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CENTRE FOR ECONOMIC RESEARCH

**SURVEY OF BRITISH ECONOMIC POLICY
FROM 1920 TO THE 1980s**

PART 1: FROM 1920 TO CIRCA 1949

BY

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SURVEY OF BRITISH ECONOMIC POLICY FROM 1920 TO THE 1980s

PART I

FROM 1920 TO CIRCA 1949

Submitted In Fulfilment Of Contract For

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By

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The present monograph is Part I of a survey of British economic policy since 1920. It covers the period up to *circa* 1949. Part II, a separate monograph, is focused on the period from the late 1940s to the 1980s. The distinction between Great Britain (GB) and the United Kingdom (UK) of Great Britain and Northern Ireland is ignored throughout. Because Northern Ireland is of minor importance relative to Britain, failure to make the distinction is of little importance. Most of the statistics cited actually pertain to the United Kingdom. So, if the reader wishes, he may replace references to 'Britain' by 'United Kingdom'. But again, the distinction is a very minor one for the purpose at hand.

Policy objectives in Britain since 1920 can be classed under the following headings: Target balance of payments and exchange rate regimes; a satisfactory level of employment or low unemployment; control of inflation;; improvement of living standards and economic growth. Varying degrees of emphasis applied to these objectives at different times. Balance of payments and exchange rate objectives were important until the mid-1970s. Pursuit of the growth objective -- in the 1930s and again in the 1960s -- has been sporadic and piecemeal. For a couple of decades after 1945 the objective of full employment was dominant, whilst in the late 1970s and in the 1980s control of inflation became the key concern of policy.

The interwar decades were dominated by policies pertaining to the exchange rate and the balance of payments. For the period as a whole up to *circa* 1949, less of a concrete nature can be said about sustained pursuit of other policy objectives. The present Part I is therefore divided into three principal sections, the first dealing fairly straightforwardly with the external sector, the other two dealing mainly with domestic policies, in a more piecemeal manner.

Before proceeding, it is helpful to have some idea of the periods in which Conservative or (less to the right) Coalition or Labour governments were in power in Britain, as follows: January 1919 - October 1922, Coalition; October 1922 - January 1924, Conservative; January - November 1924, Labour; November 1924 - June 1929, Conservative; June 1929 - August 1931, Labour; August 1931 - May 1945, Coalitions; May - July 1945, Caretaker Government; July 1945 - October 1951, Labour; October 1951 - October 1964, Conservative; October 1964 - June 1970, Labour; June 1970 - February 1974, Conservative; February 1974 - May 1979, Labour; May 1979 to date, Conservative.

I. THE BALANCE OF PAYMENTS AND THE EXCHANGE RATE

I. 1. The Emergence of a Policy

Coincident with the spread of British trading and financial influence throughout the world, Britain's currency, the pound sterling, emerged as a universally acceptable means of international payment in the 19th century. At that time Britain was the world's most important source of investment capital for overseas countries. This was also the period of the international gold standard. In that era sterling was regarded as being as good as gold, due to its unquestioned convertibility into gold. With all the major currencies convertible into one another and into gold, and the stability of sterling unquestioned, sterling was widely held, both as a trading and a reserve currency. In fact, most of the world's trade was financed by sterling. Thus sterling supplemented gold as an international reserve asset.

Under the gold standard as it functioned up to 1914, the Bank of England (the Bank) did not act passively by allowing flows of gold and sterling to determine domestic monetary conditions but intervened, usually by use of Bank Rate (then the key short-term interest rate in Britain) to regulate those flows. In fact, as a policy instrument for the regulation of reserves into and out of London, Bank Rate was adjusted much more frequently in the years immediately before the war than was to be the case in the 1920s: Between 1900 and 1914 it was changed nearly 70 times (Aldcroft, 37). However, balance of payments and exchange rate policies, in the modern senses of the terms, hardly existed. At official levels 'the balance of payments' existed only insofar as it was revealed in the movement of gold into and out of London, and as indicated by the merchandise trade statistics. Furthermore, the exchange rate was treated as 'given'. By contrast, modern balance of payments policy focuses on almost all the components of the international accounts, and in contexts in which the exchange rate may be regarded as a policy variable.

Britain's merchandise trade was in deficit for many decades up to 1914. However, her surpluses on 'invisibles' (such as earnings on financial services to foreigners provided through the City of London, credits for shipping services and, most important of all, income from overseas assets) meant that her balance of payments on current account was usually large in surplus. In fact, income from invisibles was so important in Britain's balance of payments in the years immediately preceding the war that it was sufficient to pay for one half of all goods imports (Phillips and Maddock, 129). The current account surpluses were not used to accumulate large gold holdings; rather, they were invested abroad to add to Britain's stock of overseas assets. The pre-war magnitudes were such that 'from 1907 on, [Britain's] annual investment abroad appears to have exceeded the total of real net investments at home' (Pollard, 1983, 10). Although Britain maintained gold reserves

which were at low levels relative to her trade, she was able to continue to use her current account surpluses for overseas investment without ever having serious balance of payments problems in the immediate pre-war years. This was possible because of London's dominance in the world financial system; rivals such as the New York financial market had not yet emerged on such a scale as to threaten both the dominance and stability of the pound sterling. But circumstances surrounding World War I brought this situation to an end.

The war, its aftermath and induced policy measures involved the following: (i) Partly through sales and partly through defaults by belligerents, Britain lost about 20 percent of her foreign assets. These losses, along with postwar recession in primary producing British Commonwealth countries (often loosely called the Empire) in which Britain held much of her investments, meant that the contribution of invisible income to Britain's current account balance of payments was reduced. Also, Britain's merchandise trade deficits increased. But she still had moderate current account surpluses. However, her long-term foreign investment continued in the years immediately after the war, and throughout most of the 1920s. Her gold reserves, therefore, stayed at relatively low levels. (ii) Post-war reparations, other war debts, political instability and the breakdown or suspension of the pre-1914 international gold standard, increased the volatility of international capital movements. The US emerged from the war as the world's leading source of international investment. In fact, her foreign lending was a means through which some countries paid war debts. But much of the US lending was short-term rather than long-term. Following the October 1929 New York financial collapse, when US foreign investment flows also collapsed, some countries were forced into debt repudiation. (iii) Partly due to a world shortage of gold relative to the value of world trade, due to less even distribution between countries of world gold reserves with the US share of such reserves rising from 24 per-

cent in 1913 to 44 percent in 1923 (Lewis, 158), and reflecting the emergence of the US as the world's leading foreign investor, many countries increased their holdings of dollars and sterling, relative to gold, as reserve assets. Thus, international liquidity was expanded by increasing short-term liabilities against the two reserve currency countries. If severe speculation against a reserve currency were to emerge, and because of the strength of the dollar, it would be sterling that would have to bear the brunt.

The Cunliffe Committee on currency and foreign exchanges, which had been appointed by the government during the war in connection with its planning for postwar reconstruction, issued an interim report in August 1918. It took for granted a return to the gold standard at the pre-war parity, and expressed the views (as quoted by Broadberry, 122) that 'it is imperative that after the war the conditions necessary to the maintenance of an effective gold standard should be restored without delay. Unless the machinery which long experience has shown to be the only effective remedy for an adverse balance of trade and an undue growth of credit is once more brought into play, there will be a grave danger of a progressive credit expansion which will result in a foreign drain of gold menacing the convertibility of our note issue and so jeopardising the international trade position of the country.' Thus, the Committee sought a return to the disciplines and automaticity of the gold standard, and went on to mention reduction in government borrowing and increase in Bank Rate as prerequisites for restoration.

Britain's postwar return to the gold standard was in 1925. The gold parity chosen was that which applied in 1914, implying £ = \$4.86. The most widely held view among economists, both in the 1920s and subsequently, has been that sterling was significantly overvalued in the late 1920s (Macmillan, 54, 106; Sayers, Vol. 2, 390). (See, however, Matthews, 1986 and 1989, for some dissent on this issue, and Redmond, 1989). The emergence of more active balance of payments and exchange rate policies in Britain

reflected increasing difficulties in maintaining the 1925 gold parity, the ultimate collapse of the restored gold standard, and growth of domestic economic management.

The 1920s saw growing concern over Britain's ability to maintain large-scale foreign investment -- which the pre-1914 gold standard had facilitated through stability of exchange rates -- thereby providing sterling to other countries. Thus, when the first official current account balance of payments statistics were produced in the early 1920s, the term 'current account' was not used; rather, the heading was 'income available for investment overseas'. Similarly, when a Trade Figures Committee was established in 1925, its terms of reference were 'to report on the existing estimates of the annual balance of payments, with particular reference to the powers of this country to make overseas investments' (Quoted by Tomlinson, 37).

In the decades before 1914, foreigners in aggregate were quite willing to hold sterling. Although certain British export industries were losing competitiveness and imports were rising rapidly, the Bank showed little concern. Furthermore, in the years immediately preceeding World War I Britain was generally a creditor in the international short-term loan market. But she appears to have become a short-term debtor by the late 1920s (Cairncross and Eichengreen, 36; Macmillan, Part II). If confidence in Britain's financial position had remained secure, this new debtor status on short-term account would have posed no special problems. But once foreign holders of sterling began large-scale withdrawal, as in 1930-31, Britain could not withstand the strain without liquidating her short-term claims against foreigners, borrowing abroad and, when all else failed, depleting her gold reserves. Thus, by the late 1920s, Britain's international position on short-term account had the potential for forcing the country off the gold standard. However, the Bank did not collect statistics of short-term external assets and liabilities until 1931, and even then the data available to it were quite incomplete (Macmillan, 112). Changing

circumstances were then forcing Britain to have active balance of payments and exchange rate policies.

1. 2. The End of the Gold Standard and Genesis of the Sterling Area

Reference has been made above to the uneven international distribution of gold reserves which emerged from the 1914-18 war and its aftermath. In November 1929 the Macmillan Committee was appointed by the British government, charged with reporting on the financial system of the late 1920s; its *Report* is dated June 1931 -- just a few months before Britain was forced to acknowledge that the gold parity for which she opted in 1925 was not sustainable. In its review of the recent working of exchange rate arrangements, the Committee noted, *inter alia*, that: (i) The parities chosen by some countries when they returned to the gold standard in the 1920s did not coincide with purchasing power parities; for example, sterling was overvalued while France and Belgium undervalued their currencies in terms of gold. (ii) The problems created by (i) were not being offset by appropriate domestic policies, or by steady rather than volatile flows of long-term investment. Thus, in sterilizing their gold inflows, surplus countries such as France and the US did not fairly 'play the rules of the gold standard' by expanding their money supplies; had they in fact done so, price levels would have adjusted to more realistic levels internationally, and gold holdings would have been redistributed in such a manner as to facilitate the smoother operation of the international monetary system. In the view of the Macmillan Committee, unless such hinderences to the smooth operation of the international monetary system were removed (perhaps through conscious cooperation as the Committee recommended), 'we can scarcely expect the international gold standard to survive in its present form' (Macmillan, 107). The Committee's fears were realised just a few months later.

Early in 1931 Germany and Austria announced that they intended to form a customs union. This proposal was resented by the allied nations of World War I, and particularly by France, which exerted pressure by withdrawing funds from Austria (Lewis, 63). The German foreign reserves then came under pressure, a situation which continued until an international debt moratorium was agreed in August. Attention then shifted to London. Two recent reports had disturbed confidence; one (that of the Macmillan Committee) drawing attention to the weakness of Britain's gold reserves, the other (that of the May Committee) predicting a substantial budget deficit unless the prevailing Labour government curtailed its expenditures, which were unusually high because of greatly increased outlays on unemployment payments. London's short-term external liabilities were large. Although Britain was also owed large short-term sums, much of these were tied up by moratoria in Austria and Germany. The Bank therefore had to allow its inadequate gold stocks to run down, and withdrawals out of sterling proceeded so rapidly that on 20 September 1931 gold payments were suspended. Thus Britain went off the gold standard and the pound initially depreciated under a float.

The origins of the so-called Sterling Area go back to the last century. Its development and demise ran parallel with British imperial history. Up to 1931 and beyond, the trade of British Commonwealth countries was primarily with Britain, and sterling was the currency in which most of such trade was conducted. In the early 20th century, the monetary authorities of Commonwealth countries would buy and sell their local currency against sterling, without restriction, at fixed rates. There was little need for them to hold *reserves in other forms, as sterling was freely convertible into gold or foreign currency.*

To the extent that foreign currencies were earned by those countries, they were usually sent to London. Thus the Bank acted as the central bank of overseas Commonwealth countries.

Most Commonwealth countries followed Britain in 1931 by maintaining their link with sterling and allowing their currencies to depreciate against gold. Some other countries, most of which had close ties with Britain, also kept a link with sterling rather than with gold. Thus, the Sterling Area, consisting of countries which expressed their currency in terms of sterling, and the reserves of which were largely in the form of sterling, was not confined to Commonwealth countries. Many other countries linked their currencies to the US dollar, while a few European countries stayed on the gold standard until the mid-1930s.

The link between most of the Sterling Area countries was strengthened in 1931-32 when Britain, which until then (but with an increasing number of exceptions) had pursued a free trade policy, abruptly switched to general tariff protection. The October 1931 election brought into parliament a huge majority anxious to impose protectionist policies. While protection was being debated, emergency legislation -- the Abnormal Importations (Customs Duty) Act -- was rushed through Parliament at once in order to stop a flood of imports which had already commenced in anticipation of more permanent duties. Temporary duties of 50 percent were therefore immediately applied to a wide range of manufactured products. Early in 1932 the Import Duties Act brought in a more permanent general protective tariff and firmly initiated the protectionist era in Britain. For as long as Britain maintained a free trade policy, there had been little opportunity for formally granting trade discrimination in favour of Commonwealth countries. However, an important feature of the system initiated early in 1932 and modified later that year and in 1933, was that almost all goods from Commonwealth countries entered Britain duty free, and those countries extended some tariff preference for British goods. Furthermore, extra import duties were imposed on foreign products viewed as competitive with imperial exports. This was the system known as Imperial Preference, which continued well into

the period after the Second World War under the name of Commonwealth Preference. In the view of one researcher, 'in the interwar period British economic controversy was obsessed with the Empire.... Because [the measures of 1932-33] lowered tariffs within the Empire relative to tariffs on foreign goods, they integrated Britain and the Empire more fully' (Drummond, 23, 288). In consequence, the geographical pattern of British trade in the 1930s shifted more in favour of that with Commonwealth countries (though it is probable that this shift was also in part due to the fact that Sterling Area countries devalued in 1931 as a bloc relative to third countries). A corresponding retreat from dollar markets did not seem important at the time, but it was to prove very serious for Britain during and after the 1939-45 war.

The Sterling Area of the 1930s was an informal grouping. Members were free to alter their exchange rate against sterling -- which some did -- and any country could in principle accede to or secede from the bloc. No legal or administrative commitments were then attached to membership.

1.3. The Balance of Payments and Economic Management in the 1930s

Controls over foreign investment had been introduced in 1914 as a war contingency, and were maintained until about 1925, when they were replaced by moral suasion from the Bank. More stringent controls were introduced on 22 September 1931 -- just after Britain's break from the gold standard -- when foreign investment was temporarily forbidden. However, in 1932-34 the controls were relaxed in favour of Commonwealth and Sterling Area countries (Kindleberger, 388; Sayers, 1976, Appendix 30). But it should be recognised that the discriminatory nature of the import controls implemented in the 1930s reflected both political (cohesion of the Commonwealth) and economic (balance of payments and job-creation) objectives.

Although it was forced on the authorities, the suspension of gold payments in 1931 had sustained direct and indirect beneficial effects on the British economy. Because the ensuing depreciation imposed gradual upward pressure on the price level, and because money wage changes tended to reflect labour market conditions in the years of widespread unemployment in the early 1930s, depreciation enhanced the cost competitiveness of British goods in both the domestic and foreign markets. Although there was a lag of a few months (the merchandise trade deficit, valued in sterling, continued to grow following September 1931, until January 1932), this ultimately strengthened both the demand for British output and the incentives to supply such output. However, ordinary market forces, accentuated by the responses of foreign governments in raising their tariffs against imports of British goods and in inducing depreciations of their own currencies, eventually neutralized the impact of sterling's depreciation on the competitive position. An estimate of Britain's trade-weighted effective exchange rate suggests that Britain's competitive gain from depreciation under the float continued until 1936 (Redmond, 1980). The floating pound does seem to have arrested the fall in Britain's share of world merchandise exports, which had earlier been declining but remained roughly constant over the 1930s.

An Exchange Equalisation Account was set up in 1932 as a Treasury (ie. Department of Finance) fund to be used to smoothen fluctuations in the exchange rate caused by capital movements, thereby managing the float. The Bank administered the account on behalf of, and with the advice of, the Treasury -- 'an arrangement which marked the end of the era in which British international monetary policy had been controlled by an independent central bank' (Peden, 98). In practice, the main task in managing the account was to prevent sterling from appreciating to levels which it would otherwise have attained. Once sterling had depreciated from \$4.86 in September 1931 to \$3.40 in March 1932, speculators felt that it could only strengthen. However, in order to stabilise Brit-

ain's import prices and to encourage her exports, the Bank tried, unsuccessfully, to prevent this. The US also wanted higher prices, and devalued against gold in 1933/4. Thus, British exporters enjoyed only a brief respite, in 1931-33, from American competition in international markets.

Probably the most important long-term effect of the decision to float was that, freed from the constraints imposed by sterling's gold parity, it made possible a reorientation of policy towards domestic economic management. Not only was the exchange rate managed in the interests of competitiveness, but a floating exchange rate made a policy of cheap money feasible. The pursuit of domestic policy objectives was also assisted by the fact that for several years after 1931, Britain was in the unusual position of being a net receiver of capital from abroad (largely because of controls on outflows and due to inflows reflecting relative political and economic stability in Britain) and was able to use some of that foreign exchange to accumulate reserves.

Whenever sterling showed a tendency to appreciate, the Exchange Equalisation Account responded by purchasing gold and foreign exchange in return for sterling. It first did so in the summer of 1932. In fact, in six of the seven years 1932 to 1938, Britain accumulated gold and foreign exchange through sale of sterling. Furthermore, the authorities also appear to have taken Britain's merchandise trade balance into account: when the size of that deficit increased, they intervened to weaken the pound with all the more vigour (Cairncross and Eichengreen, 90). Thus the exchange rate was managed in order to maximise exports for employment reasons and as part of a policy of reserve accumulation.

A summary of Britain's balance of payments position in the 1930s is as follows: in spite of the new policy regime the merchandise trade deficit, on average and in nominal

terms, remained much as it was throughout the 1920s. But although export volumes fell, the quantity of imports actually rose. That such changes did not greatly increase the nominal value of the merchandise trade deficit was due entirely to terms of trade changes, which moved in Britain's favour. Turning to other elements in the balance of payments on current account, the value of net invisible exports was considerably lower in the 1930s as compared to the 1920s. In consequence, the current account position was transformed from moderate surpluses in the 1920s (except for 1926) to moderate deficits in the 1930s. In regard to the capital account, the nominal value of net foreign investment by Britain greatly fell in the 1930s. This reflected both policy restrictions by the British authorities on investment outflows, and depressed economic conditions abroad. The effects on Britain's reserves were accentuated by short-term capital inflows, much of which were attracted by relative economic and political stability in Britain in the 1930s, in spite of low interest rates. The net effect under the system of a managed float for the exchange rate was that Britain's gold reserves substantially increased between 1931 and 1938 (Phillips and Maddock, 134).

The long-term benefits of sterling's managed float derived mainly from the lower interest rates and increasingly expansionary monetary policies adopted in the 1930s. Prior to the 1931 depreciation, the monetary and fiscal options open to Britain were limited by the commitment to defend the exchange rate. Under the gold standard of the late 1920s, British interest rates were therefore closely linked to the general level of world interest rates, and the money supply could not be determined independently of those interest rates and the level of income. However, as short-term measures to maintain the exchange rate, Bank Rate sometimes had to be raised to 6% or 7% in the 1920s. The 1931 decision to float provided the authorities with an opportunity to pursue independent monetary policies. Low short-term interest rates came early in 1932, when Bank Rate

was lowered in successive steps from 6% at the beginning of the year to 2% six months later, and the Bank expanded the cash reserves of the commercial banks through open market purchases. In the presence of the newly implemented tariff barriers and controls on capital outflows, the danger that the monetary expansion might lead to unacceptable rates of exchange rate depreciation were then less threatening.

The immediate objective of the generally cheap money policy was to lower the cost of the government's debt. Stimulation of domestic investment -- and hence of output and employment -- appear to have been secondary objectives. Transition to a cheap money policy was heralded by conversion of the government's 5% War Loan, 1929-47, to a 3.5% basis, and the lowering of all interest rates which the conversion operation facilitated.

The War Loan had accounted for just over one quarter of the entire national debt at the beginning of 1932 (Youngson, 90). In June of that year the government took advantage of market conditions in Britain's depressed economy, where a guaranteed long-term yield of 3.5% was generally more attractive than holding cash or equities, by announcing that the 5% War Loan could be converted to 3.5% stock, repayable from 1952 onwards (the exact date of redemption thereafter being left to the discretion of the government). Over 90 percent of the stock was converted by the end of 1932. However, the government alone did not initiate cheap money in Britain: it availed of opportunities provided by market conditions in a depressed economy under floating exchange rates, and then adjusted its own policies in order to perpetuate favourable conditions insofar as interest rates were concerned. Thus, the money supply was expanded in 1932 in order to facilitate the conversion operation, and the monetary stance remained expansionary throughout the 1930s as a whole.

Within the private sector, residential construction was the activity most frequently cited as benefiting from the cheap money policy. Industrial investment in sectors such as iron and steel was also stimulated. But cheap money -- made possible by departure from the gold standard -- was but one factor among many contributing to the recovery of the 1930s. For the record, over the remainder of the decade after 1932, British manufacturing production expanded at a rate unparalleled in modern British history: By 1937, manufacturing production had increased by nearly 50% over a period of six years (Cairncross and Eichengreen, 84, 102).

1. 4. World War II and the Balance of Payments

In 1939, the Sterling Area became legally recognised as the basis for a system of exchange control which was then implemented (Midland Bank, February 1972, 11). Some non-Commonwealth countries left the Area around that time. A central feature of the new arrangements was that both current and capital account transactions within the Area -- which continued to be made in sterling -- remained virtually free of control, as in the late 1930s; however, payments between the Area and the rest of the world were made subject to rigid control. All Sterling Area countries set up similar exchange control procedures. Thus the Area became a discriminatory bloc. Moreover, in 1939-41 arrangements were negotiated under which (subject to some qualifications, mainly in regard to South Africa) any increases in their holdings of gold and dollars by Member countries were sold for sterling in London, and all such additional gold and dollar holdings of the sterling bloc were channelled into a common Reserve Pool in the Bank of England's Exchange Equalisation Account (Cairncross and Eichengreen, 25). During the war -- and for some years of dollar shortage after the war -- this policy worked to Britain's advantage, as it enabled her to finance dollar purchases indirectly via the dollar receipts of oth-

er members of the Area. As the official history *The British War Economy* put it, by the early 1940's 'the sterling area was in fact a financial union centered in London and managed by London' (Quoted by Strange, 57, 58). For a couple of decades thereafter, movements in Britain's gold and dollar reserves thus reflected the balance of payments positions of both Britain herself and the rest of the Sterling Area.

In at least three respects World War II brought very major changes in the British balance of payments. These were the enormous deficits on merchandise trade account, massive loss of foreign investments and hence future losses of earnings in the form of interest and dividends from abroad (part of so-called invisible receipts), and the accumulation of new liabilities, generally described as 'the sterling balances'.

The deterioration in Britain's merchandise trading position reflected the change in the use of domestic resources, away from export markets, brought about by the war effort. To a considerable extent, this was alleviated by Lend-Lease -- announced in December 1940 when the US was still neutral -- under which the US agreed to provide Britain with goods during the war free of charge. Assistance under Lend-Lease was accompanied by a number of provisions. *First*, Britain was required to sell off important capital assets in the US. *Secondly*, materials imported under Lend-Lease could not be used in generating exports from Britain which would compete with those from the US in world markets. *Thirdly*, Britain had to promise not to discriminate in international trade after the war. By the time that Lend-Lease was fully effective, in 1943/4, Britain had already greatly depleted her reserves and had sold a large proportion of her dollar assets. Over the war period as a whole Britain sold approximately one quarter of her overseas assets. The main disposals were located in India and in the US. Finally, there was the accumulation of the sterling balances -- ie. credits of other countries held in London in blocked accounts. These were owed largely, though not wholly, within the Sterling Area.

Most of the balances were, at that time, the consequence of massive military expenditures by Britain in India and the Middle East, as well as unrequited exports from other countries to Britain during the war. Those countries were willing to accept balances in London, rather than immediate payment, in return for their supply of resources to Britain's war effort. Apart from their role in financing the war effort, the build-up of sterling balances was justified by the British Board of Trade on the grounds that if -- as was widely expected -- the experience of the 1920s was repeated and there was a postwar slump with rising unemployment, withdrawals from the sterling balances would give a boost to British export industries (Strange, 60). The accumulation of sterling balances, like Lend-Lease, enabled Britain to draw on more resources during the war than would have been the case had immediate payments been demanded. But they also implied burdens for the future not entailed by Lend-Lease, among them the annual servicing charges incurred through the accumulation of interest, and the need to provide for their eventual withdrawal.

From September 1939 to December 1945 inclusive, Britain's imports of goods and services came to £16,900 million. Of this sum, only £6,900 million, or about 40%, was offset by exports of goods and services; the remaining £10,000 million was financed by sales of foreign assets valued at £1,200 million, accumulation of £3,500 million in new debts with other countries, and net grants, mainly from the US but also from Canada, to the extent of £5,400 million (Pollard, 1969, 332).

To keep the pound at a fixed value (set at \$4.03 in 1939) under the circumstances just described, two major kinds of policy instruments were used: import controls and financial controls. Imports of luxuries were restricted at once by a licensing system and before long most necessities were being imported by the government. In regard to financial controls, dealings in gold and foreign exchange were put under Treasury control at

once; payments abroad and purchases of foreign assets by Sterling Area residents required official sanction, and holdings of foreign securities in Britain had to be registered with the Treasury for possible -- and in many cases actual -- sale to the government in return for sterling payments to the former holders. But as already indicated, payments within the Sterling Area (other than the sterling balances in blocked accounts) were left free.

One week after the surrender of Japan in mid-August 1945, Lend-Lease was abruptly stopped, and Britain was faced with the immediate necessity of paying in dollars for US goods 'in the pipeline' to the extent of \$650 million (Pollard, 1969, 339), as well as for continuation of supplies, if she was not to be starved of necessary food and materials. But with only about 2% of the labour force engaged in exports at the end of the war, compared to about 10% before the war, Britain in the immediate post-war period had no prospect of earning those dollars through trade. The only possible course for Britain was an American loan, and at the end of the war John Maynard Keynes (who entered the Treasury from Cambridge University in 1940) was sent to Washington to negotiate it.

1. 5. The Post-War Dollar Problem and the 1949 Devaluation

The gloomy prospects for Britain's post-war balance of payments rested on two key facts. *First, Britain had lived beyond her means for some years by running down foreign assets, by borrowing, and by gifts from North America, and those gifts had ended in August 1945, leaving a huge dollar gap. Second, disruption to the economy had been so severe that it would take some years before that gap could be filled through increased exports. However, unless some means could be found to finance imports after the end of Lend-Lease, the economy would grind to a halt. Furthermore, in a war-ravaged Europe a high*

proportion of such imports would have to come from North America -- and would have to be paid for in gold or dollars -- meaning that the quest for dollars became an overriding objective of policy. Britain's dire need for dollars at the end of the war was not eased by the geographic distribution of her merchandise trade: At the end of the war, some 42% of her imports came from the American continent, but only 14% of her exports went there (Aldcroft, 192).

In the negotiations late in 1945 in connection with the Washington loan, it was reckoned that in order to finance necessary imports, British exports would have to rise by at least 50% above their pre-war volume; furthermore, to meet at the same time the need to repay sterling balances, to strengthen gold and dollar reserves, and to finance investment in the Commonwealth, it was estimated that exports would have to rise to at least 75% above their pre-war volume, and this figure became one of the main targets of policy. But it was felt that it would take 3 to 5 years to attain that target, which was in fact attained by 1950. It was in order to cover adverse balances in the interim that the US was asked for a huge loan. By an agreement of December 1945 the US made credits available to Britain to the extent of \$4,400 million, at a low interest rate of 2% and with the capital sum to be repaid over 50 years. Some of that loan was for the payment of debts outstanding on goods only 'in the pipeline' under Lend-Lease at the time that system was abruptly ended in August 1945. The US loan was supplemented by a smaller loan from Canada, made on the same terms as the US loan. The fact that the terms were identical 'was dictated by political necessity' (Youngson, 163). But some of them were severe. The context was as follows:

Towards the end of the war Britain, the US and other countries sought for the post-war world the establishment of an international monetary system in which all currencies would be freely convertible into one another, at least for current transactions. The Bret-

ton Woods Agreement of 1944 led to the establishment of the International Monetary Fund (IMF), which commenced operations in March 1947. Until the early 1970s its central objective was to enable convertibility to be achieved and maintained under a system of fixed parities -- the so-called Bretton Woods system. The US loan agreement imposed strong pressure on Britain for a speedy return to full convertibility. The agreement provided for a gradual unblocking of the sterling balances. Another condition was that Britain undertook, within one year from the coming into force of the agreement, to make 'the sterling receipts from current transactions of all sterling area countries ... freely available for current transactions in any currency area without discrimination with the result that any discrimination arising from the so-called sterling area dollar pool will be entirely removed and that each member of the sterling area will have its current sterling and dollar receipts at its free disposition for current transactions anywhere' (*Financial Agreement*, 1945, par. 6). A further condition of the agreement prevented Britain from reducing demand for dollars by using quotas or tariffs to discriminate against US exports.

In July 1946 the dollars from the North American loans became available. It was intended that they would last until 1951, by which time Britain would be able to pay her own way. However, it soon became clear that such dollars were being drawn too rapidly: in the year to end-June 1947, Britain's purchases from dollar areas came to \$1,540 million while sales to them were only \$340 million. Early in 1947 there was a fuel shortage which held back production. This has been estimated to have cost Britain at least £100 million in lost exports, equivalent to one quarter of Britain's current account balance of payments deficit in that year (Peden, 144). Also, the terms of trade moved against Britain, adding about £330 million to the import bill in 1947 (Pollard, 1969, 360). On top of all this, Britain in 1947 was still incurring high military expenditures abroad amounting to over £200 million, which exceeded the country's total receipts in invisible earnings

from foreign interest, dividends and profits in that year. It was in such circumstances that Britain was forced to make sterling convertible, under the conditions of the US loan. The convertibility applied only to sterling currently earned and not to accumulated balances, but even then, there was an immediate run on the dollar Reserve Pool, as some countries earning sterling rushed to convert such earnings into dollars. The drain on the dollar reserve was so severe that convertibility had to be suspended after only six weeks. In 1947-48, agreements were made with India, Pakistan and Egypt -- the largest holders of sterling balances -- and some other countries in regard to the rate at which those balances could be drawn on for conversion into dollars or for other purposes.

In order to minimise and eventually eliminate the hard-currency deficit, the government relied heavily for some years on continuation of wartime controls. These held down imports by a combination of rationing and licensing, supplemented by exchange control. Efforts were also made to encourage exports, for example through more liberal allocations of materials for that purpose, and exporters were urged to give priority to dollar markets. As elsewhere in Western Europe, the dollar shortage in Britain was eased in 1948-9 by injection of US aid dollars under the European Recovery Programme (Marshall Aid). Marshall Aid was politically inspired by fears of Communist takeover in Western Europe. Britain's trade balance also improved in 1948. However, little was done to strengthen the reserves.

Late in 1948 it was suggested in the Board of Trade that sterling should be devalued so as to redirect Sterling Area exports towards dollar markets and help to reduce the dollar deficit (Cairncross and Eichengreen, 116). This suggestion, as a conscious act of policy, was not implemented. But a high level of demand in Britain, combined with a minor recession in the US which made dollar sales more difficult, led in 1949 to sustained speculation against sterling. Furthermore, the US 'was known to share the [market's] view

that the pound was overvalued; the US Congress, in cutting down the appropriation for Marshall Aid in the spring [of 1949], took the line that less aid would be needed if exchange rates were adjusted. The International Monetary Fund, under American inspiration, was also campaigning for a sterling devaluation' (Cairncross and Eichengreen, 117). In the event, in September 1949 Britain was forced to yield to the speculators -- and possibly also to other forces such as the IMF and the US -- by devaluing the pound, by 30%, from \$4.03 to \$2.80. Pakistan and British Honduras excepted, all Sterling Area countries devalued in unison, thereby maintaining their fixed exchange rates with Britain (Midland Bank, February 1972, 12).

The gold and dollar reserves rose quickly following the devaluation of 1949. By 1950 a rising volume of exports was beginning to restore a long-term trade balance. After the devaluation, the Sterling Area's trade deficit with the dollar area was virtually eliminated, though this was partly attributable to the consequences of US rearmament and other factors, rather than the devaluation alone. Nevertheless, those who had stressed the need to improve Britain's competitive position could claim that the advantages accruing from the devaluation lasted several years. For example, despite the 30% devaluation against the dollar, Britain's rate of inflation between 1949 and 1954 was only slightly higher than that of the US, implying that, as in the period following the 1931 depreciation, Britain's gain in competitiveness was not quickly offset by adjustment in prices.

A steady improvement in Britain's current account payments balance over 1946-51 (except for the Korean War year of 1951) was used, not in building up gold and dollar reserves, but in making foreign investments, in paying off some of the sterling balances and in British government expenditure overseas. Thus, the weakness of sterling at the beginning of the period was still there at the end. With a gold and dollar reserve which was generally less than £1,000 million, a swing of £200 to £300 million in any one year

-- very minor compared to total Sterling Area trade -- could cause a major crisis, and this exposure continued after 1951. The order of priorities has been widely questioned. Foreign investments to the extent of £1,650 million in the six years 1946-51 have been considered too high (Pollard, 1969, 364). Furthermore, it has been argued that the high levels of military expenditure by Britain abroad in those years was something which that country could not afford.

II. UNEMPLOYMENT AND ECONOMIC POLICY

II. 1. Economic Policy, Employment and Unemployment in the Twenties and Thirties

Unemployment was high -- it was consistently around or above 10 percent of the insured workforce -- in Britain throughout the 1920s. Although official data are not available in order to make direct comparisons, it seems that such unemployment ratios were at least twice as high as the ratios which applied in bad years before 1914 (Aldcroft, 14). That current account balance of payments deficits did not emerge in those years (1926 was the only year of deficit) owes much to the fact that, for exchange rate reasons, the authorities maintained deflationary domestic policies throughout most of the decade. One out of eleven among the insured labour force was unemployed in the summer of 1930. The official unemployment rate reached a peak of 23% in August 1932, and stayed above 20% for over two years.

Britain's high unemployment rates in the 1920s were related to several factors. Most important of all from a long-term standpoint, there was very heavy reliance on a few traditional industries -- coal, cotton, iron and steel -- which, for several reasons, were in

structural decline. The problem was not yet immediately apparent in the short, explosive and inflationary boom of 1919-20, when the demand for such goods rapidly increased. The boom was assisted by easy money policies, made possible by Britain's formal abandonment of the gold standard in March 1919, when artificial wartime support for sterling was withdrawn, and sterling then sharply depreciated against the dollar. As the boom of 1919-20 -- which was associated with high rates of both export demand and domestic investment demand -- quickly collapsed, the British economy was faced with excess capacity, and therefore reduced investment, in her traditional sectors. The development of more economic mines in Central Europe, as well as some secular substitution away from coal products, were factors in the steady decline of British coal exports after the early 1920s. Exports and employment in coal did receive a boost in 1923 when France occupied the Ruhr, but this was transitory. From 1925 to 1929 unemployment in coal averaged 16%, and went to 20% in 1930. That was despite substantial reductions in the number of insured persons in coal mining in those years (Youngson, 37). In cotton, the growth of Indian and Japanese textile industries behind tariff barriers, assisted by cheap labour, helped to capture large sections of Britain's former overseas markets. Iron and steel, shipbuilding and associated engineering industries suffered from wartime expansion in Britain and abroad. The problems of Britain's shipbuilding sector were augmented by subsidized foreign competition.

It is doubtful whether sustained devaluation of sterling (rather than the 1925 return to gold at what was widely agreed to have been the by then overvalued pre-war exchange rate against gold) would have done much to assist Britain's traditional exporting sectors, the problems of which were largely beyond domestic control. However, the return to sterling's pre-war gold parity in 1925 probably militated against economic restructuring and the development of newer export industries. Such sectors did expand both domesti-

cally and in export markets in the 1920s. The principal new industries increasing employment over the decade were road and air vehicle transport, and electrical products and supply. Along with chemicals, their exports did increase. But such growth did not, and in the short-run in many respects could not, absorb the slack of labour from the declining sectors.

The geographic origin of Britain's imports accentuated the collapse in her exports. That was because her imports consisted mainly of primary produce, the prices of which fell both absolutely and relative to manufactured goods. The terms of international trade accordingly moved decisively in Britain's favour in the 1920s, and continued to do so until the late 1930s. Britain's exports had been heavily concentrated on primary producing countries. But due to the terms of trade collapse, those countries could no longer afford to import from Britain on the same scales as previously. The severity of the crisis in Britain's exports can be recognised by noting that whereas in 1920 exports accounted for 23 percent of her national income, the corresponding percentages for 1930 and 1939 were 18 percent and 10 percent, respectively (Phillips and Maddock, 111).

The shrinkage in demand for Britain's traditional exports was not offset by expansionary domestic policies. As has already been mentioned, Britain did not formally go off the 19th century gold standard until early in 1919. But it was generally agreed that the ensuing experiment with floating exchange rates in the early 1920s would be temporary. In those years, policy sought to prepare the economy for return to fixed exchange rates (Aldcroft, 5; Macmillan, 51). This meant generally high nominal interest rates which, at a time of falling prices, could not have been conducive to domestic investment. Great weight was also attached to the desire of reducing the national debt, which had been massively increased during the war and the servicing of which absorbed close to one half of all government current expenditure by the late 1920s. The exchange rate objec-

tive meant moderately tight monetary policies, while reduction of the debt burden implied balanced budgets or budget surpluses. Given the dominance of exchange rate and debt redemption objectives, reduction of large-scale unemployment was not regarded as a major short-run objective. Until the late 1920s, such unemployment was widely viewed as though it were temporary, a reflection of postwar destabilization, industrial unrest and cyclical fluctuations. Monetary policy was simplified for a few years after the return to gold in 1925: defence of the chosen gold parity became the paramount monetary objective, and Bank Rate was nudged upwards. The state of domestic economic activity therefore stayed low in short-term priorities.

Some forms of public expenditure were indeed greatly increased in the 1920s, but in most cases the objectives were broadly social and political rather than those of economic stabilization.

Public relief for the unemployed was still a local responsibility at the beginning of the 20th century. Labour exchanges (to help the unemployed -- assumed to be largely frictional in character -- to find work) had been introduced in 1909, and a system of social insurance against unemployment in 1911. But the latter scheme (which was financed by contributions from employer, employee and the state) initially covered only persons in engineering, construction and shipbuilding. In 1920 the provisions were much enlarged so as to include almost all workers earning low to middle incomes, except domestic servants and agricultural labourers. As expanded in 1920, it was intended that the system would be self-financing. However, high and rising unemployment necessitated unintended Treasury contributions to the ensuing large outlays on unemployment payments from the early 1920s onwards.

Legislation of 1930 made it easier for unemployed persons to draw benefit, on slightly increased rates of payment. The system therefore became particularly subject to abuse, as spurious claims for payment by persons not genuinely seeking work accumulated. 'Practically anyone who could show that he or she had worked in an insured trade at some time and was now not working could draw benefit; and very large numbers did' (Youngson, 82). The Treasury therefore had to increase its contributions to the Unemployment Insurance Fund. The resulting budgetary difficulties, which were highlighted by a widely publicised report (that of the May Committee) at the end of July 1931, further weakened the existing lack of confidence in the external value of sterling, and helped perpetuate the existing drain on Britain's gold stocks until the abandonment of the restored gold standard some weeks later.

Late in 1931 the government set up a dual system of payments to the unemployed: (a) insurance benefits drawn by unemployed persons as a right, and (b) a system of assistance payments determined by need. Rates of payment under (a) were reduced and its conditions for eligibility were made more stringent. The arrangements under (b) formed a secondary system designed to set floors on absolute levels of poverty. Following legislation of 1934, administration of those schemes was made more centralised, probably more efficient, and in some respects broader in coverage.

The redistributive aspects of expanded unemployment relief schemes and other social security measures (such as non-contributory old age pensions which had been introduced in 1908 and widened in character in 1925) probably helped to maintain consumption demand from the early 1920s onwards. Central and local government expenditures on construction of roads and houses was also expanded in the 1920s. But although there was a housing shortage, there was not yet any major housing boom. This has been attributed to the absolute scale of local government housing expenditures, and the com-

bined effects of legally binding rent restrictions along with high building costs (Lewis, 34).

It may be worthwhile repeating that the increased levels of public expenditures in the 1920s were not part of a strategy to reduce unemployment in general. Thus, a major national roadbuilding programme which had been initiated in the late twenties was cut in 1931, for reasons of economy, when it could have been of great use in absorbing unemployed resources to improve Britain's infrastructure, at low real cost.

In some respects the emergence of social security measures (through on a frugal scale by modern standards), and high trade union membership in the early postwar years, may have worked in the direction of increasing unemployment from 1920 onwards. With output prices falling for most of the decade, money wage rigidity tended to reduce real profit margins and hence the incentive to employ. Money wage cuts were implemented in the early and middle 1920s, but they induced widespread work stoppages, notably in the coal industry. The best-known case of such industrial unrest was the economy-wide general strike initiated by the coal miners in the summer of 1926. However, the effect on the general level of wage rates was small; although miners' wages were substantially cut, wage rates elsewhere in the economy were not greatly affected by the dispute. The extent to which improved social security accentuated nominal wage rigidity and affected unemployment levels is of course uncertain, but it was probably of minor importance in that context in the 1920s.

Developments in macroeconomic theory -- above all highlighted by the publication of Keynes' *General Theory of Employment, Interest and Money* in 1936 -- had little effect on Britain's employment policies in the 1930s. But governments elsewhere, including those in Germany (in 1932-4), in the US from 1933 onwards, and in Sweden,

adopted policies which, however subconsciously, were in accord with 'the new economics'. Thus, the January 1933 budget speech of Sweden's Finance Minister noted that 'the budget is based on the assumption ... that in Sweden there will be no spontaneous tendency towards recovery, except to the extent that the policy of the State will help to bring it about In seeking to achieve this object, the State's financial policy must obviously play an important part' (Quoted by Aldcroft, 100). Sweden therefore implemented a large programme of public works, using deficit financing. In fact, by the mid-1930s public works absorbed 15% to 20% of the Swedish Budget. By contrast, British policy in the 1920s and 1930s was generally in line with 'the Treasury view', described early in 1929 by the Chancellor of the Exchequer of the then ruling Conservative Party, Winston Churchill, as 'orthodox ... dogma, steadfastly held, that whatever might be the political and social advantages, very little additional employment can ... be created by State borrowing and expenditure' (Quoted by Aldcroft, 27). Although Coalition governments (which, it must be noted, were dominated by the Conservatives and had dubious Labour Party representation in the 1930s) were in power from 1931 onwards (until 1945), this remained the official view throughout the depression years of the 1930s. Programmes of public works had in fact been of some minor importance in Britain in the 1920s, but most of them were suspended in 1931 on grounds of economy -- at a time when deficiency of demand had become particularly serious. Although Keynes made many converts among academic economists, it was not until the early years of the war -- by which time unemployment was no longer a problem -- that the new economics received some official approval in budgetary policy.

Fiscal balance rather than programmes to alleviate large-scale unemployment was the dominant consideration behind the budgets of the early 1930s. In fact, fiscal policy may have aggravated the ill-effects in Britain of the world crisis in those years. Labour's

1930 budget was introduced in an environment of deteriorating trade and employment. Taxes were raised sharply in order to meet the revenue shortfall expected because of declining incomes and mounting unemployment relief payments. The budget of early 1931 differed but little.

At end-July 1931, a Committee presided over by Sir George May issued a report -- the so-called May Report. Ostensibly, the Report was concerned with estimating the budget deficit to be expected, and with making recommendations of ways to meet it. However, 'it is difficult to avoid the conclusion that the Report was intended to be, and certainly turned out to be, a political document designed to do the maximum damage to the Labour Government and its social welfare programme, especially the increased unemployment payments which it had authorized' (Pollard, 1969, 212). The emphasis of the May Report was set on restoring fiscal balance rather than on countering unemployment. Its proposals for cuts were drastic. Several members of the Labour government were not willing to allow unemployment relief to be cut to the extent recommended, but shortly after that Cabinet had split on the issue, and a new 'National' (Caretaker Coalition) government formed in August 1931, many of the May Committee's suggestions were implemented. Taxes were further raised and unemployment insurance contributions increased. On the expenditure side, salaries were cut across the public sector, rates of unemployment relief were reduced, and public works were abruptly discontinued.

Fiscal policy was less restrictive from 1933 onwards. In 1934 the cuts in rates of unemployment relief were reversed, while the cuts in public sector pay were also reversed in 1934-36. And amid a general environment of recovery, the budgets of 1936-39 were characterised by rapidly rising expenditure on defence.

One way of estimating the direction of fiscal policy relative to some base year is by using the concept of a constant employment budget which, given the tax rates and expenditure levels that actually prevailed in each year, estimates what the budget surplus or deficit would have been had private sector demand been high enough to maintain the employment level of the base year. Using this concept with 1929 as base year, Middleton (1981) has estimated that fiscal policy became progressively more contractionary until 1934, and remained contractionary (relative to 1929) until 1937. More recently, Broadberry (152) has questioned Middleton's estimates and argues that 'fiscal policy was probably broadly neutral through the 1930s'.

On balance, it is apparent from the immediately preceding paragraphs that fiscal policy in Britain in the 1930s was not manipulated along Keynesian lines in order to influence the level of aggregate demand. What was the contribution to output and employment of the policy of cheap money? In this context it is worth noting that in the beginning -- early in 1932 -- cheap money was not a conscious long-term macroeconomic policy objective; rather, it seems to have reflected a maze of market forces. Then, 'the advantages of cheap money, which led to its retention for nineteen years, until 1951, became apparent and acceptable only gradually. Market rates had been falling ... from September 1931 onward, long before the official policy of low rates was inaugurated. The reasons for this are not clear ..., nor was there any increase in the quantity of money at that stage. Perhaps basically the change was psychological, the increased confidence in a Conservative-minded [Coalition] government. However it was brought about, the fall in market rates gave the Government an indication of direction' (Pollard, 1969, 236).

There were many reasons why the government maintained a policy of cheap money. One reason -- at an early stage -- was that low interest rates were simply means for reducing the government's expenditure without generating social unrest. Another was that the

authorities began to look on cheap money as a method of stimulating aggregate economic activity. However, 'this motive became operative, at the earliest, in 1933, but was later responsible for the continuation of the policy' (Pollard, 1969, 237).

There has been a good deal of debate on the extent to which low interest rates in Britain actually stimulated output and employment in the 1930s. The recovery from the depression was led by a very major boom in the building of private dwellings (which had spillover effects on furniture, electric wiring, etc), unaided by state subsidies. This was boosted by industrial and commercial building from 1934 onwards (by which year investment in manufacturing had recovered and exceeded its 1929 level). It is probable that cheap money helped in the raising of finance for investment in new consumer goods industries, such as automobiles, and in facilitating domestic purchases of such output. But cheap money was only one factor underlying the building boom. It may well have played a permissive rather than a causal role. Of at least equal importance was the so-called building cycle, which had been held back from its expected upswing in the 1920s due to depressed economic conditions, and thereby accentuated a situation of severe housing shortage at the beginning of the 1930s. There was also substantial growth in service trades such as entertainment. This was in part due to rising real wages, brought about, not by rising money wages, but by falling prices, which in turn were largely induced by a collapse in the prices of British imports which caused a substantial improvement in Britain's terms of international trade in the 1930s.

Finally, one should not ignore the effects of tariff protection in contributing to the economic recovery. It could be argued not only that it brought immediate and direct benefits to industries such as iron and steel, but also that by cutting down on imports it reduced the extent to which income and employment had to fall by virtue of the decline in British exports to a depressed world economy. A fall in imports of 12% between 1931

and 1932 is hard to explain without some reference to the tariff, especially when most of this fall was accounted for by manufactures. In the view of one author, the tariff accordingly 'gave an important boost to manufacturing in 1932 and set the stage for recovery' (Hatton, 27). Note, however, that one should be careful not to regard the switch to a floating exchange rate, and the implementation of protection -- which took place more or less simultaneously -- as *fully independent* stimuli to output and employment in Britain in the early 1930s. That is because the implementation of protection presumably moderated the extent to which sterling depreciated in those years.

Unemployment in Britain remained high throughout the 1930s. Even at the peak of the recovery, in 1937, it was around 10%. It has been argued that such high unemployment rates were largely the result of *social* policy. Unemployment benefits in the 1930s were higher, relative to current wage rates, than before 1914. A study by Benjamin and Kochin (1979) has produced econometric evidence that such benefits reduced the incentive to work, and suggested that had the system operated with the benefit-to-wage ratio of 1913, unemployment in the 1930s would have been 5 to 8 percentage points lower. However, the quality of the statistical data used by those authors has been strongly criticized and it has also been suggested that the operation of the benefit system had its main impact on the numbers unemployed for short periods. A more recent study (Crafts, 1987) noted that long-term (at least 12 months) unemployment became relatively more significant in the 1930s than in the 1920s. This probably reflected the adverse fortunes of coal mining, shipbuilding, engineering, cotton and steel, and the geographic concentration of those industries. Using a methodology similar to that of Benjamin and Kochin, the same study concluded that in the 1930s, 'it is not the case that the long-term unemployed had very high unemployment allowances relative to the wages they had normally earned. In particular, there were many elderly workers with extremely low re-employment probabil-

ities and also very low replacement rates Long-term unemployment could not have been eliminated in the 1930s either by modest reductions in the allowances payable or by a general expansion of aggregate demand; from a policy-maker's perspective long-term unemployment should be seen as essentially structural', implying 'mis-matches' between the endowment of skills and potential demand for skills, deterioration and loss of skills, and imperfect mobility of labour across regions (Crafts, 432). It would seem, therefore, that the increased unemployment in the 1930s was both demand deficient and structural, while some of it was cost constrained or voluntary.

II. 2. Emergence of Full Employment and Comprehensive Social Security Policies

The outbreak of World War II led to the formation in 1940 of a broadly representative Coalition government (which, in contrast to the Coalitions of the 1930s, now had strong Labour Party representation) led by Winston Churchill. The war years also saw the implementation of national income accounting, and the adoption of Keynesian policies, by the government. In those years the immediate objective in applying these advances in economic analysis was, not to affect the level of employment, but rather to minimize inflationary gaps in an overheated economy.

From the very early years of the war onwards, there was a strong link between war-time morale and projected post-war economic and social policies. One task of the War Aims Committee, set up in 1940, was to articulate clearly the case against Hitler. This became linked to the question of post-war objectives, employment policy included. An official memorandum of 1940/41 discussed methods by which full employment might be maintained, in part, it seems, because Hitler was acknowledged to have achieved that aspiration, but only by methods deemed to be immoral (Tomlinson, 23, 228). Thus, the

pursuit of victory in the war became linked to boosting morale through the prospect of a 'new deal' for the masses (whenever the war was ended). It was around the same time that Sir William Beveridge was asked to prepare a comprehensive report (published in 1942) on the existing social security system. This had evolved in a piecemeal manner in the earlier decades of the century, but there were still major gaps in its provisions. Beveridge's own view, as stated in that Report, was 'that the purpose of victory is to live into a better world than the old world; that each individual is more likely to concentrate upon his war effort if he feels that his Government will be ready with plans for that better world; that, if these plans are to be ready in time, they must be made now' (Quoted by Pollard, 1969, 348). A Minister of Reconstruction was appointed in 1943.

The Beveridge Report sought measures to tackle all the known causes of want and deprivation. It recommended the provision of comprehensive schemes of unemployment benefit, sickness benefit, old age and widows' pensions, and maternity benefit. The report was also based on the assumption that a comprehensive public health service, available to all, would be established, and that allowances would be paid to all mothers for child support. Thus, what Beveridge sought was a comprehensive, centralised and integrated social welfare system, applicable to the entire population from the cradle to the grave. Most of Beveridge's suggestions became central features of the 'welfare state' established in Britain after the war. Beveridge made the maintenance of a high (relative to the 1930s) level of employment a basic requirement. He assumed an unemployment rate of 8.5%, but as soon as his 1942 report was completed, and aided by a group of economists, he prepared a second, unofficial report, proposing means of maintaining the unemployment rate after the war at a target level of 3%, which he believed represented 'full employment' in the sense that it was the lowest unemployment rate which a modern capitalist economy such as Britain could sustain over time.

The level of employment was the central feature of the government's plan for post-war social reconstruction. In May 1944 it published a White Paper on Employment Policy. This marked a clear turning point in its acceptance of an obligation to maintain a high and stable level of employment after the war, and of Keynesian methods -- the emphasis in the White Paper was on variations in government expenditure rather than in taxation -- of pursuing those objectives.

When the war ended, a vast controlled programme of demobilization from the armed forces and the war industries had to be implemented. For example, between the middle of 1945 and the end of 1946, engineering lost half a million workers, while building gained over half a million. Most of that transition had been planned well before the end of the war.

II. 3. Attainment of Full Employment under the 1945 Labour Government

The advent to power of the Labour Party, with a large majority in Parliament, brought to an end 14 years of rule by Coalition governments in July 1945. The new government's programme had three central features: nationalization of key productive sectors of the economy; the establishment of a welfare state that would provide minimum levels of education, housing, health care and social security for all (along the lines recommended in Beveridge's 1942 Report); and a commitment to full employment through economic management by the state.

The Labour government speedily nationalized the Bank of England; the telecommunications system; the principal airline; the railways; that part of the electricity sector still in private ownership; iron and steel; coal and gas; and most of the large road haulage concerns. Long-delayed rationalizations were then implemented in some of those sectors.

Within the Labour Party itself, however, enthusiasm for nationalization began to wane around 1949, when disagreement arose over the question of further nationalizations in the Party's next electoral manifesto (Hall, 70). Over several subsequent years, power within the party began to shift towards those who argued that a socialist economic policy could best be built around Keynesian demand management rather than by further nationalizations and centrally controlled resource allocation.

A commitment to full employment is widely regarded as the most important single distinguishing feature of economic policy in Britain in the years immediately after the war. In fact, 'with the possible exception of Sweden, no other Western government made employment the centrepiece of post-war policy' (Hall, 71). The development of Keynesian economic theory is often said to be the source of this objective. However, apart from the need to boost morale as mentioned earlier, 'much of the original wartime stress on the goal of full employment was predicated not on Keynesian ... theory, but on a belief in the possibilities of extending wartime planning into the post-war period' (Tomlinson, 17). This planning involved firm policies of taxation, free and forced saving, price control, rationing, control of civilian supplies, and centralized allocation of labour. Application of these policy instruments was facilitated by the emergence of national income accounting. Nationalization was but one feature of the extension of such planning to the post-war era.

Britain did attain approximate full employment under the post-war Labour government. Unemployment was generally below 2% of the insured labour force, and much of this residual unemployment was merely frictional (ie. workers in the process of changing jobs) or it consisted of persons deemed unemployable. However, the post-war boom bore little relationship to Keynesian policies to expand demand. Investment demand was admittedly at high levels, much of this being by the public sector in the nationalized

industries, in housing and in other areas neglected in the past or essential for the future. But in the context of demand management, policy in the immediate post-war years was in fact constrained by high levels of repressed inflation, ie. of excess demand which was prevented from generating its own open inflation due to the maintenance of price and physical controls. Personal savings, accumulated during the war when there were insufficient consumer goods upon which to spend incomes, and the accumulated balances of private firms, were waiting to be unleashed following years of austerity. Hence, a problem which policy makers faced in the immediate post-war years was to restrain aggregate demand, rather than to expand it through Keynesian or other policies.

In Britain, Keynesian ideas were first implemented in the budget of 1941, which raised taxes so as to dampen demand in the face of high defence spending. This policy was applied in the context of wartime controls, which rendered budgetary policy a simple supplement to direct resource planning. But, as already indicated, in the late 1940s, politicians were gradually persuaded that detailed supervision over the activities of the economic sectors was no longer necessary to attain the goal of full employment. British governments therefore began to dismantle the superstructure of controls used to direct the flow of goods and services in the economy during the war.

Although some forms of rationing were not erased until the late 1950s, the Labour government 'lit the first bonfire' of controls as early as 1948-49. But it did not retreat from the goal of full employment. Thus, the British experience for some decades after the Second World War was to be very different from that after the First. The latter had been followed by an explosive but transitory boom, and then by almost two decades of exceptionally high unemployment, toward which British governments adopted largely a 'hands off' approach. By contrast, the decades immediately following postwar reconstruction under the 1945 Labour government were to see successive administrations

adopt largely a 'hands on' approach, not in regard to centralized planning and physical controls, but at least insofar as Keynesian demand management policies were concerned.

III. MARKET INTERVENTION, WARTIME PLANNING AND RETREAT FROM PLANNING

III. 1. Market Intervention in the Twenties and Thirties

Wartime experiences aside, 'economic planning' in Britain has for the most part consisted of intervention and exhortation rather than centralized direction and control. In the 1930s it was largely oriented toward rationalization and survival of major economic sectors threatened with decline, while in the 1960s and 1970s it became linked to the objective of economic growth.

The First World War necessitated heavy regulation of economic activity. Rail and both internal and external transportation were placed under very tight government control. In agriculture, government departments determined land utilization, fixed prices and traded in produce. Although it remained in private ownership, coal mining was placed under government control, while iron and steel was supervised by the Ministry of Munitions, which itself owned close to 300 factories. Towards the end of the war almost all of the UK's foreign trade was conducted by the government. But at policy levels, there was a general consensus that the controls should be dismantled as quickly as possible, thereby removing hinderences to private enterprise. Although the coalminers in particular insisted on nationalization of their industry, almost the entire economy had been deregulated by mid-1921. The amalgamation of the principal railways into four large (private sector) groups was one of the few legacies of the temporary wartime switch to centralization.

Britain extended very limited, but selective, tariff protection in the 1920s. Duties imposed during the war, ostensibly in order to save shipping space and foreign exchange, were carried forward into the peace. The number of goods subject to duty was increased by an Act of 1921 which sought to protect industries deemed vital to the national interest. These included various innovations such as automobiles (where protection had been initiated in 1915), radio equipment, films and a range of other products. The list of protected goods was lengthened in the later 1920s when the tariff system was made more protective, rather than more revenue-raising, in motive. Nevertheless, Britain was still very much a free trade country at the beginning of the 1930s, with over 80% of her merchandise imports being allowed in free of duty. Most of the duties which did apply were still for revenue purposes and had been carried forward from the 19th century. Protective duties applied to no more than 3% of all imports (Aldcroft, 70).

Official reasons given for the very modest degree of protection in the 1920s amounted to infant industry arguments (Phillips and Maddock, 115). The industries in question did generally turn out to be high growth sectors. Thus, whatever the static welfare losses implied by protection in the underemployed economy of the 1920s, they do appear to have been more than offset by growth of the sectors involved. For example, Britain in the interwar years was the world's second largest exporter of automobiles (after the US). But in the latter case it should be noted that some of the success was due, not to protection *per se*, but to the structure of protection in the form of Imperial Preference which dated mainly from 1932 onwards: in 1937 about 85% of Britain's automobile exports went to Commonwealth countries (Youngson, 107). However, in many cases the comprehensive tariff of 1932 may have shielded secularly decaying industries to an excessive extent, and may have delayed economic restructuring. Also, by its effects on the volume of world trade, the 1932 general tariff probably had adverse effects on the total demand for British exports.

Although the government retreated from detailed economic regulation in 1919-20 by dismantlement of wartime controls, and apart from limited tariff and social security legislation, the 1920s did see some generally new forms of state intervention in the market economy. *First*, subsidies were made available in the 1920s for the infant sugar beet and passenger airline industries. Following the practices of some other countries, the private sector was also assisted by the government's setting up of an Export Credit Guarantee Department in 1928, to enable exporters to offer longer terms of credit to their foreign customers. *Second*, the government extended the economic role of the state by establishing several public corporations. Among the most important of these were the Central Electricity Board, set up in 1926 to undertake the wholesale transmission of electricity through its development of the National Grid, and the British Broadcasting Corporation, established as a monopoly in the same year. The National Grid, linking the more efficient producers of electricity and spreading the load, was more or less completed by 1933. Along with the concurrent housing boom of the 1930s, it greatly assisted the development of electrical appliance industries. Subsidisation of the two main airline companies was continued in the 1930s, but these were in effect nationalized into a single public company at the end of the decade. *Third*, by legislation of 1919-24, the government initiated a policy of making subsidies available to both local authorities and private builders for the construction of working class housing. In consequence, about one third of all houses built in the 1920s were by local authorities with State assistance, about one third by private enterprise with State assistance, the remaining third being built by private enterprise without State assistance (Youngson, 64).

British governments implemented a series of emergency measures in response to the economic crisis of the early 1930s. Some, such as cuts in government expenditure (including public-sector wage cuts) and tax increases were purely short-term: by 1935,

levels of public expenditure and taxation were back to what they had been in 1930. But that was not the case in regard to measures involving tariff protection in the 1930s. The most important was the Import Duties Act of 1932, which imposed a straight duty of 20% on almost all imports other than certain primary products; an additional duty of 13% was levied on imported steel. As a result of Imperial Preference, only Commonwealth countries were exempted from the full range of these duties.

Two reports of 1931 (those of the May Committee and the Macmillan Committee) recommended widespread rationalization, particularly in the major traditional export industries, so as to restore Britain's competitiveness on world markets. It was hoped that rationalization would have its greatest impact on the coal, steel, shipbuilding and cotton industries.

In order to eliminate forms of competition which were deemed to be wasteful, a compulsory cartel scheme was set up under Part I of the Coal Mines Act of 1930. A Central Council, representing the mine owners, was to determine the allocation of sales quotas between the seventeen districts into which the nation was divided, and the districts, in turn, allocated quotas to individual collieries. The cartel helped reduce output and maintain prices and profits in the short-run and, because the quotas were transferable, it led to some concentration of production. Part II of the 1930 Act had more long-term objectives. It set up a Coal Mines Reorganization Commission so as to rationalize production, mainly by amalgamations. Due, however, to opposition by mine owners, it was not successful in the latter task.

Britain's steel industry had fared very poorly in the 1920s. Cartels and tariffs abroad reduced exports, while the home market was flooded by cheap imports. The special 33% import duty on steel, introduced in 1932, was granted on the understanding that the

industry would reorganize. The British Iron and Steel Federation was set up under government support in 1934. One of its tasks was to foster schemes for rationalization by the industry itself. In 1935-6 it became responsible for price-fixing arrangements, and negotiated with foreign cartels to impose import quotas, after being granted enhanced bargaining power by virtue of a temporary increase in the import duty to 50%. It also engaged in bulk buying of foreign scrap for the industry as a whole. Tariffs, amalgamations and officially supported cartel arrangements kept up prices and profits; however, it is not clear that they made significant contribution to efficiency in the British steel industry (Pollard, 1969, 117). This view is supported by the fact that although Britain's rivals lost much of their share of the UK market, while Britain had a privileged position in Commonwealth markets, Britain's share of world steel exports fell from 21% to 17% between 1929 and 1938 (Youngson, 107).

Britain's formerly thriving shipbuilding industry was threatened with obliteration by a collapse of markets in the 1920s and 1930s. However, this was not due to worldwide excess capacity and depression alone. For compared to the prewar years, Britain's shipbuilding output fell absolutely in the late 1920s and continued to do so in the 1930s while, aided by subsidies, the shipbuilding output of her competitors increased in those years. Voluntarily, the industry responded by setting up, in 1930, an organized scheme of restriction, National Shipbuilders' Security Ltd. This organization imposed a 1% levy on the sales of participating firms, and used the proceeds to dismantle failing shipyards. One victim was the town of Jarrow, where closure of the shipyard left the town with an unemployment rate of over 70% (Peden, 104). Overall, the unemployment rate in shipbuilding reached 62% in 1932 (Youngson, 102). There was also the so-called 'scrap and build' scheme introduced by the British Shipping (Assistance) Act of 1935, under which the Treasury offered cheap loans to owners of new cargo vessels: in return, the owners were

to scrap 2 tons of existing tonnage for every ton newly built. The objective was to reduce excess capacity, to assist shipbuilders and to encourage shipowners to modernise their fleets. However, the scheme was availed of to a limited extent only. Furthermore, because British shipowners were allowed to buy foreign vessels for scrapping, foreign shipowners, who sold their old ships to British owners at inflated prices, may have been the chief beneficiaries of the scheme (Aldcroft, 126).

Faced with competition from newly industrializing countries, Britain's important cotton industry also faced collapse in the 1920s and 1930s. At first the industry responded by setting up its own restriction schemes, designed to reduce capacity and maintain prices. These measures were followed by the Cotton Industry (Reorganization) Act of 1936, which set up a board with power to raise compulsory levies, which were used to acquire and scrap excess capacity. Part of such capacity was indeed scrapped, but the levy meant that the costs of some of the more efficient firms, with little or no excess capacity, were increased. Finally, legislation of 1939 created machinery for fixing compulsory minimum prices. Thus, 'the State, having ensured reduction of capacity, ... created a compulsory cartel to raise prices' (Pollard, 1969, 123).

Despite the rationalization programmes of the 1930s, inefficient firms continued to exist, especially in the coal industry; in fact, in some respects the survival of the inefficient may have been consequences of particular features of those programmes. Although in those respects they may have impeded long-term growth, they may nevertheless be justified in terms of some protection of employment in a general environment of depression.

In an attempt to restore order to markets which had collapsed in the 1920s following withdrawal of wartime support schemes and in the face of the fierce import competition which ensued, British agriculture was transformed in 1931-33 into a highly protected,

organized and subsidized sector of the economy. In practice, and unlike the case with the industrial sector, a general tariff could not be implemented to address the problems of agriculture. That was because some important products, such as milk, faced no direct foreign competition while others, from 1932 onwards, continued to be imported from the Commonwealth as part of a bargain which in effect exchanged British manufactures for foodstuffs. The government therefore resorted to a mix of measures for agriculture, involving discriminatory tariffs and quotas, sector-organized marketing schemes to keep prices and incomes up, and outright government subsidies. Thus, policy in regard to agriculture 'amounted to an extraordinary patchwork.... Assistance was doled out first to one branch of farming and then to another, after causing wasteful redistribution of farmers' efforts and resources and sometimes penalizing branches of farming not receiving assistance. There was no strategy, only a series of unco-ordinated measures' (Youngson, 119).

Legislation of 1931 enabled two-thirds of the producers of any agricultural commodity to prepare a scheme for organized marketing, including price maintenance, which, with approval of Parliament, became compulsory for all producers of the commodity in question. This legislation had very little immediate effect. A further Act, in 1933, enabled such marketing boards to control the output as well as the prices of their commodities. By 1934 five marketing boards had been established, and others followed. One of these was for milk, which was twice as important, in terms of value, as any other farm product. Consistent with safeguarding the interests of producers in Commonwealth countries, stabilization of farm prices and incomes were the primary objectives of the legislation affecting agriculture in the early 1930s. It was not until 1937 that the military significance of increased food production domestically began to be considered.

The British government's intervention in agriculture in the 1930s has been widely criticised on grounds of cost and efficiency. Prices at home were kept up above world

levels, and British consumers and taxpayers bore the brunt of high production subsidies. At the same time, protection and organized marketing schemes shielded both efficient and inefficient producers, and thereby slowed-down the elimination of high production costs facilitated by technical change. However, although the agricultural labour force did decline by about 15% in the 1930s as mechanization and newer techniques were implemented, the fact that policy in the 1930s helped to prevent the virtual demise of some sectors of British agriculture may, in retrospect, be deemed fortunate, given Britain's strategic need for less dependence on overseas countries for food during the 1939-45 war.

III. 2. The Early Years of Regional Policy

Unemployment in the interwar years was very heavily concentrated in specific regions which had been dependent on the secularly declining traditional export activities. In 1934, for example, unemployment was 6.4% in Birmingham and 5.1% in Oxford, but it was over 60% in some of the towns in particularly depressed regions (Youngson, 128).

Regional policy within Britain had its genesis in the late 1920s when the government decided to assist market mechanisms by offering financial inducements for labour to transfer out of the pockets of massive unemployment towards less depressed regions of the economy. Altogether some 280,000 individuals obtained assistance for *internal* migration in the period 1928-38.

Another form of migration assistance was focused on the Commonwealth. Thus, under the Empire Settlement Act of 1922, over 400,000 Britons, between 1922 and 1933, received fairly small sums to assist them to migrate to Commonwealth countries (Aldcroft, 120). This legislation, for the first time in many decades, committed the British government to spend on the emigration of its ordinary citizens. According to one

researcher on imperial economic policy in the interwar years, the motivation for such legislation was 'in small part, the rhetorics of Imperial development and Empire solidarity. In much larger part, [it sought to address] Britain's unemployment problem.... Empire settlement was part of a long-range unemployment programme. By peopling the Empire it would create new export markets for Britain. And in the short run it took some people off the labour market' (Drummond, 43, 424).

A few measures in regard to industrial location emerged in the 1930s. Following ineffective legislation in 1934, in 1936 the Bank of England, with government support, set up the Special Area Reconstruction Association to lend to small firms in Special Areas of high unemployment. An Act of 1937 provided for temporary contributions towards the rent and tax liabilities of private firms in Special Areas, while the Treasury was empowered to make loans to new undertakings in such areas. In consequence, some industrial estates were built for lease, with government funding. These regional measures seem to have been of some small success in affecting the location of new factories (Peden, 106); however, the potential impact was limited by a lack of controls on factory building in congested areas, especially in the south. Thus, of almost 4,000 new factories opened in Britain in 1932-38, only 4% were in the Special Areas, whereas over 40% were in the more prosperous Greater London area (Phillips and Maddock, 160).

In the early postwar years controls over investment were used to direct new factory building to regions which had experienced high unemployment in the 1930s. Although they had only 20% of the population, regions designated in 1945 as development areas received 51% of new industrial building in 1945-7. However, as unemployment stayed low, regional policy was soon relaxed and the development areas received only 17% of new industrial building in 1948-50 (Peden, 146, 7). There was a period of hostility to everything that smacked of the interventionism of the early postwar years after Labour

left power and the Conservatives came into office in 1951. Regional policy accordingly went into decline in the 1950s.

III. 3. The Second World War and Inflation

World War I had been followed by a short-lived inflationary boom, but this came to an end with the raising of Bank Rate to 7% in April 1920. With prices actually falling in the 1920s and early 1930s, inflation did not again become a policy problem until shortly after the outbreak of World War II.

At an early stage in that war, the government began to subsidize certain foods so that prices could be kept down with a view to avoiding social unrest. It was initially intended that these would be temporary, pending agreement with the trade unions on a wage freeze. However, the subsidies were to grow with a momentum of their own throughout the war years. The early food subsidies were easy to administer, since the government, as bulk importer, could absorb the rising costs abroad and pass on the foods to distributors at any predetermined prices. In the case of home produced food, the government subsidized farmers to bridge the gap between production costs and artificially low prices. Rent controls were applied to dwellings, and price control was extended to almost all other consumer goods and services. By contrast, the government raised a large part of its revenue by sharply increased taxes on tobacco and alcohol, the weight of which was spuriously minute in the official cost of living index (in which food had a weight of 60% reflecting pre-1914 consumption patterns). Other indirect taxes were adjusted in a discriminatory manner so as to raise the maximum revenue with the minimum impact on the official cost of living index. In the event, that index increased by only 32% between 1939 and 1945 (Pollard, 1969, 324). Direct taxes had little or no obvious and immediate impact on the

cost of living. Hence, income taxes were increased, and an excess profits tax of 60% which had been introduced in 1939 was soon raised to 100%.

Subsidies and direct controls were only symptoms of the inflation problem. In order to transfer purchasing power from private to public sectors by means other than printing money (ie. by non-inflationary means), substantially increased taxation, to which reference has already been made, was called for. Late in 1939 Keynes published a national accounting approach in order to estimate the prevailing war-time inflationary gap which more repressive taxation policies soon sought to remove. This work helped precipitate a switch in methodology in preparing the April 1941 budget, which substantially raised the standard rate of income tax to 50%. What made this budget a landmark in the history of public finance was that it was the first time that a budget was prepared in a national accounting framework, as Keynes suggested, rather than being merely a cash balance sheet of government income and expenditure. A similar methodology lay behind each subsequent budget. In order to finance the war-time government deficit by non-inflationary means, private sector savings were channelled to government, partly by direct controls, and by offering attractive terms to lenders. Among the direct controls were suspension of capital investments and licensing and allocation of materials. The commercial banks were pressured into allocating their available resources to the government, and into restricting applications from the private sector for bank advances only to cases in which it was intended that they would be used for approved capital formation. The ensuing total of private sector savings channelled to the government sector -- much of it forced by restrictions on private sector expenditures -- was to cause problems after the war ended, but it played an important role in financing the war in a relatively non-inflationary manner and without resort to even higher levels of taxation.

Over one half of the cost of the war was financed from taxation; in the 1914-18 war the proportion was less than one third. In regard to the success of wartime controls and budgetary procedures in minimizing inflation during the war, one writer has summarized by stating that 'it was, a remarkable achievement to multiply the size of the armed forces tenfold, keep the volume of civilian employment almost steady, re-organize the entire structure of production, reduce civilian consumption by over 16 per cent, and have the cost of living rise by less than 50 per cent' (Youngson, 152). Even if (due to the weighting procedures used in designing the retail price index) the true rise in the cost of living somewhat exceeded 50%, the measures adopted must be deemed to have been broadly successful.

III. 4. Wartime Economic Planning and the Retreat from Planning

It has been seen that the British government, at the outbreak of the war, was concerned about the danger of inflation generated by the enormous budgetary demands of a war economy. However, it soon became apparent that the task of centrally allocating scarce resources -- not just raw materials but also labour -- was even more important. This led to the introduction of machinery to co-ordinate production, allocate labour and materials, ration goods and control prices directly.

The outbreak of war brought about the establishment of several new Ministries, some of which were given far-reaching powers. Thus, most raw materials, as well as iron and steel and machinery, could be obtained only from the Board of Trade or by licence through a government department. From 1940 onwards, civilian consumption was regulated through rationing. 'Utility schemes', under which the design of various products was limited to functional basics, came in 1941 and 1942. Agriculture, controlled largely



by appealing to the profit instincts of farmers through subsidization and official pricing policy, was expanded in order to conserve shipping space. In consequence, agriculture was made much more profitable and became intensively mechanized. By 1945 the value of British agricultural output at constant prices was about 35% higher than in 1939 (Youngson, 143). However, the keystone to the apparatus of wartime restrictions lay not with the control of commodities but in manpower budgeting. In May 1940 the Minister of Labour was given power to order any person in the UK to perform any service required in any place. The Minister was also empowered to prescribe conditions and hours of work, and its remuneration. Some of such powers were used sparingly. But control of the largest possible labour force -- including the unprecedented conscription of women for wartime production activities -- was thereby secured. Its allocation was determined by the government's 'manpower budget', under which labour force allocation was linked to the regulated supplies and demands for goods and services.

In many respects the economic problems facing the first peacetime Labour government in 1945 were similar to those of the war years. Thus, many features of the system of wartime controls were extended for some years into peacetime. The government's powers inherited from the war included: financial and physical controls over investment and allocation of raw materials; controls over imports and foreign exchange; price controls and consumer rationing; controls on the movement of labour and restrictions on strikes.

Controls on investment were very comprehensive during the war. Licences were required for all building work and for the acquisition of most types of plant and machinery. Machinery licensing fell into disuse at the end of the war. Thus, for the first six or seven years after the war, the government had four principal ways of controlling investment: first, by the licensing of building activities; second, as a by-product of steel alloca-

tions; third, by inducing manufacturers to accept export targets for machinery; and fourth, through its influence over public investment. The licensing of private building work was extended to as late as 1955.

Controls over imports and foreign exchange were essential in coping with the post-war dollar shortage. In 1946, some two-thirds of imports were purchased directly by the government, and of the one third which was brought in by the private sector, almost all of them were subject to control by licence. Only a few non-dollar foods and a few other materials from the Sterling Area were free from licensing (Dow, 154-5). During 1945-50, however, importing gradually reverted to the private sector: by 1951, only 38% of all imports were by the government, and (although the sterling crisis of that year had led to reimposition of controls on commodities which had already been decontrolled) licensing of private sector imports had been considerably relaxed. In regard to the effectiveness of the import controls, it has been estimated that 'for the first five post-war years, imports were substantially lower in relation to national product than would be expected in view of either pre-war, or of subsequent, experience; and there is little doubt that import controls ... reduced imports in total. As the controls were removed this restrictive effect must have been rapidly weakened. By 1954 or so, one would guess, they can have had little restrictive effect' (Dow, 158).

Apart from coal and steel, Britain imports almost all her raw materials, most of which, at the end of the war, were distributed under centralized allocation schemes. Like the import controls, these were gradually dismantled over the years up to about 1953. Managed allocation of coal, however, lasted until 1958. The administration of the allocations was generally based on existing organizations in the industries in question.

Food rationing was actually expanded in 1946-7; bread and potatoes, which had not been rationed during the war, then became rationed. But as shortages eased, these controls were dropped, as also were price controls. Although there was some reintroduction of the price controls during the Korean War inflation in 1951, most of the controls on food prices ended in 1952-3, when rationing schemes were also removed.

Most of the wartime controls on the allocation of labour were too drastic to be applied in peacetime. The ban on strikes 'remained theoretically in being until 1951 but could not be enforced' (Peden, 147). In 1947, trade unions agreed to continuance of government powers to allocate labour in exceptional circumstances, but the number of workers affected was small and these powers lapsed in 1950. The Essential Work Orders, which prevented workers from changing jobs, were retained for a few years for agriculture and mining, but these also were ended in 1950.

The general election at the end of the war had brought to power the first Labour government in Britain to have a clear parliamentary majority. Thus, the new government simultaneously had an ideological stance which differed from any of its predecessors, as well as an administrative opportunities to implement some features of that ideology.

The decline in wartime controls was, to some extent, offset by Labour's nationalization programme: the Bank of England and civil aviation in 1946; coal in 1947; railways, ports, canals and long-distance road services in 1948; electricity and gas in 1948-9; and iron and steel in 1951. Although some rationalization programmes were implemented, 'it is less than certain ... that nationalization contributed much to effective planning of the economy [Some of the nationalizations] made no difference. For example, the Treasury, not the Bank, had had the final word on monetary policy since 1931. Where nationalization did make a difference, the results were often disappointing, at least in the short

run' (Peden, 147, 8). The doubts of Labour ministers, and those of their successors in the 1950s, in regard to the appropriateness of ordinary commercial criteria in the operation of state enterprises, were often reflected in arbitrary and irregular intervention in the affairs of those bodies, especially in the context of their pricing and investment policies.

The institutional framework for planning under Labour gradually weakened. A Ministry of Production had been responsible for the entire range of civil and military production during the war. But it was abolished after the war ended. Some of its functions were discontinued, but many of them were transferred to the Board of Trade, which thus became responsible for most of the industrial sectors.

Starting in 1947, the government began to publish annual *Economic Surveys*, which made forecasts and set targets for the economy as a whole. The emphasis was on the short-term. Thus, the *Economic Survey for 1947* stated that 'it is too early yet to formulate the national needs over, say, a five-year period with enough precision to permit the announcement of a plan in sufficient detail to be a useful practical guide to industry and the public. There are still too many uncertainties, especially in the international economic field' (Quoted by Leruez, 47). Nevertheless, shortly after the publication of the *Economic Survey for 1947*, a Central Economic Planning Staff (CEPS) was set up in order to devise a long-term plan for the use of Britain's manpower and other resources. But in reality, CEPS 'was much more concerned with advising on general economic policy than with promoting any particular form of detailed planning [In practice] the economy was to be guided and planned chiefly by verbal means -- argument, persuasion and exhortation' (Leruez, 47, 53). CEPS did produce a very loose long-term programme at the end of 1947. However, 'it was not easy to tell whether this was a genuine plan or merely a dutiful exercise to meet the requirements [for receipt of Marshall Aid from the US] What happened in practice was that the programme was rapidly 'forgotten' ' (Leruez, 57).

The government's retreat from any serious commitment to comprehensive planning was revealed by the contents of successive annual *Economic Surveys* which, according to the introduction of the 1947 *Survey*, were initially intended to be short-term plans. The 1948 *Survey* dealt at length with targets for the current year. In noting that 'what government can do is mostly indirect. The problem is primarily one for industry', the 1949 *Survey* was less ambitious in tone (Quotation from Leruez, 60). Finally, that for 1950 spoke of forecasts rather than targets.

Labour's initial commitment to planning partly reflected the fact that controls had been readily accepted during the war, and continued to be tolerated in the early years of peace because so many items were in short supply. But as time went on consumers began to feel that these controls were no longer necessary to cope with scarcity. They came to be opposed by industry and by prominent economists such as Lewis and Meade, who (although, it seems, they were not philosophically hostile to Labour) favoured a return to market mechanisms, toward which there was a clear trend. Indeed, it would be no great exaggeration to say that 'planning had been virtually abandoned by Labour even before the Conservatives officially rejected it' upon returning to power in 1951 (Leruez, 61).

Labour's management of the economy has been deemed successful in terms of employment, prices and reconstruction. But the coal crisis of 1947 -- which had serious consequences for exports and caused widespread temporary unemployment -- should arguably have been better handled. Holding down coal prices meant that the only signal of an impending shortage was a run-down in inventories, to which only the government could react. The Minister of Fuel and Power 'at first failed to grasp the seriousness of the situation and, when he did, acted perversely by depriving industry of current supplies of coal in order to build up stocks of coal at power stations More vigorous recruitment

of miners could have avoided closure of industry' which depended on coal (Peden, 149). The subsequent return to full employment was assisted by the North American loans and Marshall Aid: otherwise, there would have been fewer dollars with which to obtain raw materials and sustain employment.

Despite the vicissitudes of 1947 and the 1949 devaluation, reconstruction rapidly went ahead under the first postwar Labour government. Although GNP fell by 4% in 1947, it rose steadily (by about 3% per annum) in 1948-51. It is worth noting that Britain's rate of postwar recovery was roughly in line with that in other countries of Western Europe, and that British production increased much more slowly after 1951. Thus, the lag in British economic growth relative to other European countries, which was to be widely noted in the 1960s, did *not* begin under Labour in 1945-51.

IV. BRIEF SUMMARY

As background material for Part II of the present study, the foregoing survey of policy in the period 1920 to *circa* 1949 can be summarized, very briefly, as follows:

1. Although Britain maintained gold reserves which were low relative to her trade, she was able to use her current account payments surpluses for overseas investment without having balance of payments problems in the decades immediately before 1914. That was possible because of London's dominance of the world financial system. But circumstances surrounding World War I and its aftermath brought this system to an end. By the late 1920s, the new scenario meant that if speculation were to emerge against a major reserve currency, and because of the strength of the US dollar, it would be Britain's pound sterling that would have to bear the brunt.

2. Along with prevailing perceptions about the nature of unemployment, exchange rate objectives meant that the elimination of sustained and unprecedented rates of unemployment was not an important policy objective in Britain in the 1920s.
3. Policy objectives in regard to managed floating of the exchange rate in 1919-25 were quite different from those in the early 1930s, after the final collapse of the gold standard: In the early 1920s policy sought to prevent depreciation of sterling, while in the 1930s it sought to prevent major appreciations of that currency.
4. Although it was forced on the authorities, Britain's departure from the gold standard in 1931 had sustained direct and indirect beneficial effects on the economy. The ensuing float of the pound seems to have helped arrest the fall in Britain's share of world exports, which had earlier been falling but remained roughly constant over the 1930s.
5. Probably the most important long-term effect of the 1931 decision to float was that it made possible a reorientation of policy towards domestic economic management. In particular, a floating exchange rate made a policy of cheap money possible, and this helped to stimulate output and employment in the 1930s.
6. Coupled with the shift to tariff protection, the Sterling Area emerged as a discriminatory bloc in the 1930s. The discrimination was greatly extended during and immediately after the Second World War. In those years the Sterling Area arrangements worked in favour of Britain, partly because they enabled that country to finance dollar purchases indirectly via the dollar receipts -- in the common Reserve Pool in London -- of other members of the Area.
7. Following the end of war-time aid from the US, the postwar dollar shortage meant that unless some means could be found to finance necessary imports, the British economy

would grind to a halt. Hence, the negotiation of huge North American loans late in 1945. And, as elsewhere in Western Europe, the dollar shortage was eased in Britain in 1948-9 by injection of US aid under the European Recovery Programme, which was politically inspired by fears of Communist takeover in Europe.

8. Developments in macroeconomic theory had little effect on Britain's employment in the 1930s. In fact, fiscal policy appears to have aggravated the ill-effects of the world crisis in the early part of that decade. But monetary policy and tariff protection made significant contributions to the economic recovery after 1932. It would seem that the high unemployment of the 1930s was both demand deficient and structural, while some of it was voluntary or cost-constrained. Probably to some small extent, the latter may have reflected the effects on wage bargaining and on the incentives to work of the development of the system of unemployment relief payments.

9. A central feature of domestic policy for several years after the Second World War was a commitment to full employment. Initially, much of the stress on *this goal* reflected a belief in the possibilities of extending wartime planning into the post-war period. However, even within the Labour Party, enthusiasm for further nationalization and centrally controlled resource allocation began to wane around 1949. For the next 25 years or so, full employment was to be pursued -- at first successfully by the standards of later years -- by Keynesian demand management policies.

10. Wartime experiences aside, 'economic planning' in Britain has consisted mainly of intervention and exhortation rather than centralized direction and control. In the 1930s it was oriented toward rationalization of major economic sectors threatened with obliteration.

11. A Ministry of Production had been responsible for the entire range of civil and military production during the Second World War, but it was abolished soon after the war ended. However, many features of wartime planning were maintained for a few years by the Labour government of 1945-51. Labour's economic management in those years has been deemed successful in terms of employment, prices and reconstruction. The lag in British economic growth relative to other Western European countries, which was to become widely noted in the 1960s, did *not* begin under the Labour government of 1945-51.

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