

British economic policy since the war

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a critical review of Andrew Shonfield's New Penguin

DEFLATE or inflate!—that is now the question. What are we worrying about—keeping the balloon up or stopping it from blowing away? We can bring it down with ropes of all sorts but what sort of gas is needed to keep it up? "We cannot be an island of inflation in a deflationary world," says Mr. Macmillan begging all the questions. Is there in fact no way of maintaining a degree of inflation against a background of world deflation which looks uncommonly like developing into a depression? Can Britain not offset the recession elsewhere by her own expansion? If we expand, must this mean a Balance of Payments crisis because the import bill gets out of hand? Can Britain in any case afford to deflate if this means stagnation? Is British competitiveness not reduced more by running industry well below capacity than by granting wage increases?

Everybody is having a go at giving answers. Professor E. A. G. Robinson¹ approves of the Prime Minister but says we must be ready to act promptly, and in the meantime expand public investment a little and call for concerted international action to stem the recession. He has the rather confused support of *The Times*.² Roy Harrod thinks that "It is doubtful if inflation is still the danger. With a gathering world recession we shall shortly have other and more serious problems to be concerned with."³ Alan Day thinks that everything depends on what happens next in America.⁴ Certainly, Britain has so far not felt the full impact of the U.S. recession nor of the general deflationary mood in Western Europe. Most of the repercussions in reduced earnings of primary producers and reduced trade throughout the world are still to come, although the first signs are already apparent. It is an excellent moment to review the scene and take a good look at the economic policies which have been pursued since the war.

Andrew Shonfield has just taken a very good look at them in his new Penguin,⁵ which should start a radical discussion among all those who are seeking for an alternative to the present Government policy. The aim of this extended review is twofold: first, to summarize at some length Mr. Shonfield's facts and arguments, because they draw attention so clearly to most of the main problems and because they suggest many of the critical decisions that have to be made; and secondly, to put forward certain basic criticisms of fact and analysis, which it is hoped will provoke further discussion and thought. Much of the thinking of this review arises from material which has been prepared for the V.F.S. Working Party on Planning and Controls and for an U.L.R. Pamphlet on Controls in a Mixed Economy, which will be published in the summer. But for the opinions here expressed the writer alone can be blamed.

II

It is the great merit of Mr. Shonfield's book that he starts from one of the contradictions that lie at the heart of contemporary British capitalism. Expansion at home in production and investment, so necessary to raising the real wealth of the people and maintaining Britain's competitive position in the world, has regularly led since the war to deficits in

foreign payments, as extra imports are drawn in to feed the expansion. The Balance of Payments crises have then been remedied by cutting back home investment—as in 1949 and 1951 and in 1955, 1956 and 1957—and by overall deflation and stagnation of the economy since 1955. As a result total net fixed investment in Britain since the war has been at a lower level than in any other European country—5 to 7% of national product compared with 20 to 22% in Norway, Finland and Eastern Europe, 15% in West Germany, 12% in Italy.⁶

A low level of investment means a low rate of expansion. Production in Britain after 1948 rose on average by about 3% per year up to 1955. (In fact in all years except 1951 and 1952 the rise was between 4 and 5%.⁷) Meanwhile average annual production increases elsewhere in Europe were at around 6% or double the British rate, and Western German production after 1951 was growing at nearly three times Britain's rate.⁸ It is not perhaps surprising that British manufactured goods have been winning a steadily declining share of the world's markets—25% in 1948; 18% in 1957.⁹

In production of petrol, chemicals, aircraft, motor cars and atomic energy the rate of investment has been much above the average and the results in the expansion of Britain's exports in these fields are clear. By contrast the outstanding case of an industry with a low rate of investment is the shipbuilding industry which produces no more than in 1913 and has been recently overtaken by Japan in volume of output and by Germany and Sweden in speed of output.¹⁰

The U.K. investment boom after 1954, which raised the overall rate of net investment from 5% to 7% of the national product, advanced the rate of purely industrial investment from about 3% to 4% of national product.¹¹ This was still much below most continental rates but the effect on the British Balance of Payments in 1955 was catastrophic: imports leapt up far ahead of exports; there was a current account deficit of £80 millions and a flight of capital from Britain; and ever since Government policy has been to deflate the whole economy in order to keep the import bill down. Is this necessary? Mr. Shonfield believes it is not.

Who takes too much out?

He examines the oft-repeated cry of Government spokesmen that "we are trying to take more out than we put in." He concludes that neither Consumption (the Dockers and the Hoggers), the Social Services (the Welfare State) nor Administration (the Bureaucracy) have been running at a higher level than elsewhere in Europe. What Britain has spent far more money on than others have been defence, overseas military expenditure in particular, and foreign investment. These two have taken nearly 10% and nearly 2% respectively of the national product every year. The overseas investment figure is unique in Europe and the defence figure compares with an average of around 6% for the other European N.A.T.O. countries.¹²

In Mr. Shonfield's Chapter Five on the Source of the Strain, he describes the extraordinary lack of consultation with Parliament or the nation, the apparent absence of any

appreciation of the costs involved, in short, what he aptly calls, the "insouciance" of British Governments in taking decisions on military expenditure. He cites the £1,500 million rearmament budget after the Korean war broke out, the manufacture of the H-bomb, the development of V-bombers to carry it, the building of a huge new Middle East base in Cyprus (*hinc illae lacrimae!*), the commitment under Western European Union to maintain four British divisions in Germany with supporting air power for 50 years, the attack on Suez without U.S. support, the recent decision to rebuild the air base on the Maldive Islands. All these are examined with ruthless logic and much amusing inside information. And the decision is reached that the whole vast network of overseas bases and the overseas military expenditure, which amounted in 1957 to £178 millions, must be pruned to a figure more in keeping with Britain's present resources.

The one or two per cent of the national product devoted to overseas investment Mr. Shonfield regards as even more deserving of a cut. The pattern of Britain's Balance of Payments has changed completely since before the war. Today exports cover a good 90% of the import bill instead of a little more than half, as before the war. Net income from overseas investment rarely amounts to more than five per cent¹³ of the value of imports and yet a Balance Payments surplus available for new overseas investment has been achieved each year since 1949 except in 1951 and 1955 of the same order as in the best years after the First World War. Then at the same time investment income regularly covered a fifth of the import bill.¹⁴

Strengthening the £—to what end?

Mr. Shonfield proceeds to enquire quite shamelessly into the grounds for worship by all Conservative chancellors of the sacred cow of the £ sterling, that is of maintaining the sterling area and a Balance of Payments surplus for overseas investment. "There is no doubt," he says,¹⁵ "that the Government has allowed its domestic policy since 1955 to be determined largely by the movement of international confidence in the £ sterling. It is the thesis of this book," he goes on, "that such a situation is both tragic and absurd and that a means of escape from it must be devised." For, strengthening the £ in every crisis has meant cutting investment and since 1955 deflating the whole economy as well.

Something needs to be said here of the sterling area today, although the writer has described its operation in some detail in another place.¹⁶ The Sterling Area is not merely an economic soubriquet for the Empire, in which Britain gives certain, now much reduced, preferences to the products of her primary producing partners and obtains in exchange some, still important, privileges for her goods in their markets. The Sterling Area of today is primarily an economic club, mainly of Commonwealth countries (without Canada), in which capital can move freely, trade is carried on in sterling, and gold and dollar earnings are mainly pooled and usually spent according to certain rather ill-defined rules of the game. Britain is the Area's banker as well as chief trader and, while holding and paying interest on short term deposits (the sterling balances) of some £3,500 millions, lends long term up to a figure of £150 millions a year as well as providing sizeable grants for colonial development. Mr. Shonfield challenges the usefulness of the whole system and particularly the high level of overseas investment.

The main argument for keeping the Sterling Area together is that, through the common pool of gold and dollars, Britain obtains the hard currency necessary to balance her dollar account which would otherwise be in heavy deficit. Mr.

Shonfield answers this one by showing that Britain's dollar gap is today of the order of £100 millions, which could easily, he avers, be covered by sales for gold in South Africa and elsewhere without recourse to the dollar pool. There is some truth in this but the whole argument needs examining more closely and this we shall do later. It is certainly true, as Mr. Shonfield says, that the dollar pool has worked to pass the dollars earned by the Colonies and the gold mines in South Africa to the other Dominions as much as to Britain. It is even truer, as he also makes clear, that the future availability of these dollar earnings is most uncertain. South Africa in fact already controls its own gold sales and does not leave them to be managed by London. Malaya and Ghana, the main dollar earners, are now independent Dominions and will undoubtedly henceforth assert their desire for spending more of their dollar earnings on their new development programmes.¹⁷

Mr. Shonfield goes further—to question the basic assumption of Marxists and capitalists alike, that overseas investment is more profitable than home investment.¹⁸ The average return, for example, on loans to overseas governments and municipalities held by U.K. residents is around 3% only. And he makes a good point in another place that the sale of such stock during the war to pay for supplies before Lend Lease began was not the great loss it is often said to be.¹⁹

Does overseas investment pay?

But most overseas investment is of course company investment and there the rate of return is higher. Mr. Shonfield quotes the Bank of England survey for 1955 as showing an average return of 14% on nominal capital,²⁰ which he estimates must be less than 10% on actual capital value. This can be little more than the 8% which he calculates as the average rate of net profits on home industrial investment. The oil companies' investment he considers as an exception but the investments in tin, copper and other overseas mining companies (excluding gold mines) should surely form a further exception? In these mining companies net profit (after deducting taxation and depreciation) as a percentage of capital assets and reserves was recorded as 28% in 1956-7 and 44% in 1955-6 compared with 13% for home industrials.²¹ Other overseas raw material producing companies, according to the same survey, generally show earnings no higher than those of home industrials, but oil and mining together account for three-quarters of the capital in overseas raw material production—itsself a large part of total U.K. capital overseas. Mr. Shonfield's major point is, however, correct, that from the point of view of the nation the value of this overseas investment to Britain is much less than if it were invested at home in improving plant, machinery and essential services.

The second argument in favour of overseas investment and the maintenance of the sterling area concerns the earnings that accrue to Britain not merely directly in net investment income—this we have seen to be no greater today than the value of each year's new investment²²—but indirectly through the city's earnings as part of the whole sterling system. These earnings Mr. Shonfield examines in some detail setting them at around £125 millions (£30 millions merchanting, £25 millions banking, £40 millions insurance and £30 millions shipping brokerage).²³ That is somewhat below the estimate given in a broadcast talk in November 1957 by Mr. John Wood²⁴ but well above Mr. A. C. L. Day's estimate of £20-£30 millions in an earlier talk²⁵ which had provoked Mr. Wood's reply.

It is not hard for Mr. Shonfield to show that the cost of these earnings is far in excess of the earnings themselves—that is the cost of the overseas lending necessary to the whole

sterling operation, the huge sums that have to be paid to holders of sterling (an extra £100 millions when bank rate is raised from 3% to 7%) and the constant threat of withdrawals and delays in payment (the difference between "leads and lags" which may easily amount to a run of £100 millions on the gold reserve as we saw in 1957) whenever confidence in sterling falls. For, to make sterling attractive to hold it has not only to be virtually convertible into hard currency, that is for non-U.K. residents; it has also to earn a high rate of interest. It is this which has been determining domestic policy. Yet, as Shonfield points out, many of the City's services—brokerage, insurance and some of the merchanting—would still presumably be required by foreign traders even if overseas investment were cut and sterling ceased to be maintained as an international currency able to look the dollar in the face.

Mr. Shonfield concludes that the whole attempt to re-establish sterling as the major if not the only world currency is part of the grandiose attempt to re-create a past that is gone forever. The attempt to do this in the 1920's by returning to the gold standard at pre-war parities was ruinous alike to Britain's domestic recovery and to her foreign trade.²⁶ Fortunately, after the catastrophic experiment in convertibility (i.e. convertibility of sterling into all other currencies including the dollar) in 1949 by the Labour Government conscientiously, if quixotically, carrying out the promises of the Keynes loan agreement,²⁷ the City's attempts to restore full legal convertibility have so far been thwarted. Some small vestiges of control over the currency still remain in Government hands. The last fatal dose of Tory freedom has not been administered.

Labour Controls and Tory Freedom

A large part of Mr. Shonfield's book takes the form of a historical study of Labour and Tory economic and financial policies with a special chapter on the crisis of 1955 which he calls the "climacteric." He shows how the Labour Government abandoned earlier conceptions and much of the war-time practice of overall central planning of the country's resources but retained many of the more irksome forms of rationing and control often without any clear *raison d'être* therefor. He suggests that with fewer controls and more confidence in the power of Government persuasion a greater influence could have been exerted over the decisions of private businessmen. His main conclusion is that clear knowledge of what it wants to do is what a Government needs most. He therefore gives much praise to the Labour Government first for its orderly carrying through of the transition from war to peace, second for its success in forcing the steel industry to expand its capacity and production in face of the threat of nationalization, and third for committing the motor industry to expand exports by allocating sheet steel according to export performance.²⁸

Mr. Shonfield is, rightly, extremely critical of the raw material quota and rationing schemes for industry that were based on nothing more than pre-war consumption levels and therefore put a premium on size and long standing in what became "a new economic feudalism" and thus discriminated against youth and innovation.²⁹ More controversial is his suggestion that the continuation of food rationing and subsidies in the interests of a theoretical economic equality among citizens was positively harmful to the economy because it encouraged inefficiency among producers by guaranteeing prices (what happens to farmers today?) and also because by releasing incomes for spending on luxuries, it encouraged luxury imports and distortion of investment from essential to inessential products.³⁰

Mr. Shonfield's main criticism of Labour is of the failure positively to encourage investment in manufacturing industry. In extenuation, he makes an interesting suggestion that the Labour Government was grossly misled by the statisticians into believing that investment in the U.K. had been raised to a level 50% above pre-war and that it was about the same as in the U.S.S.R.—at a rate, that is, of about a fifth of the national product per year. In fact the British figures being quoted were inflated gross investment figures including repairs and maintenance as well as depreciation, while Soviet figures were net. Therefore, when Sir Stafford Cripps in 1949 and Mr. Gaitskell in 1951 cut back investment, they thought they were cutting a high figure rather than a figure that was already low compared with investment rates being attained elsewhere in Europe.³¹

Sacrificing home investment

Mr. Shonfield's main onslaught is against the Tories for sacrificing home investment to the sacred cow of overseas investment and the re-establishment of the international role of sterling. In the historical chapters he goes on to make a whole number of interesting and provocative points. Starting in 1951 and 1952 by imposing stricter controls and restrictions on imports, on hire purchase, on new building licences, on engagement of workers and on bank credit, the Conservatives then used their long run of luck, in the shape of the falling world prices of Britain's imports, to carry through their counter-revolution to a *laissez-faire* economy. In so doing they went far further than they had perhaps intended, led on by the pressure of the bankers and the Liberal economists and above all, Mr. Shonfield suggests, by the Treasury, which thought to find doctrinal justification for the new Government policies.³² Even the traditional Conservative conception of paternalistic Government intervention to moderate the free-working of market forces gave way to the slogans of "Tory freedom" and of the "neutral state" arbitrating between the employers' Confederations and the Trade Unions. As Mr. Shonfield adds, this has meant that in the final analysis it is left to organized labour to decide on the level of economic activity that is appropriate for the nation at any time.³³

As we have seen, however, the Tories have held back from the final step of freeing the £ and undermining the whole basis of the Welfare State and full employment by full-blooded deflation in a final "dash for freedom." Part of the trouble has been, as Mr. Shonfield shows, that the monetary mechanism just does not work. Raising the bank rate did not in fact check the investment boom of 1954-56 nor noticeably reduce the stocks held by businesses.³⁴ In the end the Government's deflationary policy only succeeded when direct instructions were issued to the banks to reduce credit—much against their will. And it was then that they began to demand 7% as their price. Another example is that imports of steel were only checked when discriminatory hire purchase terms were imposed on cars and other metal products. Only against strong Treasury opposition was the pure doctrine of *laissez-faire* thus sullied.³⁵

Mr. Shonfield makes an excellent point that, since deflation began at length to work and the stagnation of production has increased unemployment, price stability at whatever cost in national wealth has become an end in itself. The intrinsically contradictory policy of deflation by raising prices³⁶ (including rents) has reached its own nemesis in the deadlock of the Government with London's busmen, the railwaymen and the dockers. For no one can expect workers not to claim wage increases if prices continue to rise (another two points in April 1958) and no one believes that the cause of inflation

is an excess of demand when industry is working very much below capacity. Nor can Britain hope to compete in a European Free Trade Area, with large sectors of her industry still in a hopelessly backward condition and her transport system once more deprived of the necessary capital to bring it even nearly up to date.

Mr Shonfield's five-year plan

On the basis of this analysis Mr. Shonfield makes certain important proposals. His aim is to expand domestic investment and production. He therefore advocates a five-year plan for investment with targets laid down by Parliament and the strongest Government pressure exerted, combined with large scale tax incentives, to make private businesses fulfill the targets. Mr. Shonfield gives first priority to increased and improved production of steel and machine tools and to the modernization of road and rail transport. To meet the inevitable Balance of Payments difficulties that would follow he proposes a five-year stop on overseas investment effected through capital export controls and through discriminating intervention against British companies operating overseas instead of making concessions in their favour as in the 1957 Budget. In addition, he would make heroic cuts in military spending; he would obtain loans from the U.S.A. and the E.P.U. and would give liberal encouragement to foreign investors and particularly to U.S. investors in Britain.³⁷

To improve the apparent strength of the British economy in international eyes and check the fall of confidence in sterling, which this policy would produce, he proposes revaluing Britain's sterling debt of £3,500 millions at market instead of nominal prices and including Government and private investments in the dollar area (at their market values) in the published figures of Britain's gold and dollar holdings. Support for the £ in international markets would stop, foreign exchange controls would be introduced and sterling balances would once more be blocked. At the same time, short term sterling credit provided to foreign traders would be tightened up and credits obtained from them for our exporters. "In the last resort," says Mr. Shonfield, "there are worse things than devaluation; stagnation is one of them."³⁸

A large investment programme at home would inevitably lead to some degree of inflation. There is nothing to fear in this, Mr. Shonfield believes; but to prevent inflation getting out of hand, a wage freeze with a scheme for deferred credits should be introduced. To carry the proposal through he would like to see the T.U.C.'s power strengthened by remodelling on the pattern of the more centralized Swedish movement. And to deal with the inevitable and desirable growth of private capital wealth resulting from such an investment programme, while wages are frozen, Mr. Shonfield proposes a capital gains tax when the investments mature.³⁹

III

Here, where Mr. Shonfield's book ends, is where the problem surely begins? Capitalists can only be encouraged to invest by the expectation of increased profits from their investments. Will they invest if they are going to have a capital gains tax imposed at the end of the period of investment? Those who argue in favour of such a tax suggest that investment decisions are largely made today by the directors of the great corporations with huge reserves ready to devote to investment when they think the time is appropriate. A capital gains or wealth tax, being a tax on personal, and not on corporate, incomes, it is argued, would only affect the incentive to invest through the small firm that invests the private wealth of its owners. It is, however, **still true that**

even the largest corporations raise capital on the capital market and many financial commentators—Mr. Harold Wincott for one—never cease complaining that it is high taxation that keeps down investment.

But there is a further point. Capital gains take place in a boom before rather than after the investment has come to fruition. Here the other side of the problem is revealed. Wages are to be frozen, according to Mr. Shonfield, and some system of forced saving introduced while the investment boom pushes up prices and share values. This is surely to ask the impossible of the wage and salary earners—to defer their benefits from the new investment while investors enjoy theirs immediately. The whole problem reveals the contradictions inherent in capitalist expansion which Mr. Shonfield throughout his book has tended to skate around.

His five-year plan for increased investment rests upon the expectation that tax concessions plus a wage freeze will be adequate to encourage capitalists to invest. One is bound to ask whether this is realistic, particularly in a recession such as the present, after what has been a period of some fairly substantial reinvestment albeit held back by Government policies. Many industries are already running well below capacity and if the current boom in motor car production were to be checked just as the new capacity of the motor industry and its suppliers is coming into full production it is likely that something much more than tax concessions would be needed to stimulate another round of investment.

A wage freeze, apart from its overwhelming political implications, carries with it serious economic problems. For, while keeping costs down, it is bound also in a period even of controlled inflation to reduce demand for the goods which the new investment will produce. And any reduction in demand in the shops, unless it be offset by a great expansion in export markets, is bound to hold industrialists back from launching new programmes of expansion. This is the essential contradiction for which Mr. Shonfield's proposals just do not provide a solution. Capitalists only expand when they can see good expectations of increased sales. A wage freeze while ensuring the means for expansion in the form of increased profit expectations removes the justification for expansion by reduced demand expectations.

How much Government action?

Much of the expansion in the British economy since the war has been the result of Government action, through defence orders and through the nationalized sector—atomic energy, coal and road, rail and air transport. In 1956 when private investment was at its highest post-war level, the public sector still accounted for 44 % of gross capital formation at home. Between 1951 and 1954 the figure was between 50 and 60%, compared with 30% before the war.⁴¹ Indeed it is this high level of Government "below the line" spending which has been criticized for its inflationary effects and which has been severely cut back in the Government's latest measures of deflation. With these figures in mind we can see that to create the expansionary atmosphere that Mr. Shonfield wants would require a very high level of Government spending. And of course this could be very inflationary indeed and create demands for imports that would soon repeat the 1955 crisis, Mr. Shonfield sees the danger of this and is quite prepared to reimpose an allocation system for raw materials together with exchange controls but not apparently import controls, though it is hard to see how these could be avoided;

What all this amounts to is the abandonment of Tory freedom and the growth of Government intervention in industry on a major scale. Mr. Shonfield seems prepared for

this but is somewhat shy of tackling the implications. Raw materials allocation alone, unless tied to some specific plans in terms of output or exports like Sir Stafford Cripps's allocation of steel for motor cars according to export performance, would be merely negative and restrictive. But specific plans, let alone Mr. Shonfield's five-year plan, mean planners and something more than the present remains of Sir Edwin Plowden's planning unit in the Treasury now under the surveillance of an ex-diplomat, Sir Roger Makins.⁴² And such planning and operation of necessary controls, particularly in pursuit of a policy that will be opposed by the merchant bankers, implies a much stronger Government hand in the Bank of England. This was an important lesson of the Parker Tribunal as Dr. Thomas Balogh has forcibly pointed out.⁴³

Does such an investment plan not also mean direct control, over the steel industry at least if not over other private sectors of the economy?⁴⁴ These things Mr. Shonfield leaves at the end of his book to be worked out according to whether a Labour Government carried through the investment programme with "more active State intervention" or the Tory Government "using the profit motive in active and flexible fashion."⁴⁵ The phrases have an air of disingenuousness. We have already suggested reasons for believing the second alternative to be impossible from rather theoretical economic considerations. The steel industry gives us a practical case which has been most thoroughly examined by Mr. John Hughes.⁴⁶ Mr. Shonfield accepts the necessity of very much larger imports of basic materials—"steel being the outstanding case."⁴⁷

There is certainly no margin of steel producing capacity for a programme of expansion. Only the last two years of stagnation of industrial production have allowed steel output just to catch up with home demand. Moreover it is not planned to have such a margin. If, and it is a big if, the two major steel firms, United Steel and Stewart and Lloyd, go ahead with the plan for a new plant to use home ores, this is not intended to be operating until "some year" after 1962. And this is the plan that was originally projected in 1945! Yet the steel companies have been permitted to raise prices by nearly 30% between July 1955 and August 1957 and have increased profits by 53% per ton between 1945 and 1957.⁴⁸ That is two or three times the general increase in trading profits in British industry during the period. Yet the rate of investment has remained low. The steel experience does not suggest that use of the profit motive even in "an active and flexible fashion" will get the results Mr. Shonfield wants if private industry is left to make its own estimates of future demand.

Who wants overseas investment?

The greater part of Mr. Shonfield's book is concerned with foreign economic policy and this attention to the effects of overseas investment and of the defence of sterling upon home investment and production is of the greatest value. But the contradiction between home and overseas investment is itself a symptom of deeper contradictions. Why does British capital seek investment opportunities overseas? Why do British Governments support the international strength of sterling at the cost of stagnation at home? Mr. Shonfield believes that it is not in the main a search for higher returns on capital, but that it is rather a hangover from a grander past with little thought given to the cost of being a great power in the modern world. If only, he argues, British capitalists would see what is best for the nation (and therefore it would seem to follow for themselves too) and abandon these ridiculous illusions of grandeur, all would be well. Mr.

Shonfield is clearly aware that national and private interest may conflict. In speaking of overseas investment he writes: "The first point to notice is that this is not just a matter of comparing the dividends paid out at home and in overseas investment. That is of course the investor's personal criterion. But the national interest does not always correspond to it."⁴⁹ This clue is not however followed up.

We have already suggested earlier that much overseas investment—in oil and mining—is undoubtedly more profitable than home investment. So also the interests of the City in the sterling system are very real interests and not merely Quixotic. From the national point of view the balance of profit and loss may seem to weigh against the whole sterling operation. It cannot be expected, however, that, if those who benefit from the profits do not also pay for all the costs, they will do the arithmetic in the same way as the great majority of taxpayers who pay for the costs but see little of the profits.

There is a real contradiction here also for Britain between the role of international banker and trader, which Mr. Shonfield touches on in a brief historical survey at the end of the book⁵⁰ but does not bring into the centre of his argument. It is not merely, as he suggests quoting Prof. Arthur Lewis, because we concentrated on selling steel and cotton in overseas markets at the turn of the century with the aid of overseas investments, while Germany concentrated on developing chemicals and engineering sales in European markets that Britain fell behind in the industrial race. It was, surely, even more because the returns on British investments overseas began to exceed by far the level of new investments and so impoverished the overseas markets that they could no longer afford to buy Britain's exports. Our imports were paid for increasingly by income from past investments to the permanent detriment of Britain's export industries and investment at home.⁵¹

The point becomes clearest if we look at the 1930's. Then the collapse of the prices of primary products from overseas combined with the steady flow of investment income from overseas made possible a steady if slow rise in the national income at home and even in real wages of the employed.⁵² But this was achieved at the expense not only of overseas producers but also of unemployment at home, especially in the export industries, both of manpower and of equipment, and so led to the running down of the nation's whole technical development. In the end, even the slow rise in national income and in the real wages of the employed was checked and only recovered in the rearmament drive immediately preceding the outbreak of war.

The role of the Merchant Bankers

There are, nevertheless, very real interests involved in the maintenance of overseas investment and in all the banking and other services connected therewith and with a strong £. First, there is the merchant bankers' interest. They are the people most concerned in the earnings of the City of London which Mr. Shonfield proposes to cut by reducing support for sterling as an international currency. Their interest in overseas investment and in financing international trade in sterling does not now necessarily mean that they are primarily concerned whether British trade expands or even whether the general level of world trade expands, as long as their share of trade financed by sterling expands. When sterling was *the* world currency there was no such conflict of aims. It may be suspected that Mr. Shonfield rather underestimates the cut in their earnings that would be involved by reducing the area of operation of the £ sterling and spoils his case by so doing. The tremendous pressure on the Government to protect sterling at all costs suggests that the Josses from not

so doing are regarded by the bankers as likely to be serious.

It is a surprising omission in a book which takes the post-war story up to the end of 1957 and indeed into 1958 that there is no mention of the revelations at the Parker Tribunal in December 1957. For what was, in part, revealed was the key role in the British economy played by the merchant bankers whose representation on the Court of the Bank of England is so strong.⁵³ It is clear that it was the Bank which pressed the Government ("stampeded" is how the *Statist* described it) to raise the bank rate to 7%, partly no doubt because a credit squeeze without a "swingeing" bank rate gave the bankers the worst of both worlds and partly because of the determination at all costs to make sterling more attractive.⁵⁴ The bankers cannot however have been alone in pressing this policy on the Government. Some industrialists, particularly those with an element of monopoly who are engaged in processing imported raw materials (and they also sit on the Court of the Bank of England), may gain from deflation and subsequently lower raw material prices even if the corollary is reduced markets. For they may reckon to pick up a larger share of a reduced market as well as making higher profits on turnover.

Raw materials monopolies

The 1930's are indeed marked by the emergence of such near monopolies in Britain—Unilever, I.C.I., Imperial Tobacco, British Distillers, Tate and Lyle, and the giant oil combines—all of whom have major imperial and overseas interests. By contrast the industrialists, who produce capital equipment and for whom the price of raw materials is a minor element in costs, will think differently. For them working to capacity is essential, with the corollary of expanding markets, including export markets, to which a third of Britain's engineering output now goes. There are not many sectors of engineering where monopoly is important and even where there is an element of it, as in electrical equipment and motor cars, the conditions of production favour trade expansion rather than restriction. It is not at all surprising that the two voices among the giants of British industry which have sounded most restive under the recent Government policies of deflations have been those of Lord Chandos of A.E.I. and Mr. Stedeford of Tube Investments.⁵⁵

Of course arguments may well occur inside individual companies between advocates of the two points of view. One cannot divide up industry neatly into those who support the bankers and those who want to expand. It is a nice exercise in armchair imagination to construct an argument between the directors of United Africa pushing their sales in Nigeria and their colleagues in the Purchasing Departments of Unilever who have succeeded in cutting the prices paid to the Nigerian vegetable oil producers! It is indeed here that the special role of the merchant bankers on the boards of all the greatest industrial corporations in Britain becomes so important. For it is just in the sort of argument we have suggested above that the banker's voice may be decisive on the board of directors. It is not enough here to say that the bankers are a hangover from the past with their overseas interests and all. The contradictions they are trying to solve are real ones and cannot be solved simply by reducing the power and influence of the bankers. The very heart of this contradiction lies in the nature and terms of overseas investment and in the relations of Britain with her colonies and ex-colonies.

Mr. Shonfield mentions that more than half of U.K. post-war investment has been in South Africa and Australia.⁵⁶ He does not mention that a high proportion of this has been in real estate and has contributed little either to increasing

sterling area production of dollar saving raw materials or to expanding industrialization and so raising the demand for U.K. exports.⁵⁷ He speaks in several places very scathingly of the "extravagant" development programmes of the sterling area members which are making such demands on British capital that domestic investment is neglected. This whole pattern of relationships needs, however, to be sorted out much more clearly. He dismisses as "luxurious national self-mortification" the conception of Britain exploiting her colonies. "On ordinary commercial account," he says, "Britain has an almost embarrassingly large current surplus with all the colonies taken together," amounting in 1956 when Malaya and Ghana were still colonies to £180 millions. This is only reduced, he points out, by annual British military spending in the colonies of rather more than £100 million and by direct grants of £30 millions.

If this picture of a large British payments surplus with the colonies had been true in general since the war, British colonial relations would indeed have been different. The colonies could not possibly have increased their holdings of sterling balances in the U.K. between 1945 and 1955 threefold to a figure of over £1,300 millions, reflecting an average annual surplus in favour of the colonies of over £80 millions. This meant that in fact the colonies were lending to Britain on short term sterling that was then available for long term investment by Britain elsewhere.⁵⁸ This process was only ended with the raising of short term interest rates to punitive levels after 1955. Mr. Shonfield regards the sterling balances as a valuable nest-egg for the colonies' future development. This indeed they are, but the problem of the colonies has been that the ultra-conservative banking policy of the currency boards has required that currency issues in the colonies be covered £ for £ in sterling.⁵⁹ This is the sterling exchange standard which has undoubtedly held back economic development by the normal modern means of central credit expansion. Independence in Ghana and Malaya has now led to the pursuit of a more flexible policy by the currency boards in their case.

The commercial account

Moreover, what Mr. Shonfield calls the commercial account with the colonies on which the U.K. achieved a £180 million surplus in 1956 includes items which are not in fact goods and services but are net incomes flowing into the U.K. from investments and oil operations. These totalled in 1956 some £70 millions and it is ironical indeed that this figure, which is precisely the sum of what might be called "the exploitation," should be included in the balance to prove that there is an "embarrassing surplus" and no exploitation. It is true that even excluding all non-trading items Britain had a surplus with the colonies of over £100 millions in 1956 and an average surplus of over £60 million between 1953 and 1957.⁶⁰ But on their other accounts—E.P.U. and dollar—the colonies maintained a large surplus, which was all booked into the sterling balances.

The point is of course well made that the £70 million investment income from the colonies now falls below the £100 million of military expenditure in the colonies and this suggests that the whole operation was not worth the cost. But, as we have already commented, this would only be the case if U.K. taxpayers received the benefits in proportion to their tax payment. Furthermore, Mr. Shonfield's analysis of Britain's oil operations, while revealing the military cost of the succession of Middle East and African bases and of the Suez war, does not show the very large trade deficit that the U.K. runs every year with the oil states to the extent of some £150 millions.⁶¹

In this whole calculation of profit and loss on colonial trade the point that tends to be lost sight of is that the ability of the colonies and ex-colonies to import from Britain provides powerful support for Britain's export trade. Indeed in 1956 the colonies were taking 13% of U.K. exports compared with 8% pre-war⁶² and were providing in 1958 some protection against the world recession.⁶³ In conclusion, it must therefore be said that what is wrong with Britain's overseas economic relations is not the high level of investment. Indeed it could well be argued that an annual rate of overseas investment of £150-£200 millions, even compared with home investment of about £1,500 million, is a small price to pay for annual exports of £3,500 millions. What is wrong is the nature and direction of the investment, in real estate in South Africa and Australia and in portfolios in the U.S.A.,⁶⁴ instead of in underdeveloped lands where the investment could expand production and incomes and so guarantee markets for Britain's exports.

Britain's need for Expansion of Trade

This is the part of the foreign economic problem which Mr. Shonfield never really gets to grips with. Britain's livelihood depends in substantial measure on machining and processing imported raw materials for sale all over the world. It is not simply that we have to import more than half of the food we eat and two-thirds of the raw materials our industries use and are therefore forced to export to pay for these imports. It would be possible greatly to increase home food production and reduce the whole level of industry and so of raw material as well as food imports. Nor is it true, as Socialists have sometimes maintained, that capitalists make higher profits in the export market than at home. The point is that there are very real advantages to be gained from the world division of labour by utilizing British engineering skills and accumulated capital equipment to produce advanced technological manufactures for the foreign as well as for the home market. This may indeed be the reason for the leading role of the merchant bankers—that they do by their knowledge and their discounting and other credit services open up a wider market than the U.K. for British manufacturers who do not have the continental market of their U.S. and German competitors. At all events modern production methods demand for their full exploitation wider and wider markets. And for this reason Mr. Shonfield is clearly a supporter of the European Free Trade Area.⁶⁵

Here Mr. Shonfield seems to slip into another error—of thinking that all that is needed is increased investment in home industry to improve Britain's competitive strength. But our competitors, with a higher level of investment than we have achieved, and notably Germany and the U.S.A., are also finding at the present moment that export markets are declining. Trade expansion requires not only new investment at home but a general raising of world living standards. Mr. Shonfield, like many others, has been so dazzled by the recent expansion of markets in Western Europe and in North America that he has missed a most important aspect of the world trade picture since the war. In fact the growth of world trade between 1946 and 1951 when overseas markets were growing was at a faster rate than that between 1952 and 1957 when European markets were growing. By 1946 world trade had probably re-established pre-war levels and by 1951 had risen 43 % above them. For trade in manufactures alone the rise was 76%. In the five years after 1952 the increases were respectively only 37 % and 35 %.⁶⁶ Over the same period West European trade expanded by more than 50%. But this was largely a reflection of the return of West Germany to world markets; the West German foreign trade expansion in the

same period being of the order of 200 %.⁶⁷

We cannot count on such a free-for-all expansion repeating itself. What is needed now is an overall expansion in world trade, and this cannot come about without a high rate of investment in the under-developed areas. This is essential, not only for the long term increase in Britain's standard of living, but also if we are to have a healthy and reasonably stable balance of payments, and in particular if we are to solve the perennial problem of the dollar gap.

The dollar gap

With regard to relations with North America Mr. Shonfield is splendidly optimistic.⁶⁸ While the boom in sales of small cars by U.K. manufacturers to the U.S. lasts there may seem to be some justification for this optimism, but he would be a bold man who relied on a steady expansion of U.S. imports in the future. In the first place, they have been growing very slowly—a mere 15% since 1952 and 50% since before the war. U.S. exports, on the other hand, while they have grown only a little faster than imports since 1952, are three times their level before the war.⁶⁹ Although the world's dollar gap has been closing again in 1958 as a result of loans and other extraordinary measures, it grew steadily in 1957 as gold and dollars flowed back once more⁷⁰—for the first time for many years—across the Atlantic from Europe, giving full support to Sir Donald MacDougall's warnings.⁷¹ Mr. Shonfield considers a gap of some £100 millions for Britain, which was roughly the figure in the years up to 1956, with the exception of the crisis year of 1955, to be perfectly manageable. Unfortunately, as we saw earlier, the gap in 1957 would have been £150 millions if the interest payable on the U.S. and Canadian loans had not been waived. Is this manageable?

The dollar gap was widened of course in 1957 by the flow of funds through Kuwait into U.S. investments but even after this was stopped the gap remains a formidable one. In the past it has been closed with South African gold and colonial dollar earnings, U.S. aid and U.S. military expenditures and with offshore purchases for N.A.T.O. in Britain. But with the decline of colonial dollar earnings and the ending of U.S. aid, emergency measures had to be taken in 1957 for obtaining extra loans of dollars: £100 millions worth of dollars was borrowed from the U.S. Import Export Bank, £200 millions from the I.M.F. and £50 millions from E.P.U. These as well as the original U.S. and Canadian loans will have to be paid back with interest over the years to come. South Africa will presumably continue to pay for her imports in gold but shall we always have U.S. bases in Britain and earn dollars by sales to N.A.T.O.?

On top of all this Mr. Shonfield proposes still more borrowing from the U.S. and further encouragement of U.S. investment in the U.K. Quite apart from the problem of retaining some degree of national economic independence, the consequent burden of annual interest and dividend payments to the U.S. is horrible to contemplate. Already by 1956 the net interest and dividend figure plus the net figure for other invisibles (oil, films, etc.) on the U.K. dollar account showed a deficit of £26 millions even without the U.S. and Canadian loan charges of nearly £40 millions which were waived.⁷² Yet the prospect of increasing sales in the dollar market even if the present recession has now reached its lowest level must surely be highly dubious. All previous experience has shown that the U.S.A. is highly resistant to lowering its barriers to imports or reducing its hold on the Canadian and other dollar area markets.⁷³

Of course the dollar problem could be solved by reducing the dollar share in our imports, especially of food and raw

materials—a share which has been growing in recent years as a result of trade liberalization measures.⁷⁴ This would involve a complete realignment of Britain's foreign trade and a concerted plan for expansion outside North America—which is not envisaged in Mr. Shonfield's proposals. He is mainly concerned, it appears, to withdraw from sterling markets and expand trade in the even more competitive industrial markets of Western Europe. In criticizing the concentration of U.K. trade in the sterling area and the other less industrialized countries of the world he does not seem to have completely absorbed the figures he himself quotes from the Board of Trade to the effect that Britain has been losing trade to her competitors as much in the Sterling Area as elsewhere.⁷⁵

Nor does he see, which is more important, that it was to a great extent the expansion of the trade of the under-developed lands that maintained the export boom at such a high level up to 1952. Even in 1955 more than a half of the world's trade took place between advanced manufacturing countries and primary producers.⁷⁶ Mr. Shonfield, moreover, omits entirely to mention the advance of Soviet, Chinese and East European trade—from 7% of world trade pre-war to 11% in 1956⁷⁷—which has done much to keep up levels of world trade and of primary producers' earnings and in which Britain has therefore a *prima facie* interest. Unhappily, since deflationary policies were adopted in Europe after 1956 the development plans of many overseas countries have been cut back as surpluses of food and raw materials, particularly in the U.S.A., have once more begun to depress the prices of primary products.

Mr. Shonfield generally refers to these plans as "extravagant." Yet a high level of investment is essential for the under-developed lands also, if the first stages of industrialization are to be carried through and the present terribly low levels of national income raised.

The basic contradictions of British economic policy will, therefore, not be solved by changing the minds of the bankers, or by shedding our fetishistic concern for the £. We cannot just drop the useless and wasteful overseas investment of the last decade. It must be replaced by a positive policy of credits and loans at low interest rates to under-developed countries, for their development is not only necessary in order to save world peace, but also of vital importance to nourish long term markets for the products of Britain's more advanced industries. This is where U.K. overseas investment should be directed, both through specifically British schemes, and jointly with other advanced industrial powers through S.U.N.F.E.D.⁷⁸ Such investment together with long term Government-guaranteed trade agreements, would underpin the growth of world trade on which Britain's future prosperity so largely depends. But this involves, not only deciding the issue between bankers and industrialists in favour of the latter, but, even more fundamental, a change in the relations with under-developed countries. This would mean, as we saw when we were considering home economic policy, a much larger measure of Government intervention than Mr. Shonfield is prepared to envisage: and this is the basic weakness of an otherwise most discerning and stimulating book.

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- ⁵ *British Economic Policy since the War*. A Penguin Special by Andrew Shonfield, 3/6.
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- ⁷ National Income and Expenditure. Blue Book 1957. Table 12.
- ⁸ O.E.E.C. general statistics, January 1958.
- ⁹ Treasury Bulletin for Industry, May 1958.
- ¹⁰ Shonfield op. cit. p. 43.
- ¹¹ Shonfield ibid p. 37.
- ¹² Treasury Bulletin for Industry, March 1958.
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- ¹⁶ *New Reasoner*, No. 6. Autumn 1958.
- ¹⁷ Shonfield op. cit. p. 138.
- ¹⁸ Shonfield ibid pp. 107-111.
- ¹⁹ Shonfield ibid p. 72.
- ²⁰ Shonfield ibid p. 110.
- ²¹ *Financial Times Annual Survey of Company Profits*, January 11, 1958.
- ²² In fact much of what is recorded in the annual Balance of Payments on new investment is reinvestment of earnings by retention overseas. See article by John Wood and T. M. Rybezynski in *The Times*, April 24, 1958.
- ²³ Shonfield op. cit. p. 157.
- ²⁴ See *The Listener*, November 28, 1957.
- ²⁵ See *The Listener*, November 21, 1957.
- ²⁶ See Arndt, *The Economic Lessons of the 1930's*, R.I.I.A.
- ²⁷ See R. N. Gardner, *Sterling Dollar Diplomacy*, O.U.P. 1956, p. 328.
- ²⁸ Shonfield op. cit. pp. 160-170.
- ²⁹ Shonfield ibid p. 169.
- ³⁰ Shonfield ibid p. 167.
- ³¹ Shonfield ibid p. 176.
- ³² Shonfield ibid p. 182.

- ³³ Shonfield ibid p. 238.
- ³⁴ Bank loans as a source of funds for investment by the 3,000 companies quoted on the Stock Exchange and summarized in *Economic Trends* for February 1958 have not risen above 5 or 6% of total funds over the whole period 1949-55 except in the stock-piling year of 1951 when they rose to 12%. Liquidity ratios rose steadily up to 1951 and again up to 1954 but never exceed 1.23.
- ³⁵ Shonfield op. cit. pp. 233-6.
- ³⁶ Shonfield ibid. p. 188.
- ³⁷ Shonfield ibid Chapter X.
- ³⁸ Shonfield ibid. p. 274.
- ³⁹ Shonfield ibid p. 280.
- ⁴⁰ See *Company Income and Finance 1949-53*, published by National Institute of Economic and Social Research, November 1956, which shows over that period 1949-53 that some £650 millions was raised for new investment on the market and £1,700 millions from reserves by the three thousand or so companies engaged in manufacturing, building and distribution whose accounts are published, and which are quoted on the Stock Exchange. This is the basis for the analysis now made by the Board of Trade in *Economic Trends* and includes, therefore, the larger and not the smaller companies. See above note 34.
- ⁴¹ London and Cambridge Bulletin, December 1957, p. iii, Table 4.
- ⁴² See article by Thomas Balogh in *New Statesmen and Nation*, January 11, 1958.
- ⁴³ Ibid.
- ⁴⁴ See *Plan for Steel Re-nationalization*. Fatian pamphlet by John Hughes.
- ⁴⁵ Shonfield op. cit. p. 279.
- ⁴⁶ John Hughes op. cit. and article in *The New Reasoner* No. 3.
- ⁴⁷ Shonfield op. cit. p. 264.
- ⁴⁸ Hughes op. cit. pp. 14 and 15.
- ⁴⁹ Shonfield op. cit. pp. 108-9.
- ⁵⁰ Shonfield ibid pp. 257-8.
- ⁵¹ Elsewhere (p. 107) Mr. Shonfield criticizes Marxists for not seeing this which has been precisely the point always made by Marxists. See Palme Dutt *Crisis of Britain and the British Empire ad nauseam*.
- ⁵² See Svennilson *Growth and Stagnation in Europe's Economy*, Tables 3, A1 and A3. -

- ⁵³ For a more detailed picture of the role of the merchant bankers see the forthcoming U.L.R. pamphlet and the writer's article in the *New Reasoner* No. 6.
- ⁵⁴ See the speeches of Bank Chairmen in 1956 and 1957.
- ⁵⁵ See respectively *The Director*, October 1957, and *The Times*, November 15, 1957.
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- ⁵⁷ See Cole & Shanks Fabian Society pamphlet on *Policy for the Sterling Area*, p. 9.
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- ⁶¹ See *Board of Trade Journal*, February 11, 1956.
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- ⁷¹ Sir Donald MacDougall, *The World Dollar Problem*. Macmillan 1957.
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- ⁷³ See e.g. Economic Commission for Europe Bulletin, November 1955, and see Mr. Shonfield's own comments on the Canadian market op. cit. pp. 146-8.
- ⁷⁴ See the writer's article in the *New Reasoner* No. 4, footnote 37.
- ⁷⁵ Shonfield op. cit. p. 82 quoting an article in the *Board of Trade Journal* of March 20, 1957.
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- ⁷⁷ U.N. Monthly Bulletins of Statistics Special Tables.
- ⁷⁸ Special United Nations Fund for Economic Development, which was designed to draw upon 1 % of the national income of the advanced industrial countries for aiding under-developed lands, but which has not received the support of any of the great powers, pending agreement on disarmament.