

ms. Kelly.

For: - MS. Harrod

(THIS DOCUMENT IS THE PROPERTY OF
HIS BRITANNIC MAJESTY'S GOVERNMENT)

S E C R E T

I. E. P. (41) 3

COPY NO. 35

3RD NOVEMBER, 1941

WAR CABINET

OFFICIAL COMMITTEE ON POST-WAR
INTERNAL ECONOMIC PROBLEMS

INTERNAL MEASURES FOR THE
PREVENTION OF GENERAL
UNEMPLOYMENT

Memorandum by the Economic
Section of the War Cabinet Secretariat.

Great George Street, S.W.1.

S E C R E T

INTERNAL MEASURES FOR THE PREVENTION OF
GENERAL UNEMPLOYMENT

Memorandum by the Economic Section of the War
Cabinet Secretariat

Introductory

1. In the work for post-war reconstruction the prevention of large scale unemployment is of the greatest importance. It is an essential condition for any policy devised to raise general standards of living. It would remove the greatest single factor in causing social insecurity. It would further remove one of the main economic obstacles to the development of sound international relations; for widespread unemployment is an important factor in disturbing world peace, both directly through its repercussion on international economic relations and indirectly through the internal social and political unrest which it causes.

2. Unemployment takes many forms.

- (i) There is an inevitable nucleus of temporarily unemployed persons who are passing from one job to another.
- (ii) In certain conditions there is likely to be a concentrated body of unemployment in special areas or special occupations due to a decline in particular industries which may result from changes in industrial technique or in the demand for particular products.
- (iii) But, in addition to this, there are from time to time, periods of general unemployment in which labour is unable to find work in the majority of occupations and industries. The world-wide depression which developed after 1929 affords a striking example of such general unemployment.

Unemployment of the first two types ((i) and (ii) above) requires special measures for its solution; the labour market must be so organised that employers seeking new hands are promptly brought into contact with workmen seeking employment; facilities must be made available for the transference and re-training of labour; and arrangements may be made for the localisation of new industrial enterprises as near as possible to the sources of unemployed labour. These problems will be very important in the immediate post-war period of reconstruction. For it will be necessary to transfer men and other economic resources from the armed forces and from munitions production to production for reconstruction and for

civilian needs; and at a somewhat later date, it will be necessary to transfer resources from rehabilitating the damaged capital equipment of the country to more normal peace-time occupations. In order that these transfers may be carried out as smoothly as possible care must be taken to ensure the greatest possible mobility of men and resources between different occupations.

3. This Memorandum is, however, confined to the problems of general unemployment of type (iii) above. That is to say, it is confined to a discussion of the ways in which the general level of demand for labour may be maintained at a height sufficient to absorb the unemployed into new occupations as quickly as they can be transferred to them. This also will be of great importance in the post-war period, in order to ensure that there are alternative jobs to which the men demobilised from the armed forces and from the munitions industries may be transferred, and, at a somewhat later stage, to ensure that there are alternative jobs awaiting those who have been engaged on the work of physical reconstruction of war damaged property. It will remain of importance in the more normal subsequent years, in order to ensure that there are alternative jobs for men who become unemployed in any industries which decline because of changes in the technique of production or in the demand for various products. In short, the solution of the problem of general unemployment is a necessary condition for the successful reduction of other types of unemployment. For unless there is a high demand for labour over a wide range of expanding occupations, there will be no alternative field of employment for labour transferred from declining industries.

4. This Memorandum is confined to the internal aspects of economic and financial policy for the prevention of general unemployment. It is clear, however, that a successful solution of this problem depends upon the adoption of an appropriate external economic and financial policy. Some reference is made below (p. 25 to 28) to the way in which commercial and monetary relations with other countries will affect the success of our internal policy. A full discussion of these external problems would, however, raise a large number of controversial issues which are only in part relevant to the problem of unemployment; and for this reason it has been thought better to postpone their discussion to a subsequent paper.

Industrial Policy and Unemployment

5. General unemployment can be avoided only by maintaining the demands for goods and services in general at a sufficiently high level, in order that any decline in the demand for labour in particular occupations may be offset by a corresponding increase in the demand for goods and services of other kinds. But in order that a policy of this kind may be successful, it is necessary that industrial organisation and policy should be of a kind that will readily allow an expansion in the production of those goods and services for which demand increases. Whether a large number of industries are brought under public control or left under private management, industrial regulations of a restrictive character

must be avoided. A few examples of such restrictive measures will serve to illustrate their effect. An industry may be regulated in such a way that restrictions are placed upon the entry of new firms into the industry, that the production of the existing firms is limited by quotas, or that new plant may not be installed in the industry; certain lines of agricultural production may be regulated in such a way as to limit the output of particular agricultural products; and trade unions, by limiting the number of apprentices in a given trade, may restrict output in that trade. The extension of such controls over a wider and wider field of industry makes it more and more difficult for unemployed labour and unemployed resources of every kind to find new employment. The trend of pre-war industrial policy was greatly to extend the range of such restrictive measures; and considerable pressure may be expected after the war by interested groups to maintain many of the war-time controls in order to extend such restrictions over a still wider field. Such a development would most seriously endanger the success of the measures suggested below for preventing general unemployment in the post war period.

Fluctuations in General Trade Activity

6. Experience has shown that modern industrialised communities are liable to recurrent periods of decline in general trade activity, during which there is a large increase in general unemployment. Trade depressions have a number of features in common. There is a general decline in expenditure on new works of capital construction and, in consequence, a decline in incomes and in expenditure on goods for personal consumption; this generates a further decline in the demand for goods and services. Prices and profits fall, and unemployment grows throughout the economic system. Similarly, periods occur from time to time when an abnormally high level of expenditure upon capital construction inflates money incomes and the money demand for goods and services even beyond the point which is required to absorb the available productive resources. In such a period of excessive trade boom, prices and profits are unnecessarily inflated.

7. In the immediate post-war period demobilisation and reconstruction will raise problems in many ways comparable with those of a more normal peace-time "trade cycle". On the one hand the reduction of government expenditure as the armed forces are demobilised and as the production of munitions is decreased will release labour and, by reducing the spendable incomes of those engaged in the armed forces and in the munitions industries, may threaten to lead to a vicious spiral of general trade depression. On the other hand, the desire immediately to spend money on rebuilding damaged property, on plant that has not been fully maintained during the war, on the reconstitution of depleted stocks, and - in the case of private individuals - on clothes, furniture, motor-cars and other durable consumption goods whose supply has been seriously restricted during the war, may lead to an immediate post-war reconstruction boom.

8. It is impossible to foretell with certainty how these factors will operate in the immediate post-war period; but it is probable that a considerable reconstruction boom will develop immediately after the war and that this will be followed by the threat of a serious depression. Such was the sequence of events after the war of 1914-18. After this war, as a result of the much more extensive character of war damage, there will be a much wider field for immediate post-war reconstruction; and at the same time demobilisation may well be delayed by the need to maintain large forces in Europe for some time after the war. For these reasons the immediate reconstruction boom may be more marked, and the subsequent threat of depression may more nearly coincide with the actual demobilisation of the armed forces and of the munitions industries than after the last war.

9. The work of physical reconstruction of buildings, industrial plant and shipping after the war may take a number of years. A considerable part of this work will be controlled and financed either directly by the State or from funds controlled by the State under War Damage Insurance or under the return of 20 per cent. of Excess Profits Tax for the rehabilitation of industrial plant. The transition from this period of reconstruction to the more normal period, which will follow it, may threaten to lead to a serious depression of trade activity. As the need for expenditure on physical reconstruction is reduced, it will become necessary not only to transfer labour and other productive resources to alternative use for the production of different types of capital equipment or of additional supplies of consumers' goods, but also to stimulate the money demand for these new goods and services. Means must therefore be found:-

- (a) so to plan the physical reconstruction of war damaged property that expenditure on it tails off as gradually as possible,
- (b) to initiate new alternative forms of capital construction, and
- (c) to stimulate the demand for consumers' goods.

The measures by which this may be achieved are discussed in the following paragraphs (10-20).

The Maintenance of the General Demand for Labour

10. The measures which are appropriate for maintaining the general level of demand for goods and services, and so for labour, may be enumerated under the following heads:-

- (a) Banking policy.
- (b) Investment policy.
- (c) Consumption policy, and
- (d) Budgetary policy.

11. Banking Policy. The banking system can, by changing the terms upon which new funds may be borrowed, discourage new capital construction in

times of excessive boom and encourage new capital construction in times of general depression. For this purpose the banks can raise or lower the rates of interest charged by them on advances and loans of various kinds. The market for other loans may also be influenced through the sale or purchase by the banks of securities in the capital market. A sale of securities by the banks, reduces the amount of money available in the market, lowers the price of the securities sold, and thus raises the cost of borrowing funds in the capital market for new capital construction. Conversely, a purchase of securities by the banks increases the supply of money, raises security prices and reduces the cost of borrowing new funds for capital construction. There is general agreement among economists on these principles of banking policy; but some differences of opinion exist concerning the degree to which monetary policy will be effective if unaccompanied by other measures.

12. Investment Policy. In so far as the State can directly control works of capital construction, these should be reduced in times of boom and expanded in times of depression. Additional works of capital construction employ directly a certain number of workers in a period of general depression; but, in addition to this, the spending of the incomes of those engaged on the "public works" maintains the demand for other goods and services and thus generally stimulates economic activity. The widest possible range of capital construction should be regulated on this principle by the Government. This involves in particular the regulation of capital expenditure by Local Authorities, by Public Utilities and by the Railways. Between 1926 and 1937 expenditure on the construction and maintenance of fixed capital by the Central Government, the Local Authorities, the Public Utilities and the Railways accounted for more than one-half of the total of such expenditure for the whole of Great Britain; and the proper planning and timing of this block of capital expenditure would, therefore, constitute a very powerful weapon of control over the total capital expenditure of the community. The adoption of this policy depends, therefore, primarily upon arrangements between the Central Government and the Local Authorities, Public Utilities and Railways (a) of a financial character which will enable capital expenditure to be properly timed and (b) of an administrative character which will enable plans of capital development to be prepared in advance with a view to obtaining the maximum amount of flexibility in the timing of their execution.

13. The control of the Central Government over the timing and planning of capital works might possibly be extended even beyond the range indicated in the previous paragraph. In particular, it may be possible for the Government in times of depression (a) to adopt measures to encourage capital investment

by private enterprise and (b) to stimulate works of capital development in other areas of the world (such as the Colonial Empire) - works which would not otherwise be undertaken and which would lead to the employment at home of unemployed resources in the production of the necessary capital equipment.

14. This policy of timing expenditure on capital development in such a way as to even out general fluctuations in trade activity cannot succeed unless the projects of capital development are planned well ahead. Experience has shown the difficulty of improvising additional schemes of capital development during a depression; for time must be spent in making the necessary plans, in obtaining control over the land needed for public works, and in initiating the desired expenditure. Success depends upon planning ahead the maximum number of schemes of development in such a way that flexibility is preserved in the actual dates at which the development will be undertaken. In this way a reserve of capital works may be built up against future periods of general depression.

15. The immediate post-war situation must be controlled by a proper planning and timing of the reconstruction of damaged property and of the rehabilitation of industrial equipment which has not been fully maintained during the war. This control should so work that, if there is an excessive reconstruction boom immediately after the war, the less essential projects of reconstruction can be postponed and the work thus spread over a longer period. In particular the payment of compensation for war damaged property and the repayment of the 20 per cent. of Excess Profits Tax for the reconstitution of industrial capital should be carefully controlled and timed with this object in view. The proper planning and timing of such reconstruction on the lines indicated above, involve, as in the case of the more normal works of capital construction discussed above (paragraph 12), financial and administrative arrangements between the Central Government on the one hand and Local Authorities, owners of private property and business concerns on the other hand, in order to ensure that the plans of rebuilding, etc. are worked out well in advance and that the actual expenditure is properly timed. The transition from the period of post-war capital reconstruction to that of more normal conditions will require careful planning, in such a way that, while expenditure on reconstruction is gradually reduced, new projects of capital development can be initiated and the demand for consumption goods can be stimulated.

16. Consumption Policy. Measures may be taken in a period of general depression directly to stimulate the demand for consumption goods, and in periods of excessive boom to restrain such demand; These devices may take many forms:-

- (a) Purchases of consumption goods through hire-purchase finance might be controlled in such a way that they were made difficult in times of boom and made easy in times of depression. In the absence of such control, hire-purchase is liable to exaggerate trade fluctuations; for consumers are likely to engage in commitments in excess of their incomes in good times, and are then obliged to restrict their purchases in order to repay debt in bad times.
- (b) A direct stimulus to consumption in times of general unemployment may be provided through the reduction of direct taxes levied on income or of indirect taxes levied on the purchase of goods and services, or through the payment of direct money allowances by the State to consumers. Conversely, expenditure on consumption goods in times of excessive boom may be restrained through the raising of direct taxes on income or of indirect taxes on the purchase of goods and services.
- (c) If, as a result of the long-period, development of the social services, it is decided to extend the scope of Government expenditure (e.g. by the introduction of a scheme of family allowances) these new schemes should be introduced at a time of slack trade (when it is desired to stimulate the demand for goods and services) rather than at a time of good trade.
- (d) For some time after the war it will be necessary to maintain a number of the war-time controls over the purchase of consumption goods - such as the schemes for the rationing of foodstuffs and clothing. For, so long as scarcities of raw materials and similar difficulties prevent the supply of these goods on a considerably larger scale, rationing will be required to ensure the continuation of an equitable distribution of the scarce supplies. Within limits it may be possible to time the relaxation and removal of these restrictions on consumption in such a way as to stimulate the demand for consumption goods when this is most required from the point of view of the unemployment position.

17. Deferred credits for income tax, as suggested in the recent budget proposals, provide an example of financial action of the type suggested above (paragraph 16(b)), since they are financed out of increased direct taxes payable in the war period of full employment and may be repaid in a post-war period of slack trade. Their repayment will, however, need to be carefully timed. It should be postponed, as far as possible, in any immediate post-war period of reconstruction boom, and should be concentrated in any subsequent period in which a general trade depression threatens the community. It is worthwhile considering whether a scheme of this kind - involving the accumulation of deferred credits out of direct taxes in periods of active trade and their repayment to individuals in periods of depression - should not become a permanent feature of financial policy after the war.

18. Budgetary Policy. If the policies suggested above (paragraphs 12-17) are adopted, an increase in state expenditure and a reduction in revenue must be foreseen in periods of slack trade, and a reduction of expenditure and an increase in revenue in periods of good trade. In other words, debt must be incurred in years of depression; whereas in periods of active trade, when revenue is increased and state expenditure is contracted, debt may be repaid. The policy of preserving an annual balance of revenue and expenditure with a constant provision for debt redemption must give place to a policy of concentrating debt repayment in years of active trade.

19. The post-war problem of the national debt and of its repayment will, however, be a particularly serious one for a number of reasons.

(a) At the close of the war the national debt will be much greater than before the war; and though war borrowing will probably be continued at the present relatively low rates of interest or even at still lower rates, there is bound to be a considerable increase in the total interest payable on the debt. The high rates of taxation needed to meet the interest on debt after the last war may have exerted a depressing influence on business enterprise and so have intensified the problem of general unemployment. For this reason it is desirable to repay the debt, if repayment can be financed in such a way as not itself to exert a seriously depressing influence.

(b) There is no reason to believe that the repayment of debt arranged solely on the lines suggested in the previous paragraph will be sufficient. Indeed periods in which an excess of Government expenditure over revenue is desirable to reduce general unemployment may well be more

frequency than periods of active trade in which debt may be repaid through an excess of revenue over expenditure. In other words, budgetary policy devised solely on the lines indicated in the previous paragraph might lead to a continued growth in the debt, which will already be inflated and which it will be desirable on other grounds to reduce.

- (c) In the post-war period there are certain special reasons for believing that public borrowing may have to continue for a number of years. During the period of physical reconstruction it is probable that a large part of the necessary capital expenditure will have not only to be controlled but also to be financed by the state; and further considerable sums of public expenditure of one kind or another may be required to ease the transition from a war-time to a peace-time economy. During this period public borrowing may prove inevitable. The later transition from physical reconstruction to a more normal peace-time economy may well require the initiation of new alternative forms of public capital development and of measures to stimulate the demand for consumers' goods and services. This second period of transition will again require heavy state expenditure and fairly low levels of taxation on income and on consumption, if a general depression is to be avoided.

20. There are certain methods by which this dilemma (between the need to reduce the burden of debt and the need to expand expenditure and to reduce taxation in order to stimulate trade activity) can be resolved.

- (a) In the first place, it is important that in the post-war period a deflation of money prices and of money incomes below the level ruling at the close of the war should be avoided as far as possible. For a deflation of money prices and of money incomes raises the real burden of the fixed national debt and necessitates higher rates of income tax on the reduced level of money incomes in order to meet the interest payable on it. Indeed, there is something to be said for the continuation of a moderately rising trend of prices and money incomes for some time after the war as a means of mitigating the burden of fixed debt (see paragraphs 21-22 below).

- (b) A capital levy at relatively high rates might be imposed on individuals' capital wealth (with suitable exemptions for small property and with suitably progressive rates of levy) in order to redeem, by one surgical operation, a large proportion of the outstanding national debt.
- (c) More generally, debt can be continuously redeemed out of revenue without threatening to cause general unemployment, if a form of tax can be found, the imposition of which does not restrict expenditure on goods and services by the taxpayer. Such a tax is exemplified by a tax imposed on, and paid out of individuals' capital assets. For, while a tax which is paid out of income reduces the demand for consumption goods and services, a tax which is paid out of personal holdings of capital assets does not reduce the demand for consumption goods; and if a proper banking policy is adopted (on the lines indicated in paragraph 11 above), conditions in the capital market can be kept easy, so that there are no financial obstacles to prevent industry from borrowing for expenditure on capital development. It is important, therefore, to discover what forms of taxation are most likely to satisfy these criteria, and to rely upon these taxes as far as is practicable for the raising of revenue.

The General Level of Prices

21. The measures suggested above (paragraphs 10-20) should serve to prevent violent fluctuations in the general level of demand for goods and services and so in the prices offered for such goods and services. The same instruments of control may be used, not only to prevent marked fluctuations in the price-level, but also to determine the long period trend of money prices; for a somewhat more restrictive policy must be adopted over the average of good and bad years if a gradual deflation of prices rather than a gradual rise in the price level is desired.

22. A deflation of prices is liable to lead to serious unemployment, if the fall in selling prices is not accompanied by an equally rapid rise in productivity; for a fall in selling prices leads to an increased real burden on productive enterprise in the form of costs which are either fixed in money terms (as in the case of interest on debt) or are not capable of an easy or rapid downward revision as selling prices fall (as in the case of money wage-rates). For this reason, after the present war every effort should be made, by the means suggested in paragraphs 10-20 above, to prevent any serious deflation of the general level of prices. Indeed there is much to be said for the continuation of a moderate upward trend of prices in the years following the war. (See paragraph 20(a) above).

Wages Policy and Unemployment

23. We do not advocate attempts to reduce general unemployment by variations in the general level of wage-rates. But in certain circumstances an adjustment of particular wage-rates may be useful as a means of reducing unemployment; for example, to allow wage-rates in depressed industries in a particular area to fall might help to stimulate new industrial activity in that area, or a reduction of wage-rates (as of other costs) in important constructional industries might, in certain circumstances, hasten the recovery of industry from depression.

24. There is, however, one way in which an unwise wage policy might seriously hinder the prevention of general unemployment. The underlying idea of the proposals made above (paragraphs 10-20) is that measures should be taken to increase the total money demand for goods and services whenever there is general unemployment. These measures will give rise to the danger of a vicious spiral of inflation, if widespread demands for increased wage-rates arise during a period in which considerable general unemployment still persists. For any attempt to expand the total demand for goods and services in a period of rapidly rising wage-rates would involve a continual inflation of money expenditure, money prices and money wage-rates. In fact, in order to prevent a runaway inflation, the attempt to reduce general unemployment would have to be abandoned. A wage policy which refrains from insisting upon rapidly rising wage-rates, except in so far as increases in productivity permit, is for this reason a necessary condition for a successful effort to prevent such unemployment.

International Economic Policy and Unemployment

25. An outstanding feature of trade fluctuations is the fact that they usually occur more or less simultaneously in most of the economically developed nations. The world-wide character of the great depression after 1929 was a striking example of this fact. For this reason it is of importance that international action should be taken to control general fluctuations of trade activity. The most important countries should co-operate in the timing of national policies on the lines indicated above in paragraphs 10-20, designed to restrain the general level of monetary demand for goods and services in times of world-wide boom and to stimulate such demand in times of world-wide depression.

26. There are great difficulties in carrying out a national policy on the lines indicated in paragraphs 10 to 20 above in the absence of such international co-operation. If, in a period of world-wide depression, the United Kingdom alone attempted to maintain and expand the internal money demand for its goods and services, while other countries made no such attempt, the United Kingdom would endanger the balance of its commercial and financial relations with the rest of the world. The maintenance of incomes and prices in the United Kingdom combined with the fall of incomes and prices abroad would stimulate the British demand for imported goods, while the foreign demand for British exports declined. The payment made for the excess of imports would necessitate the loss of the United Kingdom's reserves of gold and of foreign exchange, unless measures were taken to offset the unfavourable balance of trade. Such measures might take the form of imposing special restrictions upon imports or of allowing the exchange value of sterling to depreciate.

27. For these reasons the adoption of purely national policies against trade depressions endangers any international agreements to remove import restrictions and to stabilise the exchange value of the different national currencies. Public opinion will almost certainly insist that a national policy of the kind necessary to diminish unemployment, should not be abandoned for the purpose of preserving international commercial and monetary agreements. It is therefore, of the utmost importance to achieve international co-operation in the planning and timing of national monetary, budgetary and investment policies for the control of trade fluctuations. In default of effective international action on these lines, internal policy designed to prevent general unemployment must necessarily be less effective, and its prosecution would involve the adoption of national measures (either of exchange control, of exchange fluctuations or of restrictions on imports) to control the balance of payments.

28. In the immediate post-war period the United Kingdom together with a number of other countries will be faced with a strain upon its balance of payments with other countries. For the income from our overseas investments will have fallen as a result of the mobilisation and sale of a large part of our overseas assets, and our export trade will have fallen to a low level. At the same time it will be necessary to import considerable quantities of goods necessary for reconstruction, for the reconstitution of depleted stocks and for the expansion of civilian production. The problem of bringing the United Kingdom balance of payments into adjustment will, for these reasons, require careful attention, and the solutions adopted must be such as not to impede the internal measures against unemployment suggested above. This particular problem lies outside the scope of the present memorandum.

Summary of Problems requiring further investigation

29. The main problems of policy, which require further detailed study in order to apply the general principles of policy outlined above, are the following:-

- (a) The measures necessary to ensure an easy transference of labour between occupations, industries and regions (paragraphs 2 and 3)

- (b) The extent to which the forms of industrial control and organisation which are likely to exist after the war are open to the objections raised in paragraph 5.
- (c) The extent to which capital expenditure by the central government, the local authorities, public utilities and the railways can be planned and timed in the way suggested in paragraphs 12-15 and the administrative and financial arrangements which would be necessary for this purpose.
- (d) The extent to which the central government should, and the means by which it could, influence the timing and planning of capital expenditure by private enterprise (paragraph 13).
- (e) The extent to which capital works in overseas territories (such as the Colonial Empire) could be planned on the same principle (paragraph 13).
- (f) The administrative and financial arrangements necessary to ensure that physical post-war reconstruction by local authorities, public utilities, private enterprise and property owners in general is planned well in advance and is timed properly (paragraph 15).
- (g) The measures, if any, which are desirable and practicable to control hire-purchase in the way suggested in paragraph 16(a).
- (h) The extent to which the lowering and raising of rates of taxation on income and on goods and services might be used as a means of controlling private expenditure on goods and services (paragraph 16(b)).
- (i) The possibility of introducing the system of deferred credits of income tax, proposed in the Budget of April, 1941, or a similar scheme, as a permanent peace-time measure (paragraph 17).
- (j) The desirability and practicability of imposing a capital levy or of introducing other suitable forms of taxation for the repayment of the national debt (paragraphs 20(b) and (c)).
- (k) In addition to the above problems of internal policy, a further study should be undertaken of international economic policy and of the commercial and foreign exchange policy of this country from the point of view of their effect upon general unemployment (paragraphs 25 to 28).

War Cabinet Offices,

Great George Street, S.W.1.,

8TH JULY, 1941