take the main responsibility. Admittedly the Trade Unions are not free of fault, and the workers' attitude to higher productivity often leaves much to be desired, especially when contrasted with the American worker's attitude. The U.S. productivity team commented sharply on the attitude of the Unions in the textile industry. But it is management, and not the workers, who set the tone in industry. It is their function to lead, and if an air of sloth and complacency is detectable in the leadership, it will always communicate itself to the rank and file, who cannot then be greatly blamed. It is a truism in war that the fighting calibre of a unit depends on the quality of the officers.

But Socialists must not smugly assume that only industry is culpable. The Labour Government had, on balance, an excellent record of assistance to exports and investment, and control over imports and non-essential consumption. But there were some glaring failures, due again to the lack of a sense of urgency. Perhaps the most notable was in the sphere of fuel and power. A shortage of coal was one of the most debilitating weaknesses of the post-war economy, and still remains so. Yet no co-ordinated policy for fuel-saving was ever initiated. Each nationalized power industry was

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allowed to go its own way; neither physical controls nor prices were used to influence consumption; and the result is a use of limited resources which everyone agrees to be scandalously wasteful. (The nationalized industries themselves are also to blame in this matter.) The present Government, with its bias against planning, will probably do even worse.

Looking to the future, has either party the qualities in it to inspire the national effort that is needed?

The mantle of leadership cannot now fall on the Conservative Party or the business class. They are too mistrusted by large sections of the population, whose confidence they cannot gain to the extent required to introduce large changes with popular support. Nor are they psychologically well adapted to the task that confronts them; it is changes, big changes, that are needed, in mental attitudes and the shape of the economy; and no Conservative Party is well suited to the task of change. In any case their economic policies are poor instruments for the business in hand. The obsession with monetary techniques and price movements, and with old-fashioned liberal slogans, is a guarantee of failure when the problem is one demanding not *laissez-faire*, but more effective planning.

The lead must come from the Labour Party. There was little sign a year ago that it was in any shape to give it. It was distracted by profoundly sterile quarrels about the exact size of the arms programme, and had no time to concern itself with long-term problems. There was, moreover, a disquieting reversion in the Party at large, rashly encouraged by the then mutinous traditionalist elements in the leadership,⁸ to old-fashioned phrases and policies having little relevance to the problems of the day; and, with a few notable exceptions on the so-called Right, no one was willing to put honestly before the rank and file the nature of the difficulties ahead.

But there are today, happily, encouraging signs that the

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period of *malaise* is over. The long-term economic problem is attracting detailed study and attention. There are grounds for hope that the Party may now realize that it has not a single, but a dual role: to remain the party of social reform, but at the same time to put before the country a bold long-term policy, whatever the sacrifices entailed, for the economic regeneration of Britain.

I V

What should this policy be? A full statement would need another book, and only a bare outline can be sketched in here.

The first necessity is a change in the machinery of planning. The present arrangement of a Cabinet Economic Section advising the Chancellor, who is the finally responsible Planning Minister, works well for short-term planning of the year-to-year variety, and should not be disturbed. But Britain's difficulties are such that this staff is always overwhelmed by an immediate crisis, and has little time to reflect at leisure, and peer far into the future. What is needed is an additional staff, allied to the present one and also under the Chancellor, whose sole and specific role would be to assess the long-term trends, and measure their consequences for the home economy. All the very amateur calculations in Part II, chapter v, for example, should be professionally made by competent experts, so that the Government can see what movements of resources are needed for a period of years ahead.

To secure these movements will require the use both of controls and prices. Neither alone are sufficient. The price-mechanism is too blunt and imprecise a weapon for the smooth performance of large changes. A general reduction in company taxation, for example, accompanied by a relaxation of building licence controls, which taken together would

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largely bring the capital investment programme under the influence of market forces, might have no effect in raising capital outlays in the engineering industries; these outlays are not now much restricted either by a shortage of funds (since net profits are already high, and borrowing easy) nor by licensing controls (which are deliberately used to encourage essential projects). But it might significantly increase outlays in less essential directions which have hitherto been held back by relatively low net profits or by Government veto; and the net result would be a decline in essential relative to inessential investment.

Nor will controls alone be effective; there are both physical and political limits on what they can accomplish. Once materials cease to be scarce, allocation controls lose their bite and can easily be circumvented. In other cases, because for political reasons they must be based on a non-discriminatory 'fair shares' principle, they impede technical progress and protect the *status quo*. Nor can they be used to any significant extent to secure a movement of labour. Financial inducements must therefore also be employed.

The requirement is an increased supply of capital, labour and managerial skill into those industries which need to be expanded: steel, coal, engineering and agriculture. So far as capital is concerned, the first necessity is a sufficient volume of savings for a high level of total investment. Consumption must be firmly restrained by a stern Budgetary policy so that a large part of the annual increase in output can be made available for capital expenditure. If the present stagnant production figures continue, we may even have to face a decline in consumption. In either event a high degree of political honesty and courage will be needed, and lavish promises of new benefits must be avoided.

Next, the right distribution of total investment between social and industrial expenditure must be secured. Partly this is a matter of keeping the housing programme within firm limits — again mainly a test of political courage, and

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one which the present Government has signally failed to pass. Partly it is a question of maintaining licensing controls on new building, so as to prevent a drain of resources into inessential projects such as new cinemas, hotels, luxury shops, etc. The Labour Government was especially successful in this latter respect; the flow of scarce resources into these luxury channels was minute—in marked contrast to Western Germany, where market forces were allowed free play.

Third, the right distribution of industrial investment must be obtained. An important aspect of this is the right geographical distribution. For a country relying so heavily on exports, flexibility is vital. Export demand is shifting and uncontrollable, and the distribution of resources must alter in quick response. But how are resources to be made mobile? The least mobile factor of production is inevitably labour, since the social and personal cost of migration is so high. New capital is on the whole more mobile, and it should where possible be steered in such a way as to diversify industry in all the main centres, so that changes in export demand may be reflected in a quick re-employment of redundant labour. This will not happen automatically under the price-mechanism; for many industries, cost-differences between different areas are fractional, and location is a function of all manner of non-economic and sometimes irrational influences. There is therefore a continued need for location controls.

We must also lean heavily on controls to ensure the right industrial pattern of new investment. No doubt the profit-motive will work generally in the right direction, inasmuch as the industries needing the new investment already show the longest order-books and the best commercial prospects for the future; nor should the use of price influences be quite so firmly eschewed as it was by the previous Labour Government—a higher price for coal and steel might do something to encourage both investment and economical use.

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But such influences are far from sufficient by themselves. Less essential industrial projects would, if uncontrolled, absorb a disproportionate share of scarce resources at the expense of the more essential. In coal and steel (whatever the price), moreover, investment would probably fall below the required level simply because capital schemes take so long to come to fruition, and (in the case of steel) capital charges form so high a proportion of total costs, that business executives (private and public) feel them to be particularly risky. This cautious attitude will be strengthened if the next year or so brings an American recession, and with it a decline in world demand and a temporary glut of raw materials. It will then need an iron nerve to initiate investment plans on the assumption of continuing long-term scarcity, and the industries themselves cannot be expected to display such a nerve. This is a case where price and profit movements, being determined by purely cyclical influences, give no guide whatever to the secular trend of demand.

Under these circumstances a clear directive to the Coal Board will be needed to ensure that its long-term investment plan, already behind schedule, shall be not merely maintained but enlarged — any tendency to internal recession provides, after all, the ideal opportunity for expanding essential investment. In the case of steel, the matter is more difficult now that the industry has been returned to private ownership; no amount of Government control of the kind proposed can compel the industry to undertake schemes which it does not think are commercially justified, and this provides an overwhelming argument for re-nationalization when the Labour Party again assumes office.

(Price movements by themselves would also be ineffective in influencing demand. It is often suggested that a rise in the price of coal would be a sufficient inducement to fuel economy in industry. This is doubtful. Fuel costs are usually too insignificant a proportion of total costs for even a large rise in the price of coal to have much effect. A more

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promising device might be to offer 100 per cent initial allowances on any fuel-saving plant installed. The variation of initial allowances from year to year, to encourage or discourage total investment, was one of the most ingenious innovations of the Labour Government. It might now be extended to variations between industries as an additional method of influencing the direction of investment. Some intervention of this kind, perhaps accompanied by an increase in price, is urgently required if coal is to play its proper part in the export effort.)

V

Turning to the supply of labour and managerial skill, more reliance will have to be placed on financial inducements. This will often involve the surrender of very long-standing relationships between rewards, and may prove repugnant to conservative-minded circles on the Left.

The supply of labour is mainly a problem in respect of coal, where labour is likely to prove more scarce, at least for the next ten years, than new capital. If direction of labour, and a sufficient degree of deflation to drive men willy-nilly down the pits, are both eschewed, and if non-financial inducements (such as improved working conditions) are not thought to be adequate, then labour must be attracted by higher relative wages. The history of the last few years shows that recruitment to the industry rises after each large wage increase, but falls back again as the other main industries successively catch up and the previous wage relationships are restored. What is needed is therefore a wages policy in the very limited sense of an agreement first to raise, and then to stabilize, the ratio of mining to other wages.* This alone will involve a big change in mental attitudes within the Trade Union movement.

The supply of particular skills is also important. The ex-

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pansion of the aircraft industry in 1951-52 was held up for a time by a shortage of skilled labour. This industry is vital to our national survival. If a similar shortage should again threaten the output of Comets, Viscounts and Britannias, the highest priority would have to be given to remedying it. But, to take only one illustration of the problems that might be involved, it might be found again, as was the case in 1951-1952, that one of the main difficulties was housing. The required technicians were available, but could not move to the vicinity of the aircraft factories because they found no place on local authority housing lists. Attempts were made at a special allocation of houses for these important migrants, but met with vociferous opposition. This was a wrong, though natural, attitude. The doctrine of 'fair shares' cannot be so rigidly interpreted that it jeopardizes national recovery; and this is another sphere where the sacrifice of traditional and deeply-felt attitudes may be needed.

The overall supply of skilled labour may equally turn out to be a problem. Differentials between skilled and unskilled labour have been much narrowed in the last few years, and there are some signs that they are not now wide enough to induce a sufficient number of men to accept the financial sacrifice involved in apprenticeship. If a wider gap proves to be necessary it may again meet with opposition from some of the most powerful unions.

One of the biggest advantages of the U.S. over Great Britain appears to lie in the supply of trained managerial skill. The ratio of highly trained and educated personnel to total employees is high, and this may be relevant to the American lead in productivity. This view is supported by the high correlation shown by British industries between the degree of efficiency and the extent of employment of trained personnel. The percentage of employees in different industries with higher education or training is as follows: aircraft production 16, chemicals 13, general engineering 12, vehicles 10, iron and steel 6, textiles 5, coal mining 2.' The concen-

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tration of the industries generally considered progressive at the top, and those generally considered backward at the bottom, can hardly be mere coincidence.

The deficiency is particularly marked in the case of coal. The E.C.E. has commented strongly on this. 'The industry is handicapped by a shortage of capable men at the higher managerial levels . . . A situation apparently without parallel in the coal mining industries of other countries exists, in which investment programmes are held down, not by financial limitations, but by a lack of men capable of conceiving and carrying out reorganizations of pits and coalfields . . . This managerial bottleneck may be more serious than the more highly publicized shortage of manual labour.'⁸

It thus seems that one of the main desiderata, particularly in coal but also in other industries, is to increase the flow of technically trained leaders. Whatever the country's financial difficulties, a higher proportion of the national income may have to be devoted to technical education, in which at the moment we are outstripped by Germany as well as America. There may be a psychological resistance amongst the workers to what appears to be the creation of more office posts manned from the outside. This emphasises how important it is, if confidence is to be won, to eradicate nepotism and create a genuinely equal opportunity for training and promotion. But here again there is a difficult task of leadership facing the Labour Movement.

In agriculture also the main shortage is fundamentally one of managerial skill. Everyone agrees that a large increase in output is technically possible if only average standards of farming efficiency can be raised to the best levels now obtaining. But this will often need new farmers. There is much talk of manure and fertilizers—no doubt very important—and nice calculations are made, accompanied by neat pictorial diagrams, of numbers of pigs, sheep, and the like. But how to replace poor farmers by better ones, who will actually use more fertilizer and breed more pigs, is never

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discussed. The Labour Party will have to grasp this nettle when it next forms a Government, whatever forebodings the Party tacticians may have about the farming vote. There are only three possibilities: physical dispossession by County Agricultural Committees, an increase in land rents, or land nationalization with the State as an active landlord. One or other of these will have to be adopted: higher food production is too urgent to allow of further prevarication.

V I

This is not meant to be an exhaustive discussion, but rather an illustration, by means of examples, of what is required. It gives a rough guide to the sort of economic policies which the next Labour Government will have to pursue, and to which the Labour Party ought now to be educating the electorate. Many of these policies will be unpopular, and will go against the grain with old-fashioned people. They must be presented as a firm, bold long-term plan for Britain's survival; as an alternative to recurrent crises and painful muddling-through; and as the essential condition for maintaining and improving the standard of living.

What is their relation to the more traditional aspects of Labour's programme? And what, in particular, to nationalization? All the non-economic arguments for nationalization — those, for example, which relate to the distribution of incomes and power in society — are here ignored, though they might legitimately determine the pace of nationalization. But on the purely economic side, no simple slogan or formula makes any sense. Nationalization is obviously not the central issue of major relevance to this long-term plan, which could be more or less successfully carried out either under public or private ownership. It is silly to take an extreme position, and argue *a priori* that one or other form

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of ownership is essential to the redeployment of resources. They are equally foolish who argue on the one side that there is some mystical quality of enterprise, inherent in ownership by passive shareholders, which at once evaporates when the state takes over — the quotations earlier in this chapter should dispel any such simple view; and on the other side that any industry which is germane to the plan automatically qualifies for nationalization, as if a proved need for expansion or a high export potentiality were a sufficient condition. The only sensible approach is through a detailed industry-by-industry study; it is highly irresponsible for people possessing no technical knowledge to draw up long lists of candidates in order to merit a 'Left-wing' label. Even to the layman the case for re-nationalizing steel is clearly made out; and expert scrutiny may show that other important industries would give better results if publicly owned. Until the study has been made, it is best to keep an open mind.

But the social reform and egalitarian aspects of Labour's programme are directly relevant to the plan. It is vital to its success that the confidence and co-operation of the workers should be won; they are asked to surrender many deeply-ingrained attitudes and practices, which they will naturally decline to do, and so frustrate the re-deployment of resources, if they feel that the privileged classes are strengthening their position in the period of national strain. It is therefore of the first importance, quite apart from any considerations of socialist principle, that the economic programme should be accompanied by a programme of radical reform: a further redistribution of capital wealth, a reform in the present class system of education, and measures to strengthen the participation of workers in the management of industry. Without a sense of partnership in a common effort, the economic changes will not occur at all.

Particularly important is the maintenance of a high level of home demand and employment. People sometimes speak as though deflation and unemployment were guarantees of

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a flexible economy. This is not so. Naturally, if a shift of resources is required, or if export demand alters, men must lose their jobs. But a high overall level of employment, such that the period before finding a new job is short, will give much more flexibility than a deflationary state of affairs, in which the period of unemployment is prolonged. Even the fear of prolonged unemployment tends to ossify the mental attitudes of labour. It encourages restrictive practices, and resentment against the introduction of new methods and machines, and so makes the economy less technically progressive; it also encourages redundancy strikes, and so makes it less flexible. Only full employment can induce labour to accept the responsibilities of a mobile and dynamic economy.⁹

It is for these reasons that the leadership must come from the Left. Of course the Labour Party cannot promise speedy and spectacular increases in the standard of living of the workers. The fruits of redistribution have, from this point of view, now been largely plucked; and total consumption (quite apart from the automatic adverse effect of worsening terms of trade)¹⁰ must be rigidly restrained if the necessary home and foreign investment is to be secured. (It may, indeed, actually fall in the near future as the result of American recession. If so, a courageous Government would firmly use the opportunity to steer resources out of consumer goods into the capital goods sector, the quicker to expand investment.) There can thus be no loosening of belts for the next five years.

But thereafter, once the spurt in investment has been achieved and is exerting its beneficial effect on productivity, and provided demand is held high enough to encourage maximum output, an appreciable rise in living standards should be possible. Under a radical government, our present form of society, freed from the dispiriting deflationary influences of the inter-war years, has in it very strong tendencies to expansion.¹¹ Provided the challenge is

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accepted, and the necessary adjustments to altered world conditions are made, the national wealth could increase significantly faster in the second half of the century than in the first, and with it the standards of the British people. But if the country proves too hidebound to adapt itself, we shall stumble along, a poor people, watching opportunity's bald cranium recede into the distance ahead.

NOTES

¹ *National Income and Expenditure 1946-51* (H.M.S.O.), Table 31.

² *v.* Part I, chapter II, pp. 38-41 and Appendix.

³ December 23rd, 1952.

⁴ *The Times*, December 29th, 1952.

⁵ Always referred to, by an amusing convention, as the Left-wing of the Party.

⁶ It does not follow from this that the case for a more elaborate wages policy, as a defence against cost-inflation, is also made out.

⁷ Figures taken from 'Re-Thinking Our Future' (*Observer* pamphlet, 1952).

⁸ 'The European Coal Problem' (E.C.E., February 1952), p. 12.

⁹ The common view that full employment prevents large movements of labour is not borne out by the facts. From March 1951 to March 1952 (before unemployment had reached its minor 1952 peak), the following gains of labour were made: engineering 107,000, mining 79,000, food, drink and tobacco 35,000. These were balanced by equivalent losses in textiles (138,000), distribution (21,000), and transport (17,000). Yet unemployment never rose above $2\frac{1}{2}$ per cent of the insured population during this period.

¹⁰ Though this may not make itself felt for two or three years (*v.* Part II, chapter IV). We are thus granted an interval in which to make the necessary changes.

¹¹ I have analysed these factors in more detail in *New Fabian Essays* (Turnstile Press, 1952).

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