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THE DEVALUATION OF THE POUND:

AN EVALUATION

by

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Preface

The devaluation of the pound sterling set off a chain reaction of currency devaluations that will have an effect on world trade and prices for many years. Obviously it is impossible to evaluate all of the reverberations of such a far-reaching action in a paper of this type. At this early date it is impossible to draw definite conclusions based on observed facts in any single area, much less about the action of devaluation and all its implications.

I have used Chapter I to describe the situation at the time of the devaluation and to discuss the immediate reasons and the accessory measures. Chapters II and III are an attempt to show the development of the conditions making the devaluation necessary and at the same time to indicate some of the effects it is likely to have on individual industries and the various items composing the "invisible" section of the balance of payments. Chapter IV covers several areas where government influence is strong, in an effort to show the trend of government policy. Chapter V treats elasticities and purports to show that some drastic action on the part of the British government was necessary and that the devaluation was the most promising one available.

TABLE OF CONTENTS

TABLES

Chapter I

Devaluation and Accompanying Measures

On September 18, 1949, after many months of denying any intention to devalue, the British government devalued the pound sterling from $4.0275 to $2.80 in terms of U. S. dollars per pound. Following such a sudden and drastic step two questions come immediately to mind. (1) What happened to cause them to change their mind or at least their public attitude at this time? (2) What can they hope to gain by such a comparatively simple manipulation?

In looking for the answers, it seems logical to start by considering the statements of the Chancellor of the Exchequer, Sir Stafford Cripps. Speaking before the House of Commons on September 27, 1949, he seemed to consider the reversal of a favorable trend in trade with the dollar area as the efficient cause. Sterling area dollar deficits were incurred at an average quarterly rate of $1,024 million in 1947, $508 million in the first half of 1948, $338 million in the last half of 1948, and in the first quarter of 1949 the deficit was only $328 million. During the second quarter of 1949, however, the deficit was $628 million.[1] The Chancellor cited a reduction of income of the sterling area from

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[1] British Information Services, Reference Tables on Britain's Trade and Dollar Position, ID 931 revised, (October, 1949), Tables VI and VII.

sales to North America as the cause for the reversal and indicated two reasons for this occurrence. American and Canadian prices which had risen faster than those in the sterling area were now falling faster and "an attack had been launched on sterling."[2] For these reasons and because the reserves were being dissipated, the Chancellor said,

> We had to take some immediate step that would enable us, before our reserves ran out, to increase the total of our dollar earnings by recreating confidence in the sterling-dollar rate of exchange and by making it clear that there was no gain to be derived from waiting for it to fall. That could only be done by a reduction in the rate of exchange.[3]

Let us examine the Government's answer to our first question. The statistics on reversal of the deficit trend have been referred to above and would seem to be valid. The extent of the "attack on sterling" cannot be proven statistically, but it is an interesting and very logical explanation for a worsening of trade position and worthy of examination. The post-devaluation trade activity seems to bear out Sir Stafford's assumption. The action is not attributed to any group or country but in all probability was initiated by American business men and politicians looking for a solution to the unbalance of trade and noting the price of the pound sterling on the free markets and "black bourses." Several of these men gave talks urging Britain to devalue.[4] Encouraged

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[2] Hansard, 468 H. C., Deb., 5s., p. 11.

[3] Ibid.

[4] Chancellor Cripps found it necessary to proclaim the stability in Rome on April 30, and because of accelerated clamor, again in London on May 18. The possibility of a

by this official opinion, buyers of British exports held off buying where possible in anticipation of a more favorable rate. This attitude was communicated to the British buyers and despite the repeated assurances that no adjustment would be made, the importers hastened to spend any exchange that they could accumulate. Manufacturers depending on imported raw materials would naturally stockpile in the shadow of rising prices. An increase in food and raw material stocks of £100 million was estimated to have taken place in the three months preceding devaluation. Since this increase represents a disgorging of about 25% of the reserves available at the beginning of the period, it would seem to substantiate the British side of the attack.[5] Verification of the export part by a related series in the econometric sense is not possible; however a good, but not unchallengeable argument can be developed on the basis of aggregates. Since most of the agitation for exchange adjustment came from the United States, and since Canada, because of Empire ties, would give more credence to Cripp's pronouncements, let us compare the British exports to these leading dollar nations for the period immediately bordering devaluation.

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devaluation was mentioned in four different articles in the <u>New York Times</u> between these dates (8th, 9th, 16th, 18th) with particular references to statements by Paul G. Hoffman, E. C. A. Administrator and Secretary of the Treasury Snyder. This was during the quarter year in which the reverse of dollar deficit trend occurred.

5 "Sterling Since Devaluation," <u>Economist</u>, 157 (November 26, 1949).

Table 1

Imports From United Kingdom[6]
(monthly average in £ million)

	1948	1949 1st Q.	1949 Apr.-Aug.	1949 Oct.	1949 4th Q.
United States	5.5	5.3	3.4	5.6	6.3
Canada	6	6.4	6.4	6.4	7.0

The pronounced fluctuation in U. S. trade compared to the stable Canadian trend cannot, I believe, be explained away by the comparatively mild recession-recovery phase of the U. S. economy that coincides roughly with the import variations. The fact that the domestic dip here was most apparent in durable manufactures and minerals, two fields in which British imports are of little consequence, is reinforcing evidence.

The Chancellor's reference to comparative internal price levels in Britain and the dollar countries may have a certain slight validity. Prices in the United States as determined by the Department of Labor and used in the report of the Economic Advisers started to fall in mid-1948 led by wholesale indexes. Consumer prices followed later in 1948 but leveled off late in 1949. British cost of living had pretty well leveled off in late 1947 and by April, 1948, was well under control. Canadian prices followed the American pattern rather closely.

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6 Compiled from Reference Tables on Britain's Trade and Dollar Position, British Information Services, ID 931 revised (October, 1949). British Exports Rise Sharply, B. I. S., R5583. London Daily Mail, No. 2360, Overseas and Transatlantic Edition (February 4, 1950), p. 4.

Table 2

Cost of Living[7]

	United States	Canada	United Kingdom
1937	100	100	100
1944	122	117	130
1945	125	118	132
1946	136	122	132
1947	155	134	100[8]
1948:			
January	164	147	104
February	163	148	106
March	163	149	106
April	165	150	108
May	166	151	108
June	167	152	110
July	169	155	108
August	170	156	108
September	170	157	108

The United Kingdom index makes comparison difficult for several reasons. First, the food subsidy obscures the share of the taxes that are really being spent for food. Secondly, price control and rationing are more stringent there and nationalization has a tendency to curb any attempt at gouging in those industries affected and those threatened. Finally, the change in indexes throws greater weight on fixed price

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7 International Labour Review, LVIII (December, 1948), pp. 803-20. Items include food, fuel and light, clothing, rent and miscellaneous others. Average quantities are for 1935-39 average in U. S. and Canada.

8 Albert Palache, "Long Term Finance of Enterprise," The Industrial Future of Great Britain, Institute of Bankers (London, 1948), p. 198. Index was changed as follows:

	Old	New
Food	60	34.8
Rent and rates	16	8.8
Clothing	12	9.7
Fuel and Light	8	6.5
Miscellaneous	4	18.5
Drink and Tobacco	-	21.7
	100.	100.

items such as tobacco, services, and beverages and less on fluctuating food. The assumption of price movement might be valid but there is room for skepticism.

The Chancellor's concern over the state of the Sterling Area gold and dollar reserves was, of course, closely tied to the deficit trend. It is impossible to know whether the balance was approaching a critical point set mentally by H. M. Treasury, but the minimum safety level necessary in order that sterling might perform as an international currency was set at $2,240 million in gold and American and Canadian dollars.[9] On devaluation day the actual balance (Table 3) was almost a billion dollars under this figure. The foreign assistance, Marshall Plan aid, Canadian credit and the International Monetary Fund, may have been considered as mitigating the stringency of the safety level. The inevitability of the expiration of these "exceptional assistances" and the need to attempt to restore the reserves to a level of safety was probably a moving cause. As seen below, the proclaimed barrier was passed definitely in the second quarter of 1948 but was not seriously violated until a year later.

One cannot evaluate the influence of political pressure from dollar area countries and from some sources in England until Sir Stafford Cripps publishes his memoirs. We know with certainty that he denied that any such force was effectively persuasive.

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[9] "1949 Gold and Dollar Deficit," Economist, 158 (January 7, 1950).

Table 3

Gold and Dollar Reserves[10]

Date	Dollars (millions)	Pounds (millions) Old	New
12-31-45	2,476	610	
6-30-46	2,301	567	
12-31-46	2,626	664	
3-31-47	2,380	586	
6-30-47	2,420	593	
9-30-47	2,383	587	
12-31-47	2,079	512	
3-31-48	2,241	552 (ERP)	
6-30-48	1,920	473	
9-30-48	1,777	437	
12-31-48	1,856	457	
3-31-49	1,912	471	
6-30-49	1,651	406	
9-18-49	1,329	330	
9-30-49	1,425	351	509
12-31-49	1,688	416	603

In deciding to effect such a substantial depreciation, the primary consideration was to aid the exporter. It was considered necessary to go to "three dollars to the pound sterling and probably a bit lower"[11] in order to provide "substantial and unmistakable new incentive for our exporters which would place them in a fairly competitive position in the North American markets"[12] An extra bit was subtracted in order to convince the world at large and principally the prospective customers in the dollar markets "that this was

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10 "Report on Cripp's Economic Review," Economist, 158 (January 14, 1950).

11 Hansard, 468 H. C., Deb., 5s., p. 14.

12 Ibid., p. 14.

not a tentative first step but a completed operation."[13] Consideration was also given to the level of exchange rates in the free money markets because it was hoped that the move would reduce dealings in blocked sterling and end this "leak." In the same speech the Chancellor acknowledged that they had considered a floating rate because it might better protect the internal economy from the effects of the foreign balance. This was rejected because it was felt that stability of the pound was important to world trade and was secured by a stable rate. While many economists might disagree with this theory, I believe that few could condemn the Government for taking the course in light of the definitely precarious reserve situation. Any speculative attack against a floating rate would have been disastrous to the working balance.

Having settled the rate, there remained the ancillary steps to be declared. General opinion seems to hold that here lies the weakness of the operation. Six types of activity were touched upon--reduction of dollar imports, reduction in the investment program, encouragement of export to dollar areas, limiting personal income, cutting government spending, and limiting domestic consumption. The limitation of dollar imports was imposed prior to the devaluation. On July 14, 1949, the government temporarily halted all new dollar purchases and announced a provisional program for cutting dollar expenditures 25% during the year beginning July 1, 1949.

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13 Ibid.

This action poses a dilemma and many problems. The dilemma involves a conflict between free trade and the dollar deficit. Every effort that was within the limits of American toleration is being exerted to cut dollar area imports. Still in 1949 they were 21.2% of total import value.[14] All of this volume is essential to production, being mainly food, non-ferrous metals, raw cotton, timber, sulphur and machinery not obtainable elsewhere. Cuts were effected in all these commodities and it is clear from their nature that some substitute source of supply was the only alternative to a lowered standard of living and harmful curtailment of production. Certainly if these sources were commensurate with free trade policy they would have been used before with no qualms. The choice then involves turning from the absolutely most advantageous source to one made advantageous only by relative availability of the means of payment. Theoretically, this implies a sacrifice in terms of quality or absolute cost or both which may prove to be a deterrent to productive recovery. Bilateral agreements are the principal instruments for circumventing free market channels. If a large portion of the output of one industry is used as coin in one of these "barter" agreements, it seems reasonable to assume that the incentive of that industry to become competitive on a world basis is removed--a second way in which productive recovery is deferred. One might argue that under an economy wherein

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14 Ray Daniell, "Devaluation Stops Drain on British Gold," New York Times, XCIX (January 4, 1950), p. 47.

government planning and not incentive in an economic sense brings about progress toward a competitive level no interruption need result from such a situation. Ideally this might be true, but since human beings operate even a socialistic economy, the tendency would probably be to drop the one problem as temporarily solved and face the aggregation remaining. Thus another rigidity would be introduced into an economy already overburdened with them.

Of the many problems involved, in addition to the tendency toward permanent dislocation, the outstanding ones are American resentment and domestic adjustment. The curtailment of oil imports from American owned sources in the near-East is the outstanding example of the U. S. attitude.

An unusual assemblage of interests is banded together in condemning the restriction. Coal mine-owners, the United Mine Workers, the Railroad Brotherhoods and the railroads, who proclaim that cheap foreign oil is already displacing coal as a heating fuel, join the oil industry and oil unions in urging government action. As a result, at least three congressmen have initiated action designed to vitiate the restriction or force its removal.[15] Only government support of agricultural prices in this country prevents a similar sentiment from motivating the farm bloc to like action.

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15 "Foreign Trade," Time, LV (March 20, 1950), p. 85. Senator Connally (Texas), head of the Foreign relations committee which controls E. C. A. appropriations announced that he would block all further aid to Britain until the discrimination was abandoned. Philip Geyelin, "Foreign Oil," Wall Street Journal, CXXXV (April 13, 1950), p. 1. Rep. Gossett (Texas) and Sen. Thomas (Oklahoma) have proposed large tariff increases on oil.

The repercussions of domestic privation have been mentioned above and while they may not be as quickly apparent as the American action, they can be even more costly in terms of progress toward economic balance. Further adjustments and sacrifices can scarcely add to morale. These drawbacks leave room to question the action even though the estimated saving of $400,000,000 annually on a pre-devaluation basis seemed to be a justification to term it wise and courageous.

The reduction in the investment program obviously can be another two-edged sword. A £140 million cut from a £2,100 million annual budget was planned. This will not take place immediately but will involve exporting engineering equipment and vehicles which were meant for the domestic industry; delaying projects in the fuel and power industries; reduced standards in new school building and postponement of school meal service expansion. The housing program and the general building program will be selectively controlled. A quick perusal of the savings shows us that in a country in which domestic investment has lagged for years, the effect could be depressing. Further treatment of the investment needs and remedies will come in Chapter II of this paper but the conflict is apparent.

The third type of accompanying measure--the encouragement to export to the dollar areas--was strongly stressed by Sir Stafford Cripps in his speech to Parliment on September 27, 1949, but no new means were added to stimulate results. If the devaluation is to be effective in leading to a balance of payments, much of the progress must come in this sector. The speech called attention to the facts that many more British products could be competitive on a price basis in dollar markets; that profits were now available where they had not existed before and that the Washington talks[16] preceding devaluation led to an atmosphere of cooperation that promised to ease the problems faced by the exporter who wished to enter the American market. He also mentioned the fact that products must be "sold" to Americans and Canadians. A discussion of aids provided by the Government will be included under Government Policy in Chapter IV.

The "limiting personal income" measures are also fraught with controversy. This fifth area covered in the supporting speech dealt with limiting domestic consumption. While this was only in the form of a request to divert commodities to export markets by abstaining from home consumption, any degree of effectiveness will release money and open up possibilities for inflation. It is for this reason and in order to keep costs down so that devaluation might serve to make British products competitive price-wise that personal incomes were to be limited. The tax on dividends was raised from 25% to 30% and a stern warning was issued that any increase in dividends would provoke stringent restrictions at a future date. The attitude toward wage and salary increases is summed up in the text of the Chancellor's September 18, 1949, announcement

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[16] The Anglo-Canadian-American discussions held September 7-12, 1949, to consider measures contributing to a solution of the sterling-dollar problem.

speech:

> If we were now to allow costs to rise as a result of higher wages and salaries, we should rapidly deprive ourselves of all the advantages of our lowered exchange rate... It is only in the exceptional and genuine cases where some wage survives which, together with all the subsidies and social services, is insufficient to provide a family with a minimum reasonable standard of living, that there can be any possible excuse for going forward with a claim for an increase. But even if such an increase is given to those at the bottom we cannot accept the maintenance of differentials or relativities as any argument for present increases to those paid higher rates. Especially and specifically there can be no justification for any section of workers trying to recoup themselves for any increase in the cost of living due to the altered exchange rate. That is a general burden spread over all and must be accepted as a very real and essential contribution towards the avoidance of mass unemployment.[17]

The first dispute is raised by those believing that income limitation removes the incentive of management, capital and labor. This inflation-incentive controversy defies settlement in a general way because of the psychological aspects to be considered. For management and capital the easing of laws preventing capital accumulation may well be productive of more effort without inflationary results. The accumulation could be spent for capital goods. The Government could then reduce its expenditure in this area by an equivalent amount and the level of efficiency of the capital investment should increase because of the necessity that the private investment be efficient to be profitable. Moreover it does not seem too much to assume that the relaxation of the almost confiscatory

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17 "Complete Text of Cripp's Address," New York Times, XCVIII (September 19, 1949), p. 6.

nature of British profits taxes[18] would produce a more than proportionate increase in investment, thereby reducing the volume of government financing and producing a deflationary pressure that would reduce other monetary costs. To have this effect the additional private investment must stem from either reduced consumption expenditure by the private individuals or from savings, which by replacing credit extended to the Government, contract monetary volume.

This theoretical policy is at variance with practicality in that a Labor government would have great trouble in trying to justify more liberal treatment of capital than they could accord to their supporters. Then too, with the Government committed to a policy of nationalization, with regulation rampant in so many aspects of industry and every day life, and with security being guaranteed by the government, a decrease in profits tax might not furnish enough encouragement to change the rate of private investment materially.

Still more dynamite is contained in the wage and salary restrictions. Destruction of the wage structure and detaching the wage level from cost of living, thereby depriving labor of its fair share of the national product by union standards, would seem to be declarations closely akin to heresy when coming from a Labor government. It is generally conceded that the chances of deriving immediate benefit from the devaluation hinge on the ability of the Government to

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18 Income and profits taxes take from 53% to 65% of profits. Daniell.

make this proclamation stick and on reducing its own expenditure--the last type of measure to be considered.

The reduction in Government expenditure, although purported to be the real weapon to be used in curbing spending, is not very drastic. Other than the capital expenditure cuts mentioned above, only £110 million are to be lopped off. This will be accomplished by curtailing services which are not essential to Government policy and by more efficient administration of the "necessary" services. An additional £30 million are to be saved from administrative expenses connected with Defense. The total of all the economies, including the questionable capital expenditures, will be approximately 6% of the annual budget, but many of them will not be put into effect until the 1950-51 fiscal year.

Measuring adequacy of government economy in considering inflationary effects is a virtually impossible job. The efficiency of the bureaucratic replacement for what was formerly a private function can be judged only after considering the benefit to the public, both desired and conferred, the relative costs, and the alternative methods of achieving the desired end. Add to these, political implications, questions of incentive and quality of service, and the difficulty is easily apparent. Let us assume, however, that the British Government is honestly trying to make the best of an opportunity to restore the nation to a position of prominence in the world market. We might then get an indication of the possible economies by comparing the expenditures with those of the U. S., whose government is not exactly devoted to blatant <u>laissez faire</u>. Bearing in mind the difficulties in evaluating outlined above and admitting to a great difference in the national economies, there still seems to be room for a more stringent set of budget reforms than those put forth by the Prime Minister. (See Table 4.)

If we eliminate foreign aid, which is 1.4% of the total taxes for Great Britain and 13.0% for the U. S., the difference is even more striking. The welfare expenditures of the United States were headed by veteran's compensation (over 40%) which should decline considerably, while the same item in Britain was only about 7% of welfare expenditures. Most governments are loath to cut spending but since the need for low prices is recognized and all-out effort is being made to control other parts of the economy, a little more valiant effort might be expected here.

The purchasing power limitations are useful in stimulating exports, not only in keeping prices on a competitive level internationally but in controlling the amount of output that can be absorbed by the home market and hence the volume freed for foreign trade. France and Italy used qualitative and quantitative restrictions combined with high interest rates to limit purchasing power and increase exports thereby. Both added to their monetary reserves in 1949.[19]

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[19] Per Jacobsson, "Devaluation," <u>Skandinaviska Banken</u>, XXXI (Stockholm, January, 1950). The article sponsors credit control as an alternative to import control for remedying an adverse payments balance.

Table 4

Tax Collections and Government Expenditures for 1948 in U. S. and U. K. [20]

	Great Britain		United States	
	Total (millions)	Per Capita	Total (billions)	Per Capita
National product	£ 10,620	£ 212.4	$247.0	$1685
Total taxes and charges	4,300	86.0	58.9	402
Taxes as a percent of national product	40.5		23.8	
Expenditure other than Welfare				
National defense	750	15.0	10.9	74
Public debt charges	580	11.6	5.8	40
Foreign aid	60	1.2	7.7	52
Public Service	720	14.4	8.6	59
Total	2110	42.2	33.0	225
Above as percent of taxes	49.1		56.0	
Above as percent of nat'l product	19.9		13.4	
Welfare Expenditure				
Veteran compensation	100	2.0	7.2	49
Food Subsidies	470	9.4	.4	3
Housing and other subsidies	90	1.8		
Social security payments	470	9.4	2.9(a)	20
Education	240	4.8	4.6	31
Health, family allowances	380	7.6	2.6(a)	17
Total	1750	35.0	17.7	120
Above as a percent of taxes	40.7		30.	
Above as a percent of nat'l product	16.5		7.2	

(a) 1947 figures

[20] Monthly Letters on Economic Affairs and Government Finance, National City Bank of New York (New York, October, 1949), p. 119.

Costs in future production, unemployment, and living standards were higher in each case than England is willing to pay and who can say where the greater long term benefit will fall even in material terms. Indeed one of the alternatives to devaluation was greatly increased austerity and unemployment. This gold standard remedy for unbalance was, and in the future probably will be, avoided at all costs. The question following devaluation is just what privations Britain is willing to undergo. I think that it can be accepted as self-evident that the desire for goods turned into effective demand by the addition of purchasing power will absorb either production or imports. Some combination of import restrictions, wage and dividend control, or export quotas for industry are necessary if the object is to balance payments in international transactions in the short run without the aid of borrowing or gold flow. The attitude in England seems to be that if this short run balance can be achieved and industrial progress is pushed at the same time, the long term situation will work out. Sir Stafford Cripps expressed this attitude in saying,

> Time is now so short and our reserves have got so low that a change in the dollar rate of exchange is the only way in which we can get our prices down quickly enough. We had hoped that growth of our productivity and other improvements would have made this unnecessary, but events have moved too fast.[21]

The devaluation then is seen as a device to artificially put Britain in the competitive place that she hopes to merit by increased productivity. Recognition of the gravity of the

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[21] "The Pound Devalued," The Times, late London Air Edition, No. 51,490 (September 19, 1949), p. 3.

situation existing after devaluation is contained in another pronouncement by the Chancellor:

> We were in a grave situation before September 18 and we are still in a grave situation--the difference is that now, for a period of time we have a better chance of emerging from our difficulties than we had before the alteration was made, but provided, and only provided that we take the right action.[22]

The tenor of this statement does not seem to coincide with the Government's effort at economy.

To sum up, the precarious state of the Sterling Area gold and dollars reserves inspired the British Government to devalue in an effort to bring a halt to the outflow of gold and dollars and to stabilize sterling. The accomplishment of this objective would entail increasing exports with particular emphasis on the dollar area and decreasing imports. The extent to which the pound was depreciated was intended to bring British goods to a competitive level in the world market and to stabilize sterling, thereby partially restoring its position as an international currency. Various regulations and suggestions were added to increase the chances of success of the measure. The ability of the Government to secure co-operation in the additional measures will, to a large extent, determine the usefulness of the manipulation if the British economy has the ability to recover its trade position to the extent necessary to restore a semblance of balance to world trade.

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22 Hansard, 468 H. C., Deb., 5s., p. 7.

Assuming the initial capacity to recover, the question narrows to two crucial issues. First, can exports be expanded enough to overcome the devaluation and deficit gap, particularly in the dollar area. In 1949, the deficit gap was £400 million in the dollar area and the 44% increase in import prices from this sector will leave an additional margin to overcome. Secondly, can costs of production be prevented from rising to wipe out the effects of devaluation and negating any productive effort. The interwoven political, economic, and social aspects of the empire and the world influence both of these issues and the British nation must overcome much of its famous rigidity and display a long latent proficiency to adjust to changing world conditions if any long term benefit is to follow from the long delayed devaluation.

Chapter II

Supply Problems: The Industrial Approach

The tendency of superficial thought on the deficit balance of payments that plagues Britain's economy is to attribute the situation wholly and completely to the disruption of international trade and internal industry which are unavoidable consequences of the Second World War. The few deficit balances before the war are charged off as temporary or due to the preparation of the belligerents for the coming conflict. True, this view is not widely accepted now because of the effort put forth trying to reach the causes. More generally believed is the theory that, as in physical sciences, the war was a catalyst that accelerated the process but did not change its direction. The fundamental source of the difficulty is the relative deterioration of Britain's industrial plant. In order that a country might export capital and thereby increase its investment income, it must be able to supply the needs of borrowing countries at competitive prices. In order that best use may be made of export facilities such as shipping, insurance, brokerage, and financing, it is necessary that a substantial volume of foreign trade originate in or pass through the country. A declining relative industrial position is therefore a declining position in international trade. A glorious past, a vast empire, or a history of successful foreign investment may, during a period interspersed with wars, economic depressions and political experiments, conceal the trend and its effects as they apparently did in the case under review. The time must inevitably arrive, however, when analysis shows that failure to progress relatively with major competitors brings an economy to a situation wherein progress must come in a hurry at great cost or a new method of existence must be found. Britain seems to be in just that position at the present time.

Assuming that the relative decline of Britain's competitive industrial position is a key element in her present difficulties and endeavoring to evaluate the efficacy of steps taken to solve the problem, a logical starting point would seem to be an investigation of the development and decline of industry.

Since 1825, or earlier, the trade balance has been against Great Britain.[1] The volume of trade that existed, however, supported an "invisible" trade sufficient to allow, or stronger, require a substantial amount of foreign investment, shipping and those services vitally connected with foreign trade. One side of the physical volume deficit is, of course, the fact that domestic food and raw materials were not of sufficient quantity to support the populace without recourse to outside sources.

I propose to indicate some of the factors that caused Britain's industry to lose its leading world position and in

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[1] A. E. Kahn, Great Britain in the World Economy (New York, 1946), p. 127. Every future citation on Kahn refers to this work unless otherwise stated.

brief references to the industries having an important bearing on exports, show the plans and prospects for improving their competitive positions and capacities. The problems vary with the specific industry but generally, the presence of a skilled labor supply available at one-third of the wage in the United States gives promise of a possible solution. Where labor is in short supply, mechanical means are available for increasing productivity. The difficult part to estimate is the "liklihood" of attaining substantially increased efficiency but in this chapter, except for a few comments, we are only concerned with the possibility and the plans. Section A deals with the trades that featured the rise of Britain in world trade. Section B treats the newer industries. Section C is a summary and mentions some general problems.

A. Early Bulwarks

Britain's situation in the happy, halcyon days of her prime reduced to its essentials can be called a trade economy based on natural resource exchange. Needed raw materials and foods, the products of fertile soils, verdurous pastures and metal mines were exchanged for coal, iron and steel products and textiles, products which owe their bountiful existence to the abundance of coal in the United Kingdom's sub-strata. Granting ingenuity, enterprise and craftsmanship, one cannot minimize the dependence of iron and steel production on coal or that of surplus textile production on steam power. Equally impressive and more important is the dependence of these industries on foreign trade and the dependence of the country's economy on these industries. As late as 1907, these "staple" trades[2] accounted for 51 percent of those employed in industry, 20-25 percent of the totally gainfully employed population and 70 percent of exports.[3]

The development-decline cycle of the staple industries seems to follow enough of a pattern so that a generalized history is in order. Not proposing to delve into the causes of the Industrial Revolution, we shall begin by stating that England, having few natural resources, apparently began by producing articles which made use of what she did have--coal and a geographic position favorable to foreign trade. She began producing basic articles which lent themselves most easily to uniform volume production--textiles and iron products. With this beginning, she gained the position of first industrial and trading nation in the world. The vulnerability of a position founded on such a basis becomes quickly apparent. As other nations grew in material culture and began to industrialize they chose the same door by which Britain came in. Relatively cheap labor in abundance and, in many cases, cotton crops or iron deposits gave them comparative advantages. Labor needed little training for these industries and Britain's living standard and wage rate had risen. Raw materials were near at hand rather than an ocean away and were often of

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[2] Coal, iron and steel, textiles, engineering products, cutlery tools and hardware.

[3] Kahn, p. 67.

superior quality. For many years, however, the decline in Britain was relative and overshadowed by absolute growth. As the trend continued, a large world capacity was developed in each industry and as new technical developments and a tendency toward nationalism arose an absolute decline in exports set in which had disasterous effects on such a specialized economy.

At the risk of overemphasizing the various phases in the development, let us follow the cotton textile industry as closely as statistics will permit. The position of this trade is particularly striking in that Britain's sole natural advantage seems to be the damp, humid Lancashire climate. Most of the rising rivals had almost unlimited inexpensive labor and a much larger domestic market. This would be true of India, Japan, Brazil and the United States, to name the most important. Three of these countries also possessed abundant native crops of the raw material.

In 1820, textiles comprised 90 percent of Britain's total exports; by 1913, this percentage fell to 40 although actual value increased 600 percent.[4] This set of facts has no sinister import. On the contrary they seem to indicate that the economy was growing and diversifying and the industry was prospering. As far as it goes, this was true. The year 1913 saw the peak of exporting and producing in the cotton textile industry. More than 7,000,000,000 yards of cloth

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4 R. W. G. Mackay, _You Can't Turn the Clock Back_ (New York, 1948), p. 32.

were exported.[5] The First World War then intervened forcing industrially backward countries to develop basic production facilities and developing a spirit of nationalism throughout the world. The descent from the peak was rapid and uninterrupted. Exports in 1938 were down to 1,386,200,000 yards and Great Britain's consumption of raw cotton fell from 18.9% of the world's total in 1913 to 9.6% in 1937. During the peak year 1913, 38.8% of the world's spindles (the usual measure of industry capacity) existed in Great Britain. This declined to 25.9% in 1937. There was a wide discrepancy between cotton consumption and industry capacity even in the banner year. This was due to two major factors. a) English production concentrated on better grades and used mainly mule spindles which consumed less cotton. b) Competing countries made better use of equipment by longer hours and double shifts.[6]

Table 5

Cotton Industry Capacity and Raw Consumption

	Spindles (millions)		Raw Cotton Consumed (000,000 bales, for half-years)	
	1913	1937	1913	1937
Great Britain	55.7	38.8	1.91	1.46
U. S.	31.5	27.0	2.89	4.09
Germany	11.2	9.8	.79	.54
Japan	2.3	11.9	.79	2.06
India	6.1	9.9	.85	1.54
World	143.4	149.6	10.14	15.14

5 H. Haygarth Jackson, "Textiles and Export," The Industrial Future of Great Britain, Institute of Bankers (London, 1948), p. 157.

6 Kahn, pp. 94-5.

7 Ibid., p. 95.

Table 5 discloses several significant trends and events. The gains made in both capacity and consumption by the newly industrialized countries at the expense of the old producers have been referred to above. The tremendous drop in British capacity is largely attributable to the law imposed in 1936 levying a tax on spindles for the purpose of buying and scrapping excess capacity. While this was an attempt at solving the problem it failed to reduce costs because the industry was burdened with the expense of removing excess capacity.[8] Two factors add significance to the fall in English consumption of raw cotton in the face of a rising world total. The ratio of exports to production declined steadily from 88.9% in 1907 to 50.9% in 1937-8. This percentage is expected to have been close to 34.3% in 1947 despite the export drive.[9] The seriousness of the competition in the Far East is demonstrated by the fact that British piece goods exports to that sector declined by 91% between 1913 and 1937. India alone tells a large part of this story. In 1913 she took 43% of Britain's piece goods exports; this fell by over 50% or some 2,700 million yards by 1937. The ratio of domestic production to total supply in India rose from 26.5% to over 82% in the same period excluding hand loom figures. Japan's portion of the imports rose from .1% to 54.6% and Britain's fell from 97.4% to 43.7%.[10]

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8 Ibid., p. 99.

9 Kahn, p. 68, and Jackson, p. 164.

10 Kahn, p. 97.

To bring the situation up to date, a bill was passed in 1939 to allow the industry to reorganize itself with comparative freedom from government supervision. Action on this was prevented by the war, but is underway now and a tendency toward verticalization is very noticeable.[11] Despite this tendency and despite the fact that the Japanese and German industries were out of the market, a government source[12] states that output and exports are still substantially below pre-war level. This is partially due to the exigencies of war which closed 40% of the textile plants and shifted workers, plants, and equipment to industries having a higher priority. Had this been done with the thought in mind of eliminating the most inefficient plants, the effect might have been beneficial but the criterion was location.[13] Plants near defense industries were closed in order that the transfer of labor might be easily effected.

Another factor causing difficulty in cotton textile industries throughout the world is the synthetic fabric boom. While this may prevent or at least retard recovery in the cotton industry, it will probably react in favor of the British textile industry. Outmoded capacity may be replaced by plants capable of handling rayon and nylon. Great effort is being expended to increase manufacturing capacity for synthetic

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11 Jackson in his article (p. 166) states that in 1947 about 40-44 percent of the production was handled by vertical concerns (those involving the complete process).

12 European Co-operation, Cmd. 7572 (December, 1948), p. 26.

13 Jackson, p. 158.

fibres.[14]

Still using the cotton industry as an example, let us look at the factors causing the decline, historically and currently, in the export effectiveness of the old industries. These causes may be divided into two classes; those controlled by some factor in the English economy, and secondly, those outside of that control or extrinsic to the economy. Many of the former are rigidities attributable to growing old and some type of remedial action is being attempted in most cases. In the first place the industry grew as small, independent, non-integrated units. The causes and the effects of this are fundamental flaws in the British system and major contributors to the present state of confusion. The industry developed before the corporate form was widely accepted and because foreign competition was slow to appear, a pattern of small single-operation firms were profitable and probably much of the plant and equipment was fully depreciated before production curtailment was necessary. This took away any incentive to modernize. Technological improvement failed to move into the United Kingdom to any extent because of this and because most of the firms were run by later generations of the founding family and combined tradition with lack of interest and ability to produce stagnation at a high capacity level. The labor movement in the country added wage rigidity to the other deterrents to adjustment. This combination prevented British industry from competing successfully with vigorous new foreign firms

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[14] Cmd. 7572, p. 27.

making use of modern equipment and cheap labor. The lack of aggressiveness so apparent in the production carried over into marketing and enabled the new competitors to gain more rapidly than the relative productive position would have justified.

British cotton men were at a disadvantage in that they had to import raw materials, but so did Japan. They had a smaller domestic market than the newcomers but had developed a huge world market. New plants and those damaged in the First World War naturally acquired modern equipment but this did not preclude the English firms from putting forth effort to modernize. The spirit of nationalism that was rampant after World War I and was intensified by the depression of the 30's could not be remedied by the textile industry nor could the absence of the industrial boom that took place elsewhere in the world in the mid-20's. I think, however, that in both cases a more vigorous, less rigid industry would not have suffered as much. This is admittedly sheer speculation but alternate markets and varied quality and costs could have been attempted in an effort to minimize the effects. The competition was mainly in the lower grades of textiles which were much in demand in depression years and in the production of which modern equipment excelled. This can be illustrated by 1935 figures. In that year, Japan accounted for 41% of the total yardage of world cotton piece good exports as against 29.9% for the United Kingdom but Britain led in value terms 37% to 27.3%.[15] Indeed even now the market is demanding more of the lower grades of cloth than the industry is able (or chooses) to supply.[16]

Much of the failure to keep abreast of competition can be charged to inability to finance merger among small firms, modern machinery, or expensive market drives. The concerns in the industry were financed largely by plowing back earnings or by family investment. This was not always a matter of choice. The London money market attained its strength and reputation by catering to trade. In order to serve world commerce, the City considered liquidity to be of paramount importance. Discount houses, bill brokers and the merchant bankers all arose because of this penchant for liquidity. Banks would not in normal circumstances make a loan for a longer term than six months and no other institution risked money on small firms when the long term market was occupied with governments and large reputable firms seeking funds. Even the stock exchange and issue houses could furnish little aid to the small, ambitious firm. They too were preoccupied with the more lucrative foreign opportunities that came in great volume to London for funds. The relatively small financial size of London brokers and jobbers made it imperative that they either concentrate on securities of governments or established industries or that they play for the larger

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15 Kahn, p. 96.

16 Jackson, p. 165.

returns to be gained on foreign ventures.[17] It is easy to imagine the attitude of the British investor toward a small local firm when faced with glamorous foreign and awesomely large domestic choices. It is small wonder that the British industries evolved as they did.

The maladjustments in staple industries began with their nature. These were easy to imitate and were, therefore, imitated by countries desiring to enter world trade. They were capable of being started as a small family business and growth was not necessary for profit in the early days. When competition made a certain amount of consolidation imperative in order that economies of size and integration could improve the world position, rigidities had frozen incentive and neither the desire nor the financial means for it were present. The famous money market had grown in a pattern that enabled it to furnish invaluable aid to the export end of the business but methods of aiding production by financing combinations or improvements had not been adequately developed. Such things as a small home market, tariff barriers, modern and vigorous competition, and management steeped in tradition rather than ability were added handicaps to industries having growth difficulties.

The first attempts by the Government to alleviate the overexpanded condition which followed as a result of the contracting market were not particularly well-suited to the

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17 H. Parker Willis and B. H. Beckhart, Foreign Banking Systems (New York, 1929). Much of the historical picture of the situation is contained in Chapter XVII of the book.

problem. The number of units was reduced by a process of buying them with the proceeds of a tax on the rest of the industry and destroying them. This procedure had unfavorable effects cost-wise because the tax added to the costs of existing producers, most of whom could ill-afford it. A reorganization bill which gave the cotton industry power to reorganize itself was passed immediately prior to the Second World War and as a result did not operate effectively until after the war. In coal, the same timing prevailed but the government took more responsibility and had power to force consolidation or dissolution. The British Iron and Steel Federation, a sort of trade association presumably had the same objectives but seemed to make use of quotas to spread the market among all of the companies rather than attempting any realignment of organization or elimination of badly outmoded facilities.

Whereas the First World War found these basic industries at the peak of their development, the Second World War found them sickly and struggling. Part of the reason for the difference was the spirit of nationalism that followed the first war and the forces of protectionism and industrial self-sufficiency that were set in motion by that spirit. As mentioned previously, this process of development was just speeded up by the war and not, in a strict sense, caused. The way in which the second war affected these industries varied according to their value as determined by national defense and the desirability of employment in them. Steel, which was most important strategically, grew and prospered. Cotton suffered from lack of investment, transfer of employees, machines and plants to other uses, and rapid development of synthetic replacements. Coal was of strategic importance but because the industry was dying and working conditions were notoriously unpleasant, men had to be drafted to increase production.[18] Many of these "Bevin boys" left the industry at the first opportunity so not much permanent expansion resulted. Some destruction of plants by enemy bombing took place but the volume thus affected was not substantial.

The staple industries emerged from the war with one thing in common--a tremendous immediate demand for their products, both domestically and in the export market. There was considerable difference in the willingness, ability, and advisability of meeting the demand in each case. Steel capacity was at pre-war level but so basic was the home need that exports could not be expected to grow rapidly. Increased capacity could come only slowly and expensively. In coal, the critical shortage was manpower or a substitutable machine power. Under-investment in equipment and the aging of the labor force have kept man-shift productivity much below modern American or European mines. The age of the British mines means that the workings are at a great distance from the shafts in most deep mines leaving room for improved efficiency in haulage. Cotton textile plants and workers were much fewer than pre-war, while the age of equipment and the labor force added to the problem of increasing output.

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[18] G. D. H. Cole and Raymond Postgate, <u>The British People 1746-1946</u> (London, 1947), p. 565.

This problem of age distribution in the labor force in cotton textile and coal industries is a source of difficulty now but in the future it gives promise of becoming a virtually insurmountable obstacle if full employment continues. Since the early 30's there has been little room for young men nor has an incentive existed to call them. There is conservatively a ten year gap in the age distribution of employees in these industries. The attraction of these trades is still not strong, so one can look either to conscription or vastly increased mechanization for a future solution.

The inception of the Marshall Plan necessitated a four-year survey of plans for economic reorganization.[19] In this compilation, the goals believed to be necessary for the attainment of national economic independence are set forth. The possibility of reaching them was proclaimed by the acceptance of E. C. A. Export markets for 40 million metric tons of coal are assumed for 1952. Most of this volume will affect the dollar deficit by replacing U. S. exports in Europe, Canada and South America. The 1948 exports were 20 million tons on an output of 210 million tons.[20] The industry is nationalized and extensive plans are being made for bringing about the increased output. The Coal Board plans to invest approximately $600 million on various improvements in the four years from 1949 to 1952. Much of this will be in underground haulage and surface cleaning plants with mechanical

19 European Co-operation, Cmd. 7572.

20 Ibid., p. 19.

loaders being used where geological conditions permit. A program for closing less efficient mines is to be instituted and a longer range reconstruction and new development plan is in existence. Since the short run rate of improvement needed is unprecedented, much of the export volume is scheduled to come from economies in home consumption--a rather enigmatic aim when one considers the need for electric power and steel, the large coal consuming industries, in the U. K. program for the future.

It is interesting to compare output in 1937 with that in 1947 because the 1937 production was 240 million tons, very close to the desired quantity now.

Table 6

Coal Mining Statistics[21]

	1937	1947	Percentage Change
Production:			
Mined coal (million tons)	240.4	186.3	-22.5
Open-cost coal (million tons)	----	10.2	----
Wage-earners on colliery books (000)	778	712	-8.5
Average number of shifts per week:			
Possible	5.58	5.35	-4.1
Actually worked	5.18	4.68	-9.7
Absenteeism percentage	7.08	12.51	+76.8
Average output per man-shift (tons)	1.17	1.07	-8.5

21 E. Stanley Tucker, "Fuel and Power," The Industrial Future of Great Britain (London, 1949), p. 28.

An increase of 11,000[22] in the number employed and of .05 tons per man-shift average[23] took place in 1948. The drop in productivity per man-shift coupled with rising wages has increased the price of British coal relative to competitors, notably the U. S. From 1939 to 1946 the average annual output of the American coal-miner rose 44% compared to a 10% decline in Great Britain. As a result, labor cost in America rose only 55% as against 133% in England until 1946 even though wages in the United States climbed faster.[24] Much of this differential has been wiped out by the U. M. W.'s wage and pension programs since that time. The mechanization of mines is being used to offset declining labor productivity, and economies in use are seen as the immediate hope of reaching quotas.

Steel, as previously stated, was being produced at a level above that of pre-war years but domestic demand kept exports below the pre-war volume. This demand promises to remain high for many years to come because of modernization and development needs in which steel is replacing timber in many cases. Also many of the products being exported require steel. The industry recognizing the urgency of home market demand and seeing a vast market abroad, instituted a billion dollar re-equipment and development plan immediately after

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22 "Redistribution of Manpower in Great Britain," _International Labor Review_, LVIII (November, 1948), p. 665.

23 Tucker, p. 29.

24 _Ibid_., p. 31.

the war. The British Iron and Steel Federation formulated the plan at the request of the Government. The Iron and Steel Board was created in April, 1946, to oversee and approve the various projects as they were finally drafted. This board was composed of representatives of labor, industry, consumers and the Treasury. The Development Plan is designed to increase production to about 17 million metric tons by 1952-53 fiscal year. This will fulfill the expected home demand and allow 1.5 million tons for export. This is slightly above the 1,411 million ton average for 1935-38 as given in European Co-operation, and imports are expected to be substantially lower than they were at that time. Part of the development is an attempt to provide more steelmaking capacity in order that the steel finishing equipment, now not being completely utilized, be free from dependence on foreign sources of semi-finished supplies. An integral feature of increasing crude steel output is the expansion of blast furnace capacity. This move is also expected to result in more efficient coal consumption due to newer types of equipment. The steel program is a keystone of the whole reconstruction program and is progressing rather smoothly. It is also still owned and financed privately but prospects for remaining that way depend on the strength, or lack thereof, of the Labor Government. Although costs are not a crucial issue here, modernization and locating new plants with an eye to the transportation of raw materials and semi-finished goods should improve the average.[25]

Despite the plight of the textile industry, approximately one-fifth of total visible exports in 1947 came from this source.[26] With a greatly expanded world demand, world production was only 85% of the pre-war figure and exports only 57% in 1947.[27] With competition still struggling under peace treaty problems, Britain endeavored to secure a large portion of the export market by limiting home consumption to 70% of 1938 and encouraging production. The rationing was successful judging from the volume of exports in light of the production figures in Table 7.

Table 7

Textile Production[28]
(% of 1937)

	Cotton	Cotton Yarn	Wool	Rayon
1946	44.8	53.6	65.0	133.2
1947	44.8	53.6	68.8	150.6
1948 (Jan.-May)	52.2	64.5	80.2	171.4

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25 Many aspects of the discussion on steel are outlined in Cmd. 7572, pp. 21-23, and in Robert Shone, "Iron and Steel," The Industrial Future of Great Britain. Shone ascribes much of the success of the steel industry's production plans to the fact that private ownership is being more selective than would the government in choosing the projects to be developed first. He favors central planning for the good of the economy but feels that industry will not prosper under bureaucratic control. At the time he wrote the article he was Economic Director of the British Iron and Steel Federation.

26 Cmd. 7572, p. 26. 1947 textile exports were equivalent to $818 million compared to $490 for 1938.

27 "Problems of the Textile Industry," International Labor Review, LVIII (October, 1948), pp. 496ff.

28 Ibid.

The Cotton Board of 1940 struggled valiantly to bring order and correct deep-seated troubles. In recognition of the labor difficulties (similar to those for the coal industry) a Recruitment and Training Department was organized. Reorganization plans were instigated. An example of the benefit to be derived from constructive planning in a firm is the redeployment at Musgrave Mill, Bolton.[29] With the consent of the union, industrial consultants rearranged operators, altered the layout of machines, put more machines under the control of each operator, changed the pay system from day rate to incentive and added a few minor innovations. As a direct result, production per man hour increased 39%, plant output increased 15% with a 21% decrease in the number of operators and 10% less labor per pound of processed cotton was used.

Apparently the Board was not moving toward the goal of 202% of pre-war exports rapidly enough because the Cotton Industry Development Council replaced it on April 1, 1948.[30] The Council is also composed of representatives from industry, labor and of some independent members. It is designed to investigate methods and promote efficiency in operation, accounting, marketing, research and any other phase of the business that can be improved. Plans are underway to install

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29 "Report on Labor Redeployment in Musgrave Mill Cardroom, Bolton," Labor Department of the Cotton Board, International Labor Review, LVIII (September, 1948), pp. 377-80.

30 "Problem of the Textile Industry," International Labor Review, LVIII (October, 1948), p. 499.

sizeable amounts of new equipment and to continue the improvements and "rationalisation" that were begun by the Board. The Cotton Spinning Act of 1948 made reequipment subsidies available to groups controlling at least 400,000 spindles and by August of that year, 15 groups controlling 17 million spindles were organized to take advantage of them.

Rayon and wool producers are not as highly organized but are also striving to increase efficiency, production and exports. Both were in better condition than was the cotton industry so such a concerted effort was not necessary.

The old industries were being expanded and modernized under industry-wide plans with the intention of making their products close much of the dollar deficit. The immediate opportunity existed. According to the United Nations Department of Economic Affairs, coal and steel shortages were the chief obstacles to economic recovery in Europe.[31] Only textiles, of these staple products, needed price aid in world markets and their only problem was the dollar area where only one-sixth of the textile exports went in 1947. Any benefit to be derived from devaluation would come in the future when the world shortage had been dissolved. In the meantime raw material costs and costs of equipment for modernization would rise by 44% if they came from the dollar area. This high demand-rising raw material price combination was a tremendous stimulus to transferring sources of supply where possible.

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31 Department of Economic Affairs, Economic Report, United Nations (Lake Success, 1948), pp. 21ff.

B. Other Industries

The establishment of a dichotomy such as we are using in this chapter is very apt to be arbitrary. Admittedly, no attempt is made to cover every industry possible and for various reasons some may slip over the dividing line. The staple industries are considered to be those which have been important to the foreign trade of the nation for a long period and whose product remains essentially unchanged. Most of the progress is in method. Other industries to be covered are those new ones that seem likely to be important in future international trade. Not having a special faculty for prognostication, I shall rely on the present situation and Government plans for my information. The principal categories not covered in Section A are vehicles, machinery, chemicals and electrical goods. Luxury items like whiskey, potter, and leather goods are important in dollar market dealings but cost of production is not a leading consideration and since production is in the hands of craftsmen, little can be done immediately to increase volume even in the face of huge backlogs of orders.

In comparison to the mammoth enterprises of the United States, the British automobile industry is almost insignificant. However, it is the second largest in the world and with all its attendant services is probably the largest employer in Great Britain. The early industry concentrated on luxury models and the home market. After the First World War, mass production came into prominence and a small car featuring economical operation was turned out. This type of car enabled the manufacturers to expand their output and exports during the 30's when the bigger American cars were adversely affected by high tariffs and gasoline taxes which increased operating costs. Much of their market was due to empire preference and high tariff protection at home. This nurturing by protection combined with a system of taxing cars on the basis of horsepower at home led to an unhealthy development. Efficiency of production was not stressed. Numerous models were developed to appeal to the protected market. In 1937, the six largest British manufacturers, whose total production was about 350,000 cars, provided forty different engine types and more numerous body styles. American manufacturers making ten times as many cars, offered far fewer variations.[32]

Post-war developments suggest that the manufacturers profited from advice and experience--and from the shortage of supply for so many years.

Table 8

U. K. Vehicle Production and Export[33]

	Production	Export	Export as % of Production
1937	507,700	98,500	19.4
1938	447,600	82,500	18.4
1948	498,524	316,196	65.4
1949 (a)	601,470	358,224	59.6

(a) First half at annual rate

[32] Kahn, pp. 110ff. This discussion is based largely on the presentation in these pages.

[33] "Industrial Production in Britain," Labor and Industry in Britain, VII (September, 1949), p. 138, and Kahn, p. 111. It is interesting to note that export of trucks increased

A flaw in this beautiful picture developed in 1949. Export of automobiles to the U. S. in the second quarter of that year was only 707 against 8,649 in the fourth quarter of 1948 while total exports were increasing from 58,301 cars to 61,300.[34] Fear of recession tightened the American market; American production was eating away the backlog and the "attack on sterling" had begun. It was situations like this that devaluation hoped to correct. If the market for the small car exists in this country, the devaluation supported by a vigorous promotional campaign might prove effective. Nash and Kaiser-Frazer are betting that such a market exists and the effect their entrance may have on the British product is difficult to evaluate. A general acceptance of the light, economical car may bring increased sales to all or the competition may end the last hope of developing anything but a novelty and luxury market.

British engineering is reputedly sound and should the price change induce increased demand, a model more suited to American taste may be produced. Such a development may be underway in the turbine engine.[35] Britain is years ahead of us in this field and a perfected model may pay off in increased dollar markets.

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sevenfold from 1938 to 1949 while production doubled. This was at the cost of privations at home.

[34] Labor and Industry in Britain, p. 141.

[35] Time, LV (March 20, 1947). The Rover Co. has tested a model which showed that smooth performance and speed are possible with the turbine engine. The main problem is heavy fuel consumption at present.

The "engineering" industries include all of those producing equipment to be used in industry or agriculture. Expansion here depends almost entirely on steel becoming available. Some types are a British specialty with a known reputation; some have always been imported from the dollar area. Government plans call for an increase to 230% of 1938 level for exports and roughly to 170% in production.[36] Further efforts are being made to develop each category so that its contribution to the restoration of economic stability will be maximized. Home requirements, reduction of hard currency area imports or increase of exports to the same areas and development of backward areas are all considered before undertaking to allocate materials or output. The human mind is a remarkably efficient apparatus but one might be permitted to question its ability to evaluate correctly and classify such a maze of long run considerations and alternatives when profit possibilities are held in abeyance by taxes and controls.

The electrical equipment industry is a conglomeration of firms manufacturing a variety of products and serving various markets. The growth of this industry and particularly its position in the export market was determined originally by the nature of the electric power manufacturing and distributing industry. For many years, the complacency of British industry held back the development of electric power. The percentage of industry that was powered by electricity was

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36 Cmd. 7572, p. 24.

far smaller in the United Kingdom than in Germany or the United States throughout the 1920's.[37] Per capita output also lagged because producing companies were small and unorganized. Many different voltages and frequencies were supplied and inefficient plants caused prices to be excessive in some localities.

The Central Electricity Board was instituted in 1926 to reorganize the producers. Under its auspices, the "Grid," a national network connecting all public suppliers, was set up. This increased the available supply, eliminated inefficient plants and reduced costs. Electrification spread as new industry developed and as the staple trades modernized. Indeed, demand has grown to such an extent that shortages of power during peak load periods have been one of the serious barriers to attaining production goals. The Electricity Act which went into effect on August 13, 1947, transferred the whole electricity supply industry to public ownership. The central authority created by this act has the responsibility for developing and maintaining an efficient system of supply for all parts of Great Britain. This authority also has power to co-ordinate distribution areas and exercise financial control over firms engaged in distribution of electricity. The inability of the prior supervisory agency to control this sector of the industry sharply limited its effectiveness since

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[37] Kahn, pp. 114ff. Much of the background discussion on the subject follows this presentation.

the same type of duplication, disorganization and inefficiency reigned here that plagued the productive end.

A program of building generating capacity is well underway. The aim is to construct capacity sufficient to handle the peak load by the winter of 1950-51.[38] Until then, staggering of hours, cutoffs, and appeals for voluntary cooperation are being used to stretch present supplies. The continued use of these devices may be necessary if the coal supply is not sufficient to allow full use of available capacity. The estimate referred to above is admitted to be optimistic in that full use of old and deteriorating equipment is included in the available capacity.[39] Even under ideal conditions, at least one more year would be necessary to provide a margin of safety. This digression serves two purposes. It explains a further obstacle to industrial growth and efficiency and illuminates the reasons that the appliance and capital supply industries grew slowly.

The appliance and fixture suppliers were prevented from using efficient mass production methods by the large variety of voltages and frequencies that they had to serve. Manufacturers of cable, wire, and machinery fared much better and were more important to the export market. Just prior to the

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[38] Economic Survey for 1948, Cmd. 7344, p. 25.

[39] Foreign Commerce Weekly, XXXIX (April 10, 1950), p. 31. A survey here declares that the shortage will not be overcome until 1956. Stations are taking four to five years to build rather than the estimated three. Snags are time required for clearance of designs, shortages of tools, manpower and parts (valves and high pressure tubing) and under-sized units.

war the appliance division was gaining a foothold in the export market. All sections of the industry can keep busy supplying the home market for some years. A part of the output does go abroad, however, and considering the promising domestic market, this industry seems to be in an excellent position to expand efficiently and become an important factor in the world market despite large American competitors.

One more factor probably limited efficient growth in the electrical supply industries. That is monopoly. The British Electrical and Allied Manufacturers Association united all branches of the industry and sections of this paternal body controlled each branch. The Electric Lamp Manufacturers Association of Great Britain Ltd. came into existence in 1919 inheriting control from a patent pool trust. It controlled from 90% to 95% of the facilities in the lamp manufacturing industry, restricted output and dictated prices.[40] The Cable Makers Association and the Electrical Engineering Association performed like functions in the sector under their jurisdiction.

This affinity for monopoly that is displayed by the younger industries in Britain is attributed to a lack of confidence in free competition and a distaste for government control. The fear of competition was probably inspired by the example of the staple industries in the period between the wars when the new industries were growing in much the same

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[40] Arthur Fletcher Lucas, Industrial Reconstruction and the Control of Competition (London, 1937), p. 64.

pattern that the older ones had followed. That is, small inefficient units were springing up and few could finance expansion to a size necessary to take advantage of mass production methods then becoming so prevalent in other industrial countries. The protective tariff policy of the 20's certainly nurtured the movement toward monopoly. The industries were almost guaranteed the home and empire markets and rising nationalism in the world combined with their own inefficiency to deprive them of a broader market. Rather than struggle for shares of the clearly demarcated market, some industries chose to divide and control output and set prices. It seems that such a policy is going to stifle progress and allow the more vigorous counterparts in other nations to improve methods and technologies at a much faster rate than the complacent members of the monopoly.

While the association type of monopoly was the most prevalent in England, the combine was the instrument used in controlling the chemical industry--the only important export trade that we have not touched on. The fact that this group is by nature and age heterogeneous causes it to fall outside of both the old and new categories. The dominant factor is the very extensive control exercised by the Imperial Chemical Industries, Ltd. (I. C. I.). This industry developed along a different line than most of those previously mentioned. Whether because of intensive foreign competition from cartels or because of the nature of the men involved, the tendency to organize in combines which entailed ownership transfer was a feature of nearly all divisions of the chemical industry. Explosives Trades, Ltd. was formed in 1918 by combining all but three producers in this field. There were many combines formed prior to this time and they were associated tightly before the War, but the need for a more rigid organization to conduct the War inspired the final merger.

Exigencies of war also caused the centralization of the dye industry under the British Dyestuffs Corporation. This move was government-inspired to deal with the emergency existing due to the fact that Germany had been the source of supply and was cut off. The corporation was semi-public in that it was partially government-owned and directed. In 1925 the government divested itself of the shares and dropped all supervisory authority.

In the other branches of the industry, two companies exercised almost complete control by the end of the First World War. Brunner, Mond & Company and United Alkali were both begun in the nineteenth century and after an extended rivalry, based largely on sponsorship of different alkali processes, they made peace and expanded to control alkali, soda compounds, chlorine, bleaching powder, ammonia compounds and acids. In 1926, I. C. I. was organized to unite and control the industry. This paternal firm was not a passive holding company but by direct representation controlled the subsidiaries and operated to insure harmony and co-ordinated direction of the eight chemical fields controlled.[41]

Centralization of purchasing of raw materials, marketing, advertising, research and capital expenditures were considered to be the principal methods of effecting savings other than by avoiding duplication and overlapping facilities. In contrast to the trade associations, this combine had the reputation of expanding widely and eliminating inefficient plants. Technical research was also pushed and its position as the largest British industrial unit enables it to establish foreign markets easily. The formation of agreements with Du Pont and I. G. Farbenindustries limited its export expansion. Agreements dividing the world market are generally believed to have been concluded between these giants. Whether free competition in the world market would have been beneficial or detrimental to Britain's export position in this field is an open question far beyond the scope of this paper to probe. This firm is thought to be among the most progressive and wealthiest in the United Kingdom. A certain enterprise and aggressiveness must have been present to form the group originally. If this same spirit can be turned toward the solution of the balance of payments problem, I. C. I. should be able to make a sizable contribution to the export drive. The potentiality of becoming a factor in the dollar market seems extremely limited even in the event that the former

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41 Alkalies, explosives, fertilizer, synthetics (chiefly nitrogen), general chemicals, lime, metals (largely nonferrous), leather cloth, and dyestuffs. I. C. I. also has holdings in other industries but dominates only these.

agreements no longer exist.[42] The start accorded to Du Pont and other American firms is probably too great to overcome but the condition of German industry should open many other markets to competition.[43]

C. Summary

We have indicated that British industry has many problems to overcome. Some are due to the way in which the industry and the economy developed. Lack of natural advantages such as oil, non-ferrous metals, and hydroelectric power can never be remedied directly but must be compensated for by technical progress. The adherence to old methods, products and equipment must yield to the same force. Improvement that should have come over the years can not be brought about cheaply or immediately. Case studies indicate that improvement can be obtained by applying known methods more efficiently. Professor Florence of the University of Birmingham summed up some steps suggested as means of bringing about adjustment in the foregoing discussion.[44] They are not all applicable to one case, but scattered judiciously they would

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[42] Time, LV (March 13, 1950), p. 84. Patent agreements are believed to have been terminated and I. C. I. purchased Arnold Hoffman & Co., an old but minor American chemical firm. Some of I. C. I.'s 12,000 products may be manufactured here in an effort to expand.

[43] This whole discussion is based on Ervin Hexner, International Cartels (Chapel Hill, 1945), pp. 296ff., and Lucas, op. cit., pp. 174-200.

[44] P. Sargant Florence, "Industrial Change," The Industrial Future of Great Britain, pp. 203ff.

do much good. They are:

a) Shift work--more shifts on efficient equipment and discarding of most inefficient machinery

b) Staggered hours to best utilize available power

c) Standardization of product--limiting variety available

d) Incentives for management in nationalized industry

e) Increased mechanization. He shows that the increased U. S. production is closely tied to increased mechanization.

While an overnight change from present equipment to the most modern is obviously impossible, a move in that direction accompanied by the devalued price and possibly a narrowed profit margin can make good merchandise marketable. A point that is frequently missed in British trade discussions but always present in American tariff talks is that American labor, while more productive generally than any in the world, is also more highly paid. Productivity can move slowly toward the goal of equality and be competitive from the point at which the wage-productivity ratios are equal. That point should have been passed in some of the more progressive plants and industries. In other words, more British products must be brought to such a point in comparative costs that consumer preference excepted, they should move in international trade.

Overcoming the preference of the consumer is quite another thing. Advertising has established tastes in the United States and in many other dollar markets that cannot be circumvented by a slight price differential. It has been suggested that early British trade eminence was built on 1) enterprise, foresight, and self-reliance, and, 2) quality goods of first class appearance at the right price.[45] If the admirable qualities were exercised in producing the equally admirable type of merchandise the trade situation would be alleviated. Efforts are being made to create new products and to adapt old ones to the tastes of the consumers. If devaluation earns the required respite, perhaps items like the previously mentioned gas turbine automobile and the jet-propelled commercial transport airplane, which a British manufacturer is perfecting,[46] will give England a leading position in some fields of mass manufacturing to replace the old staple trades which seem unlikely to ever recover a semblance of their old position.

From the supply side it appears that recovery is possible. Plans call for a net balance on current account of $400 million by 1952-3 and a deficit of $291 million to the dollar area. The effort expected does not seem to be superhuman.[47] The gravest dangers seem to be that restrictions on investment coupled with import price increases due to devaluation will disrupt the industrial recovery program or that raw material price increases will discount increases in

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45 Leslie Gamage, "The Export Drive," ibid., pp. 131ff. He adds a third factor: a dominant merchant fleet and accompanying invisible services.

46 *Time*, LV (February 6, 1950), p. 76. The item declares that the U. S. plane industry fears that the British lead in this field will cost the U. S. many markets in the future.

47 Cmd. 7572, p. 42.

productivity. The first must be adjusted by policy shifts but the second is subject to the vagaries of world supply. Neither source is predictable to a significant degree but if the value of currency depreciation were to be determined strictly from a supply viewpoint it would most probably be negative. The added supply costs must be more than offset by demand gains.

Chapter III

Invisible Items

Though an industrial basis may be necessary for a "favorable" balance of payments, the margin is certainly determined by the "invisible" items. To say that in Britain's history the presence of a large volume of invisible items obscured the trend that now must be reversed is an admission of their importance. For our purposes a broad division of these items into two groups, 1) services, including shipping, insurance, brokerage, and fees, and 2) investments will serve best. The service income of the United Kingdom followed the tides of British trade as might be expected since most of the items are vital to material transactions. Such non-trade items as government expenditures and tourist receipts were considered deficit items when Britannia ruled the waves but will be mentioned specifically later when prospective income is treated. Investments are also related to export of goods but savings or government spending have an important bearing in this group.

Appreciation of the gain to be derived from using their own ships dates from at least the 14th Century in England.[1]

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1 A law dating from 1381 states that "None of the King's liege people do from henceforth ship any merchandise in going without or coming within the realm of England, in any port, but only in the ships of the King's liegance." Similar laws were passed under the Tudors in 1485, 1488, 1532 and 1540. The best known proclamations of this sort are the Navigation Acts of 1651 and 1660 which applied to colonies as well as the home islands. Ephriam Lipson, Economic History of England (London, 1931).

The method was recommended by the Mercantilists for adding to the wealth of the nation and is one of the reasons for the naval strength.[2] It is logical that the development of insurance, banking, and similar services would stem from an appreciation of shipping revenue. As previously mentioned (Chapter II) the physical trade volume ran at a deficit from at least 1825 and invisibles filled the gap and enabled the British people to add something to holdings abroad in all years between 1850 and 1913 except for the bad crop years in the late 1870's.[3] The amount added fluctuated with foreign trade and domestic prosperity but the total grew constantly.

Table 9

United Kingdom Balances of Payment--Annual Averages (£ million)[4]

Period	Merchandise Balance (-)	Net Service Income	Net Investment Income	Net Capital Outflow
1870-74	61.2	74.0	48.0	60.8
1875-80	120.7	76.6	47.9	3.8
1881-85	103.5	77.4	56.0	29.9
1886-90	93.3	82.1	82.1	70.9
1891-99	148.8	87.2	92.6	31.0
1900-1904	186.9	103.5	104.7	21.3
1905-09	155.5	126.8	138.2	109.5
1908-13	158.0	127.0	198.5	167.5
1914-20	—	—	—	—
1921-29	360.0	212.0	240.0	92.0
1930-37	336.0	131.0	176.0	-29.0

Until the First World War the British Isles were the foremost source of capital in an expanding world. The decade

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2 Among others, Thomas Mun in his England's Treasure by Forraign Trade (1664) postulates the procedure.

3 Kahn, p. 125.

4 Combined from W. Arthur Lewis, Economic Survey 1919-1939 (London, 1949), Table XV, p. 202, and Kahn, op. cit.,

ending in 1913 was in absolute terms the peak of British investment just as it was the production peak for the British export industry. As invention, discovery, or some social force caused a region to develop, or more intensive exploitation due to transportation changes or productive improvements came about, British industry would furnish the equipment, British investors the money, British ships the transportation and in many cases, British personnel the supervision.

In the years following World War I, a decline set in. For the years from 1924 to 1929 the deterioration of the competitive position of British industry was the key factor. This was featured by the difficulties in the staple trades discussed in the last chapter. The increases in the various categories of imports stress this relative decline. Between 1913 and 1929, food, drink and tobacco imports increased 31.2%, those of manufactured goods 42.1% and raw material imports only 1.6%.[5] Notice also (Table 11) that British exports by volume in 1929 were only 86.6% of the 1913 level. World trade in the same year was 133% of 1913.[6] The decline then was absolute as well as relative. The dependence for exports on the stagnating industries was brought out in the last chapter but the following table illustrates the reason for the relative decline rather well.

Table 13, p. 126, and Table 15, p. 128. Both authors confess to inaccuracies and the adjustment made to combine them certainly would not improve matters but I believe that the broad trends are indicative.

5 Kahn, p. 135.

6 Lewis, p. 79.

Table 10

Exports of Manufactures[7]
(Export industries classified by percent of expansion 1913-1929 and by percent of each country's total in class)

	Less than 75%	75%-150%	More than 150%	Unclassified
Great Britain	42.1	33.5	4.3	20.1
Germany	27.3	55.3	4.5	12.9
U. S.	17.1	38.8	28.6	15.5

The flaws in the industrial make-up of the United Kingdom showed up most clearly in this decade when the world was enjoying a post-war prosperity which Britain could not share equitably because of the compounded inefficiencies. During the same period, however, invisible items reached their peak in terms of monetary return. The pound sterling was still the currency of world trade, the financial center in London and English insurance firms were still revered in their field. Gross investments made abroad were still substantial and capital outflow was good although repayments make the net figure unimpressive. One factor limiting investment was that an amount of money that was formerly saved was now going into the consumption of the increased imports. Heavy taxes on business profits, incomes and inheritances followed the war as a necessary adjunct to the increased social services. This started a redistribution of income that decreased savings.

An estimated one-fifth to one-fourth of English investment had been lost during the war from sales to raise foreign

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7 Ibid., p. 78.

exchange and from defaults in the belligerent countries.[8] Because prosperity visited the raw material producing countries and the industries which were vehicles for British investment in foreign countries, income did not fall proportionately. Increased world trade used British shipping, and rates were high at this time thus enabling the merchant fleet to contribute substantially to the balance of payments.

Table 11

United Kingdom and World Exports and Imports[9]

	U. K. Volume Indexes		U. K. Percentage of World Total	
Year	Net Exports	Net Imports	Exports	Imports
1913	100.0	100.0	13.11	15.24
1924	80.0	106.4	12.94	17.62
1927	81.8	118.3	11.10	15.92
1929	86.6	121.3	10.75	15.19
1932	54.5	106.9	9.92	16.30
1936	65.4	124.6	10.30	17.60
1937	71.6	132.5	9.87	17.03

The depression of 1929-30 brought an abrupt turnabout to the current account balance of payments. The physical items balance was only about 10% or £34 million less favorable in 1931 while the invisible items fell by 33% or £157 million of their 1929 total.[10] Britain's share of world trade did not decline calamitously but the world total did fall, especially in manufactures. As mentioned previously,

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8 Kahn, p. 137. This is an Economist estimate of £850-£1000 million.

9 Ibid., p. 132.

10 Walter A. Morton, British Finance 1930-1940 (Madison, 1943), p. 73.

the staple industries continued their decline but the world situation proved favorable, with the help of empire preference to the automobile and chemical industry. This enabled Britain to retain the relative position she held in the 20's.

All categories of invisible items contributed to the precipitous decline with after effects that are felt even today. In shipping and shipbuilding the oft-repeated relative and absolute fall is again the feature. This follows naturally from the trade volume decline. Freight rates fell 25% from 1929 to 1933 and idle tonnage increased more than sixfold. The first subsidies were given to the industry in 1935 and rates were also bolstered by agreements between owners. Although recovery was complete in 1937 and rates were 32% above 1929 the British share of world capacity had been pared. From 39% of the world total in 1913 and 29½% in 1929, it had fallen to 26% by 1939. This, of course, was a direct result of the effect that the depressed conditions of Britain's trade had on shipbuilding. Part of the subsidy provided by the British Shipping Assistance Act of February, 1935, furnished funds to build one ton of shipping for every two scrapped or to modernize one ton for every one scrapped. An additional part of the program involved dismantling and razing yards that were inefficient.[11]

World War II wreaked havoc on British shipping in a

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[11] Morton, pp. 224ff. All statistics in this paragraph are taken from these pages.

relative way. One source[12] claims that almost one-half of the British Merchant Fleet, as it existed in 1939, was lost during the hostilities. Much of this was replaced and the portion of world capacity was estimated to be about 22% at the end of 1949.[13] As Runciman points out in his article,[14] the picture is not quite that black because the U. S. has laid up a large portion of its fleet and has shown little eagerness to compete for F. F. trades (foreign foreign trades). British yards are building about half of the ships under construction in the world at the present time.[15] The Government seems satisfied that shipping is adequate at present and will be in the near future for home commerce. The aim is to add ships that will operate in F. F. trade. This will require faster ships and special designs. The critical shortage is in tankers and only in this class do they intend to surpass pre-war capacity immediately. The yard capacity is deemed to be sufficient to handle planned expansion but steel supply is critical. With the moderate increase in tonnage planned; with the utilization of greater speed and faster turn-around; and with the hoped for increase in world trade, the 1952-53 income from shipping is expected to be

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12 Leslie Runciman, "Shipping," Industrial Future of Great Britain, p. 148.

13 "Shipping Industry Is at Boom's End," New York Times, XCIX (January 4, 1950), p. 53.

14 Op. cit., p. 150.

15 "Shipping Industry Is at Boom's End," op. cit., p. 53.

$360 million compared to 1947's $121 million.[16] The 1947 figure is greater than the corresponding 1938 sum because of relative price levels.

The contribution of shipping and shipbuilding to the balance of payments can, if we accept the Government's opinion, be substantial if world trade grows and if steel becomes abundant enough to permit construction to keep pace with demand. This is making several implicit assumptions. British shipping is assumed to be able to compete cost-wise with foreign merchant fleets. This is probably justified now, in that the U. S. has always had cost troubles and is the only other large fleet in existence. Much of Britain's advantage in the past rested on her predominant position in world trade and the cheap coal available for fuel. Since neither factor is as important now, only the belief that trade will require all available capacity for some time would justify the confidence of the Government. A third assumption would involve the continued idleness of U. S. capacity. This one seems sound. Devaluation probably made the competitive position better but involved little sacrifice of revenue since price increases wiped out price reductions not deemed essential to increased business. There are, of course the other factors, British shipping expenses in foreign ports and British freight and passenger payments to foreign lines. The exchange rate now will probably make the British more conscious

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16 Cmd. 7572. The Government estimates in this paragraph are taken from page 28 of this paper.

of the advantage of using their home ships and may result in a slight saving of exchange.

In the shipyards, the problems are those of finding owners willing to build in the face of high costs and taxes and trying to meet the repair cost competition of German and Japanese yards. This industry is one of the very few in which the productivity is equal to that of its U. S. counterpart.[17] There is hope that the cost difference will lure some American trade there. Devaluation should have helped in meeting the problems by widening profit margins and lowering comparative costs and could make the facilities more attractive to dollar buyers. Here, as in shipping, the volume of world trade and the idleness of U. S. reserve capacity are the first requisites to a successful fulfillment of hopes. Next is relative efficiency of the British firms and it is here that individual effort aided by devaluation can make a contribution.

While no breakdown is available on income from other services, a review of the post-war conditions in each field gives evidence that it is below the pre-war total and very likely to remain there in most cases. An exception is the income from tourists or "tourism" as it is called. Only vague estimates are available on expenditures by the visitors but Government sources, while proclaiming that the net tourist trade will show an international deficit, have high hopes

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17 Philip Brown, "Prospective National Income and Capital Formation in the United Kingdom," American Economic Review, XXXVI (September, 1946), p. 557.

for a favorable dollar balance. In order to make this a reality much encouragement is given to the promotion of tourism. Extensive advertising, with a special aim at developing off-season travel, efforts to provide plentiful travel facilities, the extending of privileges to purchase gasoline, candy, soap, rationed clothing and an allowance of $100 worth of tax free gifts are all examples of efforts being expended.[18] As a result United States citizens spent an estimated £18 million in 1949, a considerable increase over the £5 million of 1937.[19] Two questions arise here: 1) Is the return from tourism commensurate with the real costs in the light of Britain's needs? 2) Is devaluation effective in encouraging dollar travelers to the extent that dollar income will be increased? In regard to the first question we have to consider dollars earned on goods if sold to tourists as against production incentive if they were sold to Britons. Good will in the sense of future consumers for exports, and the expenditure on consumer goods rather than on producers goods that is necessitated by preparation for tourists, are opposing sides of the question. It seems to me that the historical attraction of the British Isles is a very salable commodity and in the absence of a secure market for other commodities and under the compulsion of dollar needs, the practical

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18 Cmd. 7572, p. 30.

19 "Britain Expects 560,000 Tourists This Year," New York Times, XCIX (January 4, 1950). The article tells of further privileges to purchase gasoline and food being offered as inducements, and of the Government's confidence in the efficacy of devaluation in this field.

course, in the absence of overwhelming contrary evidence, is to exploit the available assets.

The effectiveness of the currency depreciation hinges in the long run on the elasticity of demand for travel to Britain. In the short run, however, with ocean transportation and facilities in Britain and not demand being the limiting factor, the effect was probably unfavorable to a small degree because costs for imports from the dollar area, some of which are necessary for the visitors' comfort, are higher and selling prices cannot be raised the full 44% if the product is an essential part of British domestic life. In this case even under the very liberal, and not verifiable assumption, that the tourist limits his expenditure not by real items but by total budget, we find the English parting with more goods to get a given number of dollars. Those items, such as shipping, that do not enter into domestic life had their prices raised the full amount of the devaluation. The total effect of devaluation as stated would seem to be small but unfavorable.

Insurance generally personified by the famous Lloyds was an important part of the pre-war miscellaneous invisibles. The war by its very existence caused cessation of activities in this field. Higgins lists four difficulties facing the industry in its efforts to regain its former position.[20] A completely new start is, of course, always difficult.

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[20] Benjamin H. Higgins, Lombard Street in War and Reconstruction (New York, 1949), p. 94. All but the portion on reinsurance is based on this source.

Secondly, American firms have grown and are eager to compete. This is especially true in the American reinsurance market where domestic companies are becoming steadily more important. Also, much of the property, business and shipping formerly insured was wiped out or taken over by governments. Lastly, nationalization of the insurance business in some countries seems to be indicated or exchange requirements and insurance regulations are so onerous that competition would be either futile or unprofitable. Missions have been sent out by the companies to countries that were formerly large markets to attempt the restoration of business and good will. Relative restoration seems unlikely but a growing world trade might still have use for the British experts. Since competition for reinsurance in the United States is on a cost basis in many cases, a willingness to forego a measure of the windfall profit offered by devaluation may help in regaining lost patrons.

The other major components of the service income were brokerage fees for foreign security flotations and income from foreign bills of exchange. They have one thing, at least, in common: they are both virtually non-existent at present. Most loans made to foreign nations or companies are handled through government channels or are inter-company loans. In neither case do the securities houses become necessary. The discount houses and the acceptance houses so long distinctive appurtenances of the smooth working London money market found it necessary to change their means of earning a livelihood because of the dearth of bills of exchange. The trade that does take place now is subject to so many exchange restrictions and government regulations that dated instruments would be at best an indefinite thing. A recovery of multilateral trade may revive both occupations but in the foreseeable future neither seems likely to be important as a source of exchange.

The most talked of segment of the invisible items is the investment income; it was also quantitatively most important in immediate pre-war days. In the depressed 30's, the drop in returns from this sector threw the balance of payments to the deficit side. The total of £230.9 million in 1929 fell to £149.7 in 1933.[21] The greatest decline was in dividend income because of the slump in primary industries abroad. This type of industry commanded the largest share of risk capital investment. After the inauguration of the cheap money policy in 1932, the refunding of bonds cut the yield appreciably while leaving the amount of investment intact. In non-empire bonds, however, defaults caused a drop in the amount invested abroad. For the decade, the decrease in foreign investment amounted to about 3% or £100 million, leaving a balance of £3,692 million in 1938. The dominant item in the decline was the £61 million excess of repayments over new investments for the period 1931 to 1938. The

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21 Data covering investment in the period from 1929 to 1938 is taken from Morton, op. cit., whose source is Sir Robert Kindersley's articles in the Economic Journal. The author also perused some of the original sources.

oft-mentioned trade decline is the largest factor here although government restrictions were certainly to be reckoned with.

The war naturally had a disastrous effect on the foreign investment portfolio from an income point of view. The Government states that £1,118 million were received from the sale of requisitioned securities to obtain foreign exchange for carrying on the war during the September 1939-June 1945 period.[22] This figure really tells us very little of what we want to know. In the first place the amount of overseas investment still in existence is in doubt. Kindersley's estimate of the pre-war total is generally conceded to be very conservative.[23] Book value or actual value of the divested portion of the portfolio is not known and the amount of investment destroyed, confiscated by "iron curtain" countries, or shrunk through obsolescence or disuse is not even subject to methodical estimate. Based on aggregate income comparisons, one study places the total for December 31, 1948, at £3,100 million. This is tied to a £205 million income in 1938 and a £152 return in 1947.[24] No breakdown by type of security divested is available but we can assume that the

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[22] Statistical Material Presented During the Washington Negotiations, Cmd. 6707.

[23] Sterling Since the Convertibility Crisis, International Financial Committee of the National Foreign Trade Council (New York, 1949), p. 54. This publication cites some estimates as high as £4,700 million or a £ billion higher than the Kindersley total but suggests that this is probably higher than the book value.

[24] Ibid., p. 55. They assume a constant 5% yield.

most marketable ones would have been sold and also that prices on a forced sale in a war-time market would be far below book value. An article in Dun's Review cites the case of American Viscose Corporation for which £13.5 million was received at a time when the conservative book value of the company was £32 million.[25] If we can assume that this is not an isolated instance, it seems that we could also entertain the possibility that British investments have fallen well below £3,000 million and that extraordinary profits and dividends springing from the worldwide seller's market conditions have bolstered income so that the yield on the remaining investment is at a higher rate than that prevailing in the pre-war period. This would be a forewarning of a fall in return when the world reverts to near-normalcy.

Another way of looking at the situation is observing that in 1938, interest, profits and dividends from overseas paid for 21% of total imports while in 1938 the same sources paid for only 3%.[26] In the same vein, Roy Harrod shows that lost investments formerly paid for goods valued at £400 million now.[27] This viewpoint emphasizes not so much the lost investments but the price inflation. Even assuming that most

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25 Harry Ward, "The Great Experiment: British Management Looks at Labor Party Planning," Dun's Review (December, 1949), p. 18.

26 "Devaluation and the Dollar Drive," Labor and Industry in Britain, VII (December, 1949), p. 152.

27 Roy Harrod, "The Financial Position of Great Britain and the Balance of Payments," Current Financial Problems and the City of London (London, 1949), p. 5.

of the securities sold were ownership shares, it does not seem that profits on the pre-war total would have increased sufficiently to close this gap. The existence of this attitude indicates an overemphasis on the departed investments and underemphasis on increased demand, price inflation, and on the volume of physical exports on which invisibles depend for their prosperity.

The other avenue of net investment income decrease is the increase of liabilities abroad. This is a more troublesome problem than depleted assets. During the 1939-1945 period, external liabilities increased from £476 millions to £3,355 million or by £2,879 million.[28] The greatest part of this is in the form of sterling balances, a sort of demand deposit with London that in most cases required "blocking." The process of paying these demands gave rise to the term "unrequited exports." No official agency publishes a list of these very troublesome balances so we must rely entirely on unofficial guesses. One guess puts the average amount redeemed at about 220 million a year or somewhere between £500 and £600 million.[29] Table 12 shows some estimated releases and the balance at the end of 1949.

Before the war the sterling area countries had about £300 million as working balances and currency reserves. With

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[28] <u>Britain's Oversea's Financial Assets and Liabilities</u>, British Information Services, ID 710 (Revised April, 1949), pp. 5ff.

[29] "British Debts and American Security," <u>Fortune</u>, XLI (April, 1950), p. 71.

Table 12

<u>Estimated Sterling Balances, December 31, 1949</u>
<u>and Partial Estimates of Releases.</u>[30]
(£ millions)

Country	Balance 12-31-49	Released 1945-7	Hard Currency Allocation 1945-47	Released 1948-49	Hard Currency Allocation 1948-49
India and Pakistan	1,000	65 80	—	47	30
Egypt	300	80	31.7	32	6.3
Eire	275	—	14	—	—
Australia	200	—	—	—	—
Argentina	150	10	—	20	—
Palestine, South Africa, New Zealand, Iraq, Portugal	500	13.3	7.5	20	5.3
Other	575	1.5	—	14.8	—
	3,000	169.8	53.2	133.8	41.6

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30 <u>Fortune</u>, <u>op. cit.</u>, and "Unrequited Exports," <u>Economist</u> (August 21, 1949). The releases do not include the last eight months of 1949.

the increased circulating media in most countries, these balances probably would have grown, so it follows that part of the released currency may be used as working balances and not require material exports. Nevertheless, the debt represents a considerable burden on England economically and politically.

The blocking arrangements created eighteen different kinds of sterling which account for an uncertain but probably substantial volume of leakage and foster the impression that the pound is not stable at its present rate. A free market sterling rate depends on the amount of that type of sterling available and the difficulty of using it.[31] It is unreasonable to presume that any but the most complete controls will prevent financial speculators from finding methods of

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[31] Quotations from the Monthly Letter of the National City Bank of New York for November, 1949, demonstrate the range. Quotation date is October 31, 1949.

Official Rate--"American Account" sterling	$2.80
Selected Unofficial "Free" Rates:	
"Dutch account" sterling	2.65
"French account" sterling	2.63
"Industrial shares" sterling	2.08
"Government securities" sterling	1.70
Bank of England pound notes	2.55

The eighteen kinds of sterling fall under five groups. Group 1, the Sterling area, is good for transfers within the group and with government approval between groups. Group 2, the Dollar area, is the official rate of exchange and freely usable. Group 3, Transferable account countries, is usually held by banks and supervision is exercised to keep only amounts earned currently in use. Group 4, Bilateral account countries, is mostly government holdings and while transferable from one account to another within the country requires Bank of England approval to go outside. Group 5, a residual group, permits free transfer within the group and to Group 1. Sterling Since The Convertibility Crisis, pp. 74-5.

utilizing the differentials to their own advantage and in the process depriving Great Britain of dollar reserves that she would otherwise receive.

These sterling balances force Britain to release dollar reserves that she would otherwise use more profitably. They absorb exports that could be earning dollar exchange or eliminating the need for it by bringing in raw materials and in the process they make British industry soft by allowing it an uncompetitive market. They restrict convertibility of sterling and as another facet to this they are the stumbling block for the European Payments Union. Hard feelings caused by the inability to work out an equitable settlement prevent complete cooperation with India and other countries on many matters. The feeling in some quarters that the debts were war-born and should have been cut or completely frozen immediately after the war does not seem to be justified in the light of chaotic economic and political conditions in many of the creditor countries. Any form of renegation on the part of England most certainly would have cost dearly in confiscated investments, Communistic propaganda gains and loss of influence. Such an action might also weaken international banking connections and indeed even internal banking in some of the dependent countries.

At least six general methods for dissipating the blocked balances have been brought up at one time and, while not pretending to resolve the predicament, we will list these with some comments.

1. One could retain the restrictions and continue trade with those countries which depend on Britain as a market until the creditors come to terms or force investment of the balances in U. K. government securities. This is the old Nazi method and cannot be used with the existing world turmoil or with an easy conscience. There is a temptation to use some compulsion in the case of India and Pakistan. These two countries by trading freely with each other could eliminate much of the outside trade that demands dollar exchange. India also supports an army twice the size of the pre-war combined army; she is, however, a possible barrier against Communism and too important in Southeast Asia to alienate.

2. Restrictions could be removed so that the currency could seek a level at which a balance could be reached. This was the 1931 policy in England; following the abandonment of the gold standard, the currency was cut loose with the Exchange Equilisation Fund eventually being instituted to prevent unnatural fluctuations. There is, however, one big difference in the situations. Now Britain is no longer a creditor nation in the long run. The equilibrium level could be very low and fluctuations could be violent enough to throttle trade even more than the restrictions do. Creditors whose accounts are in sterling would suffer and those whose accounts are in gold or dollars would benefit through increased purchasing power if they could obtain payment.

Harrod suggests a modification of this method.[32] He advocates scheduling blocked balance releases and interest payments at a rate of about £120 million a year while at the same time making sterling freely convertible every place else.[32] The blocked balances would take the form of definitely scheduled loans and at the same time confidence would be restored in sterling. The facts that balance of trade on world account is no longer unfavorable and that experience has been gained which makes the handling of reserves more efficient would prevent the 1947 convertibility debacle from recurring. He believes that the source of much of the difficulty is the fact that £1,130 million have been sent out of the country during the period from January 1947 to mid-1949. Marshall Plan payments and Canadian aid for the same period were £1,234 million. Not only was foreign aid wasted but by making sterling so plentiful in consuming countries, it was practically impossible for exports to bring in needed foreign currencies. Trade deficits demanded hard currency payments while favorable trade balances yielded sterling rather than dollar exchange. Since the effect of this is to drain gold and reserves anyway, nothing is to be gained by restricting convertibility beyond the dichotomy suggested. A necessary adjunct to this action would be an atmosphere favorable to investment in the British Isles as a means of curtailing the outflow of funds. He claims that under the present set-up

[32] Roy Harrod, "The Dollar-Sterling Problem," International Affairs, XXVI (April, 1950), pp. 153ff. This represents a shift in emphasis (which he acknowledges) from his claim that too much internal investment was taking goods from import trades and overexpanding British industry. This attitude is explained in the article previously cited.

Britain is very near a pre-war trade level but that the rest of the sterling area is benefiting from tremendously increased imports and that this fact prevents a world balance.

The alternative to this program is a drastic tightening of controls that will eventually split the sterling area into smaller payment blocs with some of them adhering to the dollar area. Hawtrey in a comment at the end of the article asserts that confidence in sterling will be established, and well-being of the creditor nations better served by paying off the balances as rapidly as possible and making the goods available for building the economies of those countries. In rebuttal, Harrod says that Britain will do more for the sterling area by making herself strong and sound first. These two conflicting arguments demonstrate the belief that confidence in sterling must be maintained if Britain is to take a place in world trade and also show that the method of restoring (or maintaining) that confidence is not easily determined.

3. Deflation in the home economy brought about by monetary control is the old gold standard remedy and was emphatically rejected by the Government. They will not accept external balance at the cost of internal unemployment.

4. Austerity at home and using increased exports to pay off the debt is of course part of any solution. When we realize that the external debt is about one-third of the national product we can see that this solution taken alone

is bound to be long and arduous.[33] At present it is the only solution that has received any support and may be the only workable one.

5. A moratorium is part of Harrod's solution and is in a limited way what is being done. An absolute moratorium seems out of the question for political reasons as discussed in (1).

6. Aid from large creditors, or bluntly, from the U. S., is frequently proposed. One school of thought holds that by making Britain restrict exports as an ancillary part of lend-lease, we are responsible for the size of the balances and that if we hold to the 1946 loan agreement whereby releases may not take place at a faster rate than loan repayment, we will seriously hamper recovery. This school holds that we must tie loans to these creditors to agreements to abolish or fund the sterling debts.

Another argument sees the blocked balances as a cost of war and a barrier to recovery that the U. S. alone is able to bear and overcome. The appropriate course here would be to assume and pay off the lion's share of the balances. Any alternative would prevent multilateral trade from ever being restored, it is declared.

This resume of suggested solutions serves to present the many ramifications, political, moral, and economical, of

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33 "British Debts and American Security," p. 71.

the blocked balances.[34] It points to the fact, so common in any sphere of practical economics, that there is no absolutely correct solution available to man but that a compromise with the various pressures must be worked out. I should like to point out that two dominant requirements seem to exist as guides to all action in this area. First, Britain wants to retain the sterling area as a bulwark against her domination by another power. Secondly, the creditor countries are determined to develop their own economies. These aims are not blatantly proclaimed but while compromises have been made with Communism, nationalization, empire solidarity, free trade and other patent slogans or avowed foes, these seem to be pursued strongly.

Britain says that sterling must be maintained as an international currency and that this in itself is a contribution to international economic stability.[35] The attainment of this objective involves keeping that group of countries loyal who have always cleared their external receipts and payments through London and who keep part of their currency reserve in sterling or bound to London in some way. There is no formal organization to bind these Sterling area countries together although the Commonwealth Liason Commission and the Sterling Area Statistical Commission are used to handle information and interpret decisions. Common

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[34] The discussion in George N. Halm, International Monetary Cooperation (Chapel Hill, 1945), furnished much of the background for this section, pp. 144ff.

[35] Cmd. 7572, p. 4.

interest, convenience, and efficiency hold the group together. Pooling reserves, centralizing of banking functions, freedom of payments within the area and the similarity of outside area exchange controls are some of the features that are in the self-interest of each by their availability to all. The danger to the existence of this bloc would seem to be not in the lack of formal organization but in that restrictions on convertibility may cause those members having dollar surpluses to break away and form their own payment system. Devaluation may prove a means of strengthening the ties because dollar area prices have risen for them and because their exports will bring them more if the dollar exchange is spent in Britain. For instance, South Africa received £100 million for $400 millions of gold in 1948. Now the same amount of gold would bring £145 million.[36] The same would be true of other commodities such as rubber, diamonds, wool, and non-ferrous metals. The dilemma arises when the exports are channeled to the dollar market and the sterling countries are left with sterling in hand as is the situation at present. One can see a ready substitute for true multilateral trade for Britain should the need arise for a permanent arrangement.

While the creditor countries desire to raise their standard of living by domestic economic programs they have not seen fit to create an atmosphere favorable to private

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36 "Devaluation Felt But Little In U. S.," New York Times, XCIX (January 1, 1950), p. 3.

foreign investment in many cases. Foreign investment is constrained by the lack of confidence in the countries that need it. South Africa was receiving some funds until the Nationalist government came to power. Funds then began leaving the country. The constant crisis and continual rioting in India and Pakistan certainly make investors in the U. S. and Great Britain chary. Burma confiscated foreign holdings when leaving the commonwealth and the government there has not become strong enough to make a settlement. Generally threatening conditions prevent foreign investment stemming from private sources from circulating. As is becoming usual for Britain, a government program is designed to replace it. This will be touched on later, but we can say now that the outlook for increased British overseas investment is limited by unsettled conditions, home requirements, production deficiencies, and existing debt.

The devaluation may prove a help to the blocked balance situation in that (as previously stated) prices may rise enough to restrain spending in dollar markets and thus prevent exchange from being dissipated. The debt in terms of dollars was written down from $13.5 billion to $9.5 billion by devaluation and this would prove helpful if the U. S. should assume a portion of the burden. Devaluation will, however, cause investment income to cover even a smaller portion of physical imports and increase the interest payments on dollar area obligations.[37] This crucial problem cannot be treated alone but only as dependent on production and in relation to export ability. It presents many problems of its own which hamper solution of the general problem and if organized so as to benefit Britain could aid the final settlement.

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[37] Although they are sizable, I have not treated the dollar loans because even if they are paid, which is open to question, the payments have not yet begun.

Chapter IV

Government Policy

A discussion of government policy in a country which has gone as far toward socialism as Great Britain, is indeed a formidable task, too formidable to be thoroughly handled as a part of another subject. The reader may have noticed that government planning or government agencies were introduced in every phase of economic life that we have touched on thus far. Despite the fact that the immensity of the subject renders a complete coverage impossible, an attempt must be made to cover some of the areas that affect our problem most directly. Admittedly, international trade and therefore devaluation has a bearing on every economic activity in England and the influence of government has also thoroughly permeated every sector of life. No claim is made that coverage is complete or, by some standards, adequate. The aim is to indicate the trend and point out some of the most directly pertinent activities.

"The object of economic planning is to use the national resources in the best interests of the nation as a whole."[1] "The government are therefore seeking to create, through collaboration with the nations, conditions of international trade which will make it possible for all countries to pursue

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1 Economic Survey for 1947, Cmd. 7046 (1947), p. 4.

policies of full employment to their mutual advantage."[2] This planning is based on three fundamental facts: "the economic fact that the United Kingdom economy must be heavily dependent on international trade; the political fact that it is and intends to remain a democratic nation with a high degree of individual liberty; and the administrative fact that no economic planning body can be aware (or indeed ever could be aware) of more than the very general trends of future economic development."[3]

This eclectic paragraph sums up the declared object and principles of governmental planning in England. Flexibility in the general details is stressed in all of the documents. The main purpose is to erect a framework within which short term plans can be worked out, and not to dedicate the country to a rigid plan that circumstances will render impractical. The chief elements of the planning system are:

a) An organisation with enough knowledge and reliable information to assess the national resources and to formulate the national needs.

b) A set of economic "budgets" which relate these needs to our resources and which enable the Government to say what is the best use for the resources in the national interest.

c) A number of methods, the combined effect of which enable the Government to influence the use of resources in the desired direction, without interfering with democratic freedoms.[4]

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2 Seymour E. Harris, Economic Planning (New York, 1949), p. 165. The sentence is taken originally from the British White Paper on Full Employment (1944).

3 Cmd. 7572, p. 1.

4 Cmd. 7046, pp. 5-6.

The economic "budgets" on a broad national level are written in terms of distribution of man-power, national income and expenditure. Supplementary budgets are compiled for separate areas and industries. Perhaps "budget" is an inappropriate term. These plans must of necessity balance since no larger or smaller number of men can be used than are available; all goods and services produced must be disposed of in some manner and no greater amount can be utilized than has been produced. It is further recognized that the Government can only declare what policy objectives should be, point out the economic tasks before the nation, give information to guide the nation's activity and use its controls to influence the course of the economy in the desired direction. The combined efforts of the whole people must then follow the set pattern if the objective is to be reached.[5] Annual economic surveys are made and published under this program. A four year plan was also mapped out in connection with the Organization for European Economic Co-operation (O. E. E. C.).

It is not the purpose of this chapter to analyze the sincerity, wisdom or soundness of the declarations, or the faithfulness with which they have been carried out. Rather, the activities in four general fields will be explored and some attempt will be made to assess their effect on the balance of international payments and the effects of devaluation on them. The selected policy groups are export aids,

5 Ibid., p. 9.

labor distribution, import replacement and inflation-incentive conflicts.

Aid to exporters in the form of advice and counsel has been made available for many years through the Export Promotion Department of the Board of Trade and particular assistance from the consuls in the various markets has been given whenever possible. Since the crux of the trade situation is not the over-all balance but the sterling-dollar or possibly the non-dollar-dollar balance, new means were considered to be necessary for dealing with this problem. In 1947, the Government began its campaign to capture a larger part of the dollar market by sending a Trade Adviser to study the possibilities in the United States and Canada. Feeling that the task might be too huge for one man, the United States was eventually divided into four regions with a Superintending Trade Consul in each region, and the whole program coordinated under a Commercial Adviser. There consuls work with the diplomatic consular service and attempt to survey the possibilities in each region so that they may advise British manufacturers who desire to place their products on the market. They act as good will ambassadors and as a liason between the producer and the distributor. They attempt to put the product on the market by being able to answer queries from either source in regard to the other; either a product looking for a market or a market looking for a product may receive aid from the consul or his staff. The Board of Trade disseminates information on the dollar market through its publications and endeavors to impress the British business men with the urgency of the dollar drive.

On April 29, 1949, the Dollar Exports Board was organized by representatives of industry, finance, labor and trade. This board is not a governmental unit but was set up as a result of the stress placed on dollar markets and agreed to work in close conjunction with governmental bodies so that trade to dollar areas might be encouraged and facilitated. The work of the Board was concentrated on trying to provide incentives to exporters to operate in the dollar markets. These men believe with Sir Stafford Cripps that devaluation has provided the incentive and that the missing factor is now an efficient and effective method for invading the market.[6]

The other major field of government aid to the exporter is financial. This is handled by the Export Credits Guarantee Department of the Board of Trade. This department was organized in 1926 to insure the solvency of foreign customers for the British exporters. From an original risk guarantee limit of £25 million the ceiling has been raised to £600 million by subsequent Acts of Parliament.[7] During the turbulent 30's, the guarantees were extended to long term political loans and in many of its activities this department contributed to the disintegration of the financial

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6 "Devaluation and the Dollar Drive," Labor and Industry in Britain, VII (December, 1949). Much of this discussion on export aid is based on the treatment of the subject in this and other B. I. S. publications.

7 Ibid., p. 161.

institutions in London by replacing their activities.[8] At present about one-half of the allotted capacity is extended. The price of the service is extremely reasonable because the organization is not expected to make more than enough profit to cover expenses and build a contingency reserve. Shortly after devaluation the scope of activities was widened until an exporter desiring to enter dollar markets was virtually insured against the failure of his venture. Now the Department will guarantee exporters against loss arising from new market surveys, advertising and promotion, and expenses incurred in carrying an inventory in a dollar country. Credits will be extended to cover these various initial expenses, and repayment will begin only after an agreed number of years and will be a pre-determined percentage of the new market proceeds. Short of outright subsidies the Government has done everything to make it easy for the British merchant to reach the foreign customer. It might be pertinent to point out that allocation and rationing of raw materials, licensing controls over production, and even extensive price control can all be means of aiding and encouraging exports. In the complex industrial economy existing today, a tremendous amount of knowledge and wisdom is necessary if one hopes by these specific controls to indirectly channel exports where desired and still leave more than a vestige of freedom to the manufacturer. One also needs considerable knowledge and wisdom to evaluate the effects of these controls as exports

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8 Morton, p. 169.

aids. Not claiming to possess a sufficient quantity of this attribute, I shall stop at the statement of the British Government that, "Controls over production, however exercised, undoubtedly restrain initiative and enterprise."[9] Nevertheless, the general policy involves government aid, production and material control, and continuous publicity and exhortation.

Labor distribution is a problem of longstanding in Britain. The industrial shift that took place in the decade following 1929 caused concern over the fate of depressed areas. Regions had become dependent on one firm or one industry and when the fortunes of the source of employment waned, the area suffered unemployment and was termed "depressed." At the same time new industry was locating in the London area and in the Southern part of the island. The predominant consideration in selecting a location seemed to be proximity of the market. A shift in population had to occur if this trend was to grow and that very shift, by increasing the market in the area, had a "snowballing" effect. Between 1931 and 1937 the population increased by 2.7%. During the same period that of London and the South East increased by 6.6% against a decrease of about 2% in the North and 5.4% in Wales.[10] The problem, unsolved at the outbreak of war was whether to bring the industry to the population in the

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9 Cmd. 7572, p. 11.

10 G. Harrison and F. C. Mitchell, <u>The Home Market</u>, revised and edited by M. A. Abrams (London, 1939), p. 25.

depressed areas against the natural trend or to subsidize the movement and adjustment of the population toward the industry.

The White Paper on Full Employment proposed to attack the problem by promoting the prosperity of the basic industries, locating new enterprise so that no area is dependent on one industry or a group of industries that fluctuate together, by removing obstacles that hinder mobility of labor and providing training facilities to promote that mobility.[11] It condemned excessive area dependence on one industry or dependence on industries with excessively fluctuating demand, either domestic or export. This solution attacks the problem on all fronts and although proposed under the Churchill government, entails regulation of the flow and direction of investment and some control over labor.

So far the need has not arisen for pursuing measures to attain full employment; instead the problem is to furnish labor to those industries essential to the export drive. Many of the pre-war trends had to be reversed in the solution. Measures to increase the available labor force were proposed first. Industry was encouraged to make arrangements so that housewives could work part-time. Changes were made in the National Insurance Act to reward workers who stayed on after they were legally entitled to retire. Immigration was encouraged with particular emphasis on Polish coal miners. The next step was to distribute the labor force so

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[11] Harris, pp. 169ff.

that essential production would be increased.

Wartime direction of workers had been dropped so only two legal tools for doing the job remained. These were the "ring fences," which prohibited coal miners or agricultural workers from seeking employment in any other industry, and the Control of Engagement Order. Under this order workers in certain categories had to report to a government employment office when they were out of work. They were then offered a "preference list" of jobs in essential industries and encouraged to take a first preference job. They were required in any event to work in an essential industry. These controls were dropped by March 31, 1950, possibly because there had been no great call for their exercise or as a sop to labor in the face of controlled wages. This leaves the government in a position of trying to encourage large shifts in the labor force from construction, distribution and service industries to coal mining, textiles and agriculture with only appeals to patriotism as a weapon. The logical measure would seem to be the increase of economic attractions in the industries requiring workers but this was forgone when the wage stabilization policy was inaugurated at the time of devaluation. Even if this were not the case, unions would probably offer strenuous objection to any attempt to distort the scale of wage differentials that prevail. Many job evaluation men feel, however, that there is a very real relationship between a worker's satisfaction with his wage rate on one hand and his productiveness and absenteeism on the other.

One critic of the Labor government estimated that the efficiency of labor is now 90% of the pre-war standard and that despite governmental claims the man-years devoted to producing goods for commerce is 3.8 million below the 1939 total.[12] Another claims that government efforts to locate industry must be more closely integrated with available housing facilities if resources are to be conserved for export trades.[13] This is, of course, a deviation from the previously mentioned plan to distribute industry. The facts that 470,000 houses were destroyed or rendered uninhabitable during the war and that the population has increased by two and one-quarter million aggravates the housing difficulty.[14] Government planning has tied this phase of labor distribution directly to particular industry development in that housing is part of the location plan in each industrial field.

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[12] Ward, pp. 18ff. His very rough compilation is as follows:

3	Million more employable persons than 1939
1.7	" fewer unemployed
4.7	Increased labor force
8.5	Lost potential
-3.8	Man-years of labor difference

The lost potential is 1.2 million more men employed in the armed forces and munitions industry; 1.2 million more man-years devoted by industry to complying with government regulations; 2 million man-years lost by the higher rate of absenteeism and reduced work week; 1 million loss due to earlier marriages (reduces women available); .8 million man-years lost by raising school-leaving age; 1.2 million due to increased number of government workers and longer holidays; 1.1 million due to increased number of criminals and black marketeers, canteen staff personnel and hidden unemployment due to shortages.

[13] Florence, p. 197.

[14] Cmd. 7572, pp. 34-5.

This discussion of the subject of labor distribution suggests that the problem is not being dealt with in a satisfactory manner. The labor shortage is the crucial factor in coal, textiles, and in construction and is certainly important in every effort to expand an industry. It is also an issue that is not amenable to solution by compulsion. The attitude of resorting solely to exhortation to increase and distribute man-years of labor while granting shorter work weeks and fearing to disturb the scale of industrial wage differentials would seem to bear out Ward's contention that now all the able and influential union men are in the Government where they must work for labor against the common good.[15]

The replacing of imports by home production thereby tending toward self-sufficiency is an inclination exhibited by every nation which feels the privations caused by a disruption to a foreign source of supply. Comparative cost-conscious economists have harangued against the tendency from the time of Adam Smith but the argument that resource economy must yield to self-preservation has always prevailed. In Britain the motivation seems to be not war preparation but the belief that every opportunity for easing the pressure on the export industry--and so ultimately relieving the austerity at home--must be tried. In discussing other phases of the economy we have mentioned the efforts being put forth to increase production in sectors of industry

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15 Ward, pp. 18ff.

whose output formerly competed with or depended on imports. Crude steel and engineering equipment are two of the outstanding examples. We have also touched on the import restrictions which are designed to achieve the same end. The now familiar argument concerning tariffs applies here. If restrictions throw goods of a kind that Britain both exports and imports onto a world market, little gain is made because they show up in other places as competition to the British exports. MacDougall holds that a saving is possible if one manufactures goods formerly imported even when raw materials must be imported because the value of the raw materials is less than that of the finished product.[16] This is only true if the resources used in the manufacturing process could not be more profitably applied elsewhere. This truism is apt to be overlooked if we fail to consider the market limits for exports and the necessity for long term balance on international payments.

Certain raw materials cannot be produced in Britain and are necessary if the present living standard is to be maintained. With industry developing and with labor needed on all established fronts, efforts to produce the few specialized manufactured articles that come from abroad are not likely to be made. This leaves agriculture as the area to be stressed in import replacement plans. Imports of foods and feeding-stuffs accounted for 47% of Britain's imports in the

16 G. D. A. MacDougall, "Britain's Foreign Trade Problem," Economic Journal, LVII (March, 1947), p. 69.

immediate pre-war years and a large part of that total came from the dollar area.[17] Almost 40% of the imports from the dollar area in 1948-49 come under this category.[18] Plans call for an increase in agricultural output of 15% above the wartime peak in 1943-44. This will exceed any previous output in British agricultural history.[19] If this 1951-52 goal is reached and other areas contribute to the supply as expected, agricultural imports from the dollar area will fall about 45% and will be about one-third of the dollar area imports at the time.[20] One wonders how this contributes to the increased world trade so vital to the recovery of other sectors of Britain's trade economy. It could have a beneficial effect if English resources were utilized more efficiently in this manner and some were thereby freed to participate in other activities requiring fewer imports or furnishing exports to pay for more imports.

Let us examine this proposition. For this purpose, we can utilize a very detailed study covering production-cost ratios on English farms in 1949.[21] It seems pointless to

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17 Cmd. 7572, p. 15.

18 "Prospects of Britain's Dollar Balance," Labor and Industry in Britain, VIII (March, 1950), p. 47.

19 Cmd. 7572, p. 15.

20 "Prospects of Britain's Dollar Balance," p. 47.

21 C. H. Blagburn, "Import-Replacement by British Agriculture," Economic Journal, LX (March, 1950), pp. 19ff. This study was in preparation during devaluation and no alteration was made to compensate for the change in prices. While import cost changes may cause the relationships to change slightly, the author believes that no conclusion is invalidated.

reproduce the details but the conclusions are pertinent to our question. At early 1949 prices, £123 of indigenous resources and eleven acres of land were required to produce the import equivalent of £100 of agricultural goods. The ratio was approximately the same for the four types of farms, dairy, cash-crop, livestock and mixed. Costs were a little higher on the dairy farm but while no statistical attempt was made to relate calorie content to value, the author stated that the nutritional value of the dairy products equalized the real values. Cereal supplies, according to the survey, seem likely to reach normal world supply levels before livestock items, so savings could be best obtained by raising livestock. Since a price drop might come in grain (if normal supply-demand forces were allowed to operate) gain from livestock production would be increased. It is difficult to evaluate the effect on the general labor situation because so much of the farm labor is the immobile family type that would not be fully utilized in any other way. While admitting that world prices determine the optimum point of production, there seems little likelihood that price movements, even with the adverse effect of devaluation, will furnish economic justification for the expenditure in this field. Resources would be more productive and the volume of world trade would probably be greater if the same amount of labor and other factors were utilized where Britain is comparatively more efficient.

However, government measures include the provision of farm buildings, an increase in mechanization to about six times the pre-war level, intensified use of fertilizer, and land drainage and water supply improvements. Councils have been set up to pursue research and disseminate the results, and a program for encouraging entrance into the industry is in progress. Price controls are an integral part of the encouragement and they guarantee a definite minimum price to the farmer from eighteen months to four years in advance, depending on his product. The Agricultural Act of 1947 exacts a price for this, however. It provides for a County Agricultural Executive Committee with powers to enforce standards of good husbandry that go as far as dispossessing the inefficient farmer. Control over use to be made of farm produce is far-reaching and involves a ration system that covers the entire supply.[22]

In this field the government seems very determined to produce the planned results. Controls are complete and strict, and expenditure is generous. If one does not care to accept Blagburn's results as a testimony to the economic undesirability of the aims, it would seem that the fact that free enterprise did not develop the industry under a profit incentive would be even more conclusive evidence. The government's determination to promote such extensive agricultural production, in view of many years of pastoral concentration, seems to indicate a lack of confidence in Britain's ability to develop a sufficient trade in manufactures to support its

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22 Cmd. 7572, pp. 16-17.

populace. It disavows belief in either a large future volume of world trade or Britain's industrial future. The only alternatives in light of the activity are a condemnation of the thoroughness and rationality of the planning, or a preparation for war.

Devaluation has, as mentioned, raised import prices somewhat, particularly on some of the dollar area staples. The import price index which had fallen from 117 to 111 between November, 1948, and September, 1949, rose to 122 by November, 1949.[23] The effect on consumers is deflected by subsidies but this relief is about to vanish as Sir Stafford Cripps announced that food subsidies will be cut sharply.[24] This action will not affect total costs; in fact, the consumer will not benefit from any immediate tax cuts and will pay the higher prices. In any case, the rise in costs raises the point at which shifting of resources is profitable. It is estimated that the £123 used to produce £100 of import equivalent farm products would produce £200 of exportable manufactures if devoted to industrial production.[25] Relating this to the possibility of marketing these exports, an elasticity of demand for exports of about 2.5 is shown to be

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23 Sir Stafford Cripps, "Britain's Record," Labor and Industry in Britain, VIII (March, 1950), p. 7. 1947 = 100 in this index.

24 "Britain to Cut Taxes a Little," Milwaukee Journal (April 18, 1950), p. 2.

25 E. A. G. Robinson and R. L. Marris, "The Rise of Home Resources to Save Imports," Economic Journal, LX (March, 1950), pp. 177ff. This article assumes that all other effects of increased U. K. exports are negligible. The Blagburn article is their basis for farm produce costs.

necessary before it is profitable to shift the marginal units from home agriculture to export trades. The authors do not indicate whether they think such an elasticity exists or not. It seems probable to me that it does, but this must wait until the next chapter. In discussing diminishing returns as applied to producing agricultural output, they show that the elasticity necessary for profitability decreases as more resources are devoted to agriculture.

The same article suggests that if resources were devoted to home manufactures the marginal rate of substitution might be lower although food costs would still be a factor. This seems to me to be an excellent possibility since agriculture in Britain was considered of relatively minor importance when it had to exist under comparatively free market conditions. The least we can say is that if the world is expected to recover in international free trade, the agricultural development expenditures in Britain deserve study with regard to finding alternatives for that portion of government expenditure. This might even be a place to practice economy and thereby stimulate private enterprise with lower taxes.

The controversy between incentive and inflation in regard to profits and wages has entered the discussion in several places; therefore, it seems unnecessary to go into great detail here. Without a doubt some limitations on consumption are needed in a deficit country that hopes to export its way out from under the deficit. It also seems imperative that a currency as widely used and as widely held externally as the pound sterling must be protected against drastic inflation. On the other hand production even in a controlled economy is not obtained by turning a handle but by the individual labors of the members. Just what concessions we must make to inspire the individuals to peak effort are difficult to determine. Peacetime controls are not as conducive to peak effort as wartime controls because the criterion of "social welfare" is not as easily distinguished, by controlled or controllers, as that of "needs of war." Ideally some combination of freedom and restriction exists, that starting with given equipment, man-power and psychological values, will elicit the greatest excess of goods produced over real costs.[26]

The present British government seems to have decided that wages and industrial profits must be frozen where they are. They will substitute security for financial incentive in the case of the wage-earner and the farmer, and government money for the private investor. The decision as to the efficacy of this policy is the decision as to the validity of the socialistic principles. The problem is how much freedom shall be allowed. It seems to me that once a certain indeterminate point is passed the only remedy for a minor dislocation is added controls. No small concession to freedom will, because of the many regulations, yield the

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[26] The incentive value of real income as compared to money income is recognized as a further complication. It is particularly important in the consideration of inflation and incentive.

desired result. Whether this is verifiable or whether Britain has passed that point are two interesting questions far beyond the scope of this paper. Halm mentions, however, that one of the objections to exchange control is that it must be all inclusive to be effective.[27] This is an illustration of a field where once a point has been reached regulations seem to multiply of necessity. The many kinds of security sterling and commercial sterling with all the requirements imposed on the usage of each individual kind reveal the amazing confusion that can result from efforts to bring about a desired result through control. Security sterling, for instance, could at one time be used only for investment in securities with a minimum time to maturity of ten years, could be traded only among non-residents from the same foreign country and in the same class of security.[28] Generalizing from one case is dangerous thinking and frequently invalid but it is tempting.

It is with a feeling of guilt that I neglect many areas where government regulations and activities abound. Such aspects of policy as colonial development and nationalization of domestic industry are of the utmost importance to Britain's economy. Devaluation effects are interjected in these endeavors at many points; equipment must be purchased and output is affected. The contributions or barriers to

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[27] Op. cit., p. 138.

[28] "Sterling Since Devaluation," Economist (November 26, 1949).

effectiveness that may result from the policy practiced here are many and varied. However, only a complete and detailed survey of the Empire policies can cover everything and no verdict on the success of these programs is likely to be available for some time to come.

Export aids are necessary but the board instituted by industry for the purpose is considered to be the most helpful in this field. Agricultural development as a replacement for imports seems to be an unsound policy economically. Labor controls have been virtually discarded and incentives to increased production for both labor and capital have been replaced largely by exhortations. We shall therefore take a variation of the "all other factors remaining constant" assumption and say that "results of other government policies notwithstanding" plans seem to be numerous, detailed, tempered with political considerations and to fall far short of providing a stimulus for optimum use of resources.

As to the direction the policy is taking, there are to be two points of view. One is best illustrated by the _Wall Street Journal's_ comment on John Strachey's claim that the number of Britons receiving a take-home pay of at least $14,000 has declined from a pre-war 11,000 to less than 250 in 1949.[29] The comment: "Mr. Strachey boasts that the door is quietly shutting on the free economy in the cradle of

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29 _Time_, LV (February 20, 1950), p. 82. The total does not include those whose incomes include dividends and royalties.

freedom." The other holds that even the Labour Party realizes that socialism is doomed and that a return to free enterprise economy is both necessary and inevitable.[30] The lowered taxes and relaxed labor controls may be due in part to this attitude. It may be just another phase of planning but it involves more dependence on the decisions of private industries and can scarcely be construed as other than a healthy sign. The success of devaluation may depend on the vigor of private enterprise but the duration of the new attitude certainly seems to depend on the success of devaluation.

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30 John K. Jessup, "Britain's Road Back," Fortune, XLI (May, 1950). This article expounds the belief that socialism is fading and cites the fact that plans not as definite in Economic Survey for 1950 as in the forerunners as evidence that Labour realizes it.

Chapter V

Final Determinants: Extrinsic Factors

A. Uncontrollable Factors

The factors over which Britain has no control are perhaps the ones which will ultimately have the greatest part in determining the efficacy of devaluation. "No control" is an exaggeration when referring to foreign demand and world prices when, due to the contribution of each nation to total world supply and demand, any change in one nation affects the total. The difference in degree between the comparative domination of domestic activity (recognizing all of the limitations mentioned in previous chapters) and the indirect influence exerted elsewhere is enough to justify the expression. Three items dominate this area: elasticity of demand for British exports; the trend of world prices as they affect the British imports and exports, that is the terms of trade; the willingness and the ability of the other Sterling area countries to maximize dollar exports and minimize imports from the dollar countries. Britain must fit the pieces of the picture that she holds to the economic contour formed by these forces. For this reason they seem to be the final determinants of the course events will follow, and hence of the final resting place.

Immediately prior to devaluation there was a substantial amount of talk that held that it would not be effective.

Initially, it was based on three things: a) all production was being consumed at present prices so increased effective demand could not be supplied. b) Britain would not be able to control domestic prices in the face of increased import costs; export prices would therefore rise and in a short time dissipate the advantage. c) Price elasticities for British imports on the dollar market were statistically estimated to be of such an order that the total number of dollars received would decrease.[1] The urgency of invading the dollar market combined with the slump in exports to the dollar area invalidated the first objection. The validity of the second is still undecided. The latest available retail price index is that for mid-January and up until that time it had risen to 113, only one point above pre-devaluation.[2] A government source admits that unless raw material prices decline, some further rise is to be expected but hopes to keep the index below 118. The T. U. C. recommended that unions forego wage increases until it passes that point. The wholesale price index is up 14% since devaluation; raw materials from dollar sources such as cotton, nickel, zinc,

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[1] J. H. Adler, "United States Import Demand during the Interwar Period," American Economic Review, 35 (June, 1945), pp. 418-430, was one of these. Twenty others are mentioned by Guy H. Orcutt in an unpublished paper, Why the Statistically Estimated Elasticities of Demand for Imports and Exports Do Not Imply that Depreciation Would Be Ineffective, prepared for the International Monetary Fund. These elasticities (for U. S. imports) range from -0.97 to -0.01.

[2] British Economic Record (March 15, 1950), p. 4. The index is biased in that a policy of delaying price increases in manufactured goods using raw materials purchased at predevaluation prices is followed.

and copper have risen the full amount of devaluation.[3] The percentage of these dollar materials embodied in a product compared to the percentage of other factors whose prices have risen only slightly determines the amount of price advantage that remains. Since labor and fixed costs are, generally speaking, the greatest portion of the total cost on manufactured goods, it seems safe to assume that possibilities for "holding the line" are still good.

There seems to be evidence available for refuting the third contention logically, historically and from current information. No attempt will be made to criticize any particular set of calculations. The object is to establish the contrary possibility. Elasticity can not in any particular case or with any degree of accuracy, be predicted.[4] Any statistical calculation is in the form of an analogy. It must be assumed that the situation at the time the data was collected is related to the present situation in a manner that will permit a valid comparison, or some attempt must be made to adjust the disparities. The first alternative is unlikely to exist in reality and the second introduces an element of judgment than can and in many cases should alter the statistical derivation substantially. For instance, changes

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3 <u>Ibid</u>.

4 Much of this discussion is derived from Orcutt with some elements from unpublished papers by J. J. Polak, <u>Effect of Exchange Depreciation on the Value of Europe's Exports to the Dollar Area</u>, and Barend A. de Vries, <u>Price Elasticities of Demand for U. K. Exports to the United States, Derived from the U. S. Tariff Commission's Study: Post War Imports and Domestic Production of Major Commodities</u>. These were prepared for the International Monetary Fund.

in the amount demanded resulting from a price adjustment on imported (exported) products which compete with domestic products must take into account the measures that the domestic producers will take in meeting this price competition. These measures may take the form of price reductions, advertising campaigns, or forced boycotts. It is impossible to estimate statistically what course the competitors will take in two separate industries meeting the same situation.

One must also recognize that errors from many other sources creep into elasticity calculations and cast serious doubts on their accuracy. Some of the most important are:

1) Price changes may be the cause of a change in the quantity demanded, but the changing demand may also cause the price change, in which case a new demand curve is needed and an estimate of elasticity using the old one is useless.

2) In the case of devaluation, only a relatively few prices fall in the dollar area (those of imported articles) whereas in most price declines that take place over a period of time the whole price level shifts.[5]

3) Relative income levels at different times are another of the real barriers to absolute accuracy. This one has long been subject to concerted attack; however it is extremely difficult to separate the price and income influences in any historical situation.

4) Distribution of income among individuals and even,

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5 Some devices for taking this factor into consideration involve relating the price of the product to some price level index.

in the case of the United States, between the sections of the country, can have an effect on demand for imports that cannot be assessed accurately on the basis of past experience.

5) Errors of observation are almost certain to enter into any calculation based on measurements. These may spring from falsification, classification, or faulty methods of index construction. Orcutt indicates a belief that these errors will be from 5% to 10% and may easily be substantially greater than the range of relevant price variations.[6]

While holding the futility of calculating elasticities from observed data on the basis of the possibilities of error or bias indicated above and others, I believe that the following four propositions furnish logical ground for assuming

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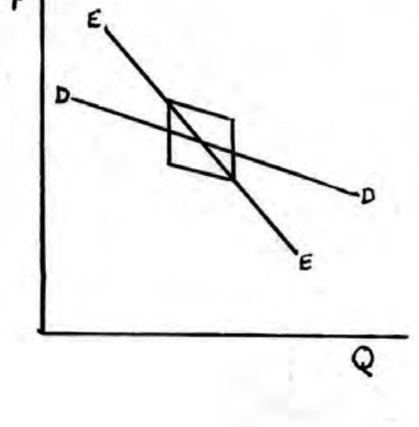
6 Orcutt, p. 12. He admits that in most cases it is impossible to demonstrate the direction of the error. If it is assumed that the errors are only in the price variable and that the quantities imported are known exactly, (which assumption seems logical with customs regulations) the "true" demand will be more elastic than that derived. Assume that DD is the line along which the "true" points will lie. The parallelogram indicates the range of the error; that is, each observed point will be the same distance to the right of the price axis as the "true" point since the quantity is assumed to be correct but the observed prices will vary in the vertical direction. Fitting the line EE to minimize the sum of the squares in the horizontal direction results in a demand schedule steeper than the real one although the degree of variation is not determinable. The illustration is also Orcutt's.



that the actual price elasticities of demand for English exports to the dollar area is greater than those generally calculated.

1. Short run elasticities are usually calculated whereas those for the long run are substantially higher. Most computations cover yearly averages, so a quantity adjustment spread over several years is chopped into small pieces. Contracts or even buying habits do not change in a short period and the public must be cognizant of the altered situation before they can act. Industrial output, both foreign and domestic must in many cases take time to adapt itself to the changed conditions in the market.

2. Demand for British exports is not usually a separate category but is a part of the demand for a product that is also domestically produced, although the consumer preference may take a sizable price change to overcome. The British share of the market is extremely small so the position of the British exporter should be analogous to that of a small producer in an industry and the demand schedule facing him should be highly elastic.[7] Their share of the market should increase in response to the price decline and the resulting production curtailment by domestic producers.

3. The price elasticity of demand for imports should be greater for large price changes than for small ones. Two

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[7] Paul G. Hoffman, E. C. A. Administrator, says that British exports to the United States are less than one-tenth of one percent of the U. S. national product. "Devaluation and the Dollar Drive," p. 163.

reasons are advanced to substantiate this statement. Consumers incur costs, both real and psychological, in making a change and a price inducement must be appreciable to motivate the shift. A jolt is necessary to disturb the psychological habit and in cases of less than perfect substitutability, some actual expense may be necessary to accommodate to the import. The differential in costs must be sufficient to justify the shift economically. This would be particularly true of machinery or chemical compounds used industrially. Secondly, concerning the aggregate imports, some products may be competitive now which were not imported previous to devaluation.[8] The interwar period is used in most elasticity studies and the price variation that was separate from income variation was smaller than the devaluation difference of our case.[9]

4. The aggregate is likely to be dominated by commodities with low elasticities of demand in the historical studies. The price changes on these commodities is likely to be the largest and they will, therefore, weight the average. This is especially true in the case where the volume of the product imported is comparatively large. It follows that while the effect of devaluation on the one product may not be important, the rest of the list may be greatly benefited.

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8 Polak, p. 5. Although the paper sponsors the case of low elasticities, he concedes that while elasticity may be small up to a certain competitive position, once the critical point is passed it may be large.

9 Orcutt, p. 14.

In the case of Great Britain, whiskey was the biggest volume item both in 1939 and post-war.[10] It also has a relatively low elasticity, primarily because the Internal Revenue Tax in the U. S. is so high that a large reduction in the foreign price per unit brings about a much smaller reduction in the total retail price in this country.[11] The total elasticity for British imports would seem to be biased if whiskey is included.

Any historical study purporting to disclose significant possibilities about the presently considered devaluation is subject to most of the above mentioned limitations. The following compilation is therefore submitted only to show that devaluation has been effective for the same country in the past.

Table 13

Trade in Manufactures During the 30's[12]

Year:	1931	'32	'33	'34	'35	'36	'37	'38
Value of sterling in terms competitors currency	100	76	76	75	73	76	83	85
Index of U.K. share of total manufactures exports	100	131	134	131	135	128	121	113
Index of volume of world manufactures exports	100	78	79	87.5	91	99	114.5	108

10 de Vries, p. 7, and "Britain's Foreign Trade," Labor and Industry in Britain, VII (September, 1949), p. 143. Whiskey constituted almost one-fourth of Britain's exports to the U. S. in April and May, 1949.

11 de Vries, p. 7. A 20% reduction in the foreign price produces only a 10% reduction in the U. S. domestic price.

12 G. D. A. MacDougall, "Britain's Foreign Trade Problem," Economic Journal, LVIII (March, 1949), p. 69. The currency

In addition to the previously discussed objections this index suffers from the fact that it covers the world rather than the dollar market, covers only one wide but undefined sector of the total trade and leads one to suspect that Britain may have been sustaining a volume of empire trade in the face of a declining world volume. However, in its favor, one can say that the world income, industry and commerce were far below today's volume and that tariff barriers in some of the principal markets were much higher at that time. Also, Britain's economy was in a stagnant period and had yet to make much progress from the depths of its decline. MacDougall claims that the study discloses three things: a) that the quantity of exports will depend on price; b) that exports are responsive to sterling values; and c) that other depreciations offset the advantage gained originally.

Informed business opinions are another bit of evidence that should not be overlooked when one is trying to determine the potential market increase for British exports to the U. S. Business men who are active in the fields invaded by British imports undoubtedly have a strong bias that shows itself in the form of exaggeration in their statements. Others, not directly affected may suffer from lack of defiite information but in each case recognition of their experience gives a validity to their opinion. When the president of a leading woolen company says, "The cards are stacked

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comparison involves 26 countries which together with the U. K. accounted for 96% of the world trade. June, 1931, is the base.

against us, no amount of management ingenuity can compete against labor rates in England which are one-third ours...," and another company head asserts that, "Devaluation will mean hard times for the American ceramics industry," it certainly seems to show a belief that price competition will be effective.[13] Of course, they do not maintain that the elasticities are greater than unity but they show that sizable inroads are expected in their market. Buyers for retailers have said that they were "preparing to increase British purchases substantially" and some opinion surveys give a strong impression that sales of imported goods are sensitive to price.[14]

The foregoing propositions seem to indicate not only that the low elasticities calculated are open to serious doubt but that there is an excellent possibility that the long-run effects of devaluation, in the absence of some form of retaliation and assuming that increased domestic costs do not invalidate it, can provide a substantially larger dollar market for British goods.

The "terms of trade" are a ratio of the volume of exports that are exchanged for a given volume of imports. They

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[13] On woolens, Julius G. Forstmann of Forstmann Woolen Co., _Milwaukee Journal_ (April 20, 1950), p. 14, and on ceramics, Leslie Brown of Lenox, Inc., _New York Times_, XCVIII (September 20, 1949).

[14] The buyer, Leo Martinuzzi, foreign buying manager of R. H. Macy & Co., _New York Times_, XCVIII (September 20, 1949). The survey, "The Market for United Kingdom Goods in the United States" by Time Incorporated, with this conclusion from Orcutt, _op. cit._, p. 4.

are usually measured by a simple ratio between an import prices index and an export prices index. It is not a function of this paper to enter the discussion of the ultimate determinants of the terms of trade or to trace Britain's cycle, though both areas are of interest. It seems rather obvious from the definition that devaluation deliberately brings about a worsening of the terms of trade with the hope that volume changes will alter the balance on current account. Because of the nature of Britain's trade, the ratio of food and raw material prices to the price of manufactures has traditionally determined the terms of trade. In fact, Kahn predicted that these terms would be favorable in the immediate post-war years because an increased volume of raw material and agricultural production would come about more rapidly than production of manufactured articles.[15] Something else apparently entered the picture because the British government said that the 1947 terms were 15% worse than those of 1938.[16] One possible explanation and an important one in that it may prevent the terms from improving in the future, is the presence of government control of exports or of farm price supports in agricultural countries. Should food and raw material prices be extensively controlled, Britain will have farther to go in increased efficiency if the pre-war ratio is to be restored. In the present situation, this may not be essential since so much of the exports from the rest

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15 Kahn, p. 282.

16 Cmd. 7572, p. 3.

of the sterling area are in this controlled group. The sterling-dollar balance may be achieved without a balance in the terms of trade.[17]

Roughly speaking, Britain's interwar balance of payments could be broken down into an empire trade credit and a non-empire trade deficit. Balance was achieved in the empire by investment outflow or invisible income and the offset in the non-empire area was the credit balance earned there by the empire (excluding U. K.). Some of the balancing transactions were between empire countries, but large amounts of rubber, tin, and other primary products went to the United States. As mentioned in Chapter III, one of the contributing

Table 14

U. S. Trade with Sterling Countries except U. K. and Canada[18] ($ million)

	1936-8 Ave.	1947	1948	1949 (5 Mo. at annual rate)
Imports by U. S.	362	993	1,113	1,056
Exports by U. S.	280	1,677	1,355	1,352
U. S. Surplus	-82	684	242	296

causes to the sterling-dollar unbalance is the disappearance of the surplus dollars formerly earned by the sterling area

17 Indeed from 1843 until 1918, Britain's prime economically, the terms of trade were unfavorable. Kahn, p. 144. If the terms were, as stated, 15% worse than 1938 and if Kahn's figure is correct, the ratio in 1947 would have been a favorable 113.3 on his index. This is a pre-devaluation figure. Data is not available for a later calculation.

18 "The Sterling Area," Labor and Industry in Britain, VII (September, 1949), p. 125.

excluding the U. K. This came about despite the fact that U. S. imports from this sector trebled.

The United Kingdom agreed, in Article V of the Economic Cooperation Agreement, to promote the production of many of the primary products, particularly chrome and manganese so that the United States might renew depleted stocks. The stockpiling in this country is furnishing an artificially large temporary market and may give rise to later troubles because of dislocation of resources in the supplying countries. However, that point is not yet reached if we are to judge by the price action following devaluation. With the exception of tin, the prices of these raw materials have risen at least enough to negate the price effects of devaluation.[19] This implies that all production is being sold at the pre-devaluation figure and the immediate effects of devaluation are neutral. In relation to Britain, however, the consequences are not neutral but positively harmful. If the dollars earned by the sales are spent in the United States by the country earning them, the unfavorable effects will be confined to the supply side. That is, in order to obtain the pre-devaluation dollar price, sterling prices were raised and the British consumer must spend more for raw materials or forego their use. If the dollars are converted to sterling, Britain will have to provide more goods to the sterling area country or, not being able to do so, will add to the substantial sterling balances now existing. A tariff reduction

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19 British Economic Record (March 15, 1950), p. 2.

by the United States would give the primary producers more dollars, thereby aggravating the short run problem.

B. Summary and Conclusion

Thus far, the paper has been an attempt to dissect the British economic body, examine the parts, trace the development of the pathologies, describe the effects of applied remedies, and suggest the way the devaluation treatment will alter each part. In the process, it has been necessary to discuss the environment and its interaction with the body and the treatment. Now we are faced with the task of reassembling the structure and judging whether the total effect of devaluation is neutral, efficacious, or harmful.

Observable results are not significant at this early date. Reserves have risen from $1,329 million on devaluation day to $1,984 on March 31, 1950; the Sterling area earned a $40 million surplus in gold and dollars in the first quarter of 1949, the first one since the war, and Britain's prices while increasing somewhat have not harmed morale or industry.[20] The first consequence is built largely on non-recurring items due to the fact that expectation of devaluation distorted trade, and on dollar aid. The second is at least partly caused by the increased industrial activity in the United States and the third is artificial in that products embodying materials purchased at pre-devaluation prices are

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20 <u>Ibid</u>. (April 14, 1950).

restricted in price. On the other hand, earnings from exports to the dollar area have not risen above the level for the third quarter of 1949, but then we have pointed out that supply and demand elasticities are not likely to be high in the short term.

Devaluation is not a panacea, nor does its very fact have long run consequences. It is, however, a very useful tool that can be used in conjunction with other materials and tools to bring about favorable results under certain circumstances. The existing situation made the measure the only alternative to the destruction of the remaining vestiges of multilateral trade, and the free world cannot afford to discard this, or any other aid to united action. Let us recapitualate the details.

1. The sterling area reserves were far below a "safety level" and trade trends indicated that they would fall farther. At some undetermined point, after foreign aid ceased, the sterling area would have to cut itself off from the hard money areas except for trade in the basic necessities and this would probably fall under bilateral agreements.

2. Production and efficiency were increasing in the United Kingdom's industrial economy, but neither the productivity nor the reciprocal demand for British products at pre-devaluation prices justified the existing rate of exchange.

3. Despite over $7 billion in foreign aid the peak of progress possible at the old rates had apparently been

passed and drastic action was necessary in order that some semblance of stability could be attained before the benefits from abroad ran out.

The devaluation does not attack all of the problems that hamper the British Commonwealth. The prospects for an early settlement of the blocked balances will be delayed further because the current earnings of the creditor nations will increase and these are currently spendable. The many problems of resource allocation that the government is trying to solve were not directly affected. Industrial efficiency received no direct boost from the new rate. All of these problems must be attacked with weapons designed for the specific battle. Some very definite benefits followed from the devaluation either directly or indirectly. The major ones are:

1. However temporary it may be, the improved reserve situation gives stability to the sterling area and removes the need for more drastic and harmful action in the near future.

2. The distance that industry must come in gaining comparative efficiency has been reduced. Markets have been literally created in hard currency areas although effort must be exerted to exploit them. Incentive has been provided for the industry to export and the prospective elasticities indicate that the final result will be more dollars for United Kingdom.

3. England made her outstanding concession to multi-

lateral trade. The danger of losing the foreign aid was not as great from failure to devalue as it is from the restrictions that are incident to devaluation and this should have been foreseen. Any alternative would have required a more drastic curtailment of international trade.

4. The devaluation had a psychological value in that it brought the seriousness of the situation to public notice and caused all sectors of the economy to re-survey the problem. This effect may result in a better atmosphere in the blocked balances area and a renewed determination on the part of the British people.

One must acknowledge that a stable economy and a willingness to import in the United States are probably greater contributions. However, Britain cannot control this area and in any event devaluation increases the benefit to be derived from a strong U. S. market and the likelihood of obtaining it. Also, the fact that price increases in the British market may offset the effect is not an indictment of devaluation but a recognition of the inability of the British economy to reach a competitive level in the near future. It is hoped that the Labor government can provide the program that will lead Britain "out of the woods" but again the failure to devalue would add no path to those available now, but would in fact remove some. In comparison to the gains, the dislocations mentioned in the body of the paper are minor.

I reiterate, devaluation was strongly indicated under the circumstances, provided several distinct benefits and did not prevent any recommended measure from being tried. Any other indicated remedy would have called for immediate, relatively permanent realignment of world trade with an accompanying serious decrease in volume. "Given the present political divisions of the world, to recommend autarchy as a general policy is to recommend war as an instrument for making autarchy possible."[21]

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21 Lionel Robbins, Economic Planning and International Order (London, 1937), p. 321. Even though the statement was composed thirteen years ago, it seems apropos--possibly even more so with the intervening experiences.

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