

November 20, 1945.

Honorable Henry A. Wallace,
Secretary of Commerce,
Washington 25, D. C.

Dear Henry:

I am sending you herewith as a matter of interest in connection with the British credit negotiations, an article prepared by a member of the Board's staff concerning "The British Balance of Payments and National Income".

Very truly yours,

M. S. Eccles,
Chairman.

Enclosure.

JBK:mla

Identical letters sent to Honorable Fred M. Vinson, Secretary of the Treasury, and Honorable William L. Clayton, Assistant Secretary of State.

The British Balance of Payments and National Income

By
Lloyd A. Metzler

The statement is frequently made, in popular discussions of Britain's post-war international problems, that "the United Kingdom is a bankrupt nation," or that "the United Kingdom has been reduced to a state of poverty by her war-time losses." Assertions of this nature refer, of course, to the loss of British overseas assets, to the increase of her overseas liabilities, and to the fact that, with the resulting loss of overseas income, the United Kingdom will find it difficult to produce and sell enough exports to pay for her imports. Without intending to minimize Britain's post-war problem, it may be said that most discussions of the bankruptcy or impoverishment of the United Kingdom give a distorted impression of the importance of the war-time changes to the British standard of living. While it is true that the British have been highly dependent upon foreign trade in the past, it does not follow that a reduction of imports will result in a permanent deterioration of the British standard of living. When the figures for exports, imports, overseas assets, and overseas liabilities are compared with the size and rate of growth of British income, it becomes apparent that British prosperity is much less dependent upon foreign trade than is commonly supposed.

Figures for net national income, total consumption, and the balance of trade are presented in the following table for the years 1938 through 1944:

Year	Net income	Total consumption	Retained imports	Exports of U.K. produce	Import surplus
	(In millions of pounds sterling)				
1938	4,619	3,607	858	471	387
1939	4,970	3,672	-	-	-
1940	5,913	3,762	-	-	-
1941	6,877	3,813	-	-	-
1942	7,554	3,953	991	269	722
1943	8,079	3,972	1,227	232	995
1944	8,334	4,183	1,299	258	1,041

(The export and import statistics in this table include only non-munitions items. Foreign trade statistics for 1939, 1940, and 1941 are excluded because the official data for these years include munitions as well as civilian goods.)

It is well known that the international problem which faces the United Kingdom at the present time is partly a result of the abnormal import surplus which developed during the war. The British economy was so completely mobilized for war that resources were not available for the production of normal exports. The large import surplus which developed when exports were reduced, together with the munitions imports of the United Kingdom, were financed both by Lend-Lease and by an increase in Britain's banking obligations (sterling balances) to the rest of the world. The termination of Lend-Lease and the reluctance of many countries to accumulate further sterling balances mean that other methods must be found to finance the British trade deficit in the transition from war to peace. The British expect that, in the long run, they will be able to increase their exports sufficiently to pay for their imports; but in the meantime they need financial assistance for the transition years.

The exact size of the deficit in the British balance of payments cannot be accurately foreseen, but various estimates have placed it between 750 and 1,500 million pounds, over a three-year post-war period. In any case, however, it is important to note that even the largest of these estimates is small relative to the probable value of domestic production in the United Kingdom. It has been estimated that, at full employment, Britain could produce a post-war net income of approximately 5.6 billion pounds, stated in 1938 prices. In post-war prices, this income would amount to approximately 7.8 billion pounds. The actual level of income will, of course, be lower than this goal, owing largely to the difficulties of re-conversion. But even if an allowance in excess of 10 per cent is made for these difficulties, it is likely that the net income of the United Kingdom over the three years 1946-1948 will exceed 7 billion pounds per year. Compared with a national product of this magnitude, even the maximum deficit of 1.5 billion pounds is relatively small. Over the three-year period, in fact, the deficit amounts to only 7.1 per cent of the aggregate net product. Considering the fact that productivity per worker increased about 1.5 per cent per year in the pre-war period, it is apparent that the deficit in the post-war balance of payments will not, in the long run, be a serious burden on the British economy.^{1/} Under these conditions, it is surely an exaggeration to say that Britain is bankrupt or destitute.

The real problem, then, is not the financing and rehabilitation of an economically bankrupt nation, but simply the provision of temporary assistance for a relatively small part of the entire British economy. While such assistance is obviously not absolutely essential for the survival of the United Kingdom as an industrially strong nation, it is nevertheless highly desirable. War damage and depreciation have reduced the

^{1/} Although the net deficit in the balance of payments is likely to be small, relative to the national income, it is important to point out that the actual importance of foreign trade is greater than the relative figures indicate, since many of the imported commodities are essential to home production. This question is further discussed below.

value of British capital by approximately 4 billion pounds, and the speed with which these losses can be replaced depends partly upon the assistance which the United Kingdom receives from abroad. Thus the British are faced with a choice of accepting a loan from the United States, if offered, and thereby accelerating their rate of recovery, or reducing their deficit immediately to the point where it can be financed by bilateral arrangements with countries in the sterling area. The latter alternative would, of course, increase the time required to restore Britain's post-war standard of living as well as her capital equipment.

The nature of the alternatives confronting the British may be seen more clearly by considering the possible disposition of the net national income in a typical transition year. It was suggested above that the average annual British income in the transition years 1946-1948 may amount to slightly more than 7 billion pounds. If assistance of 500 million pounds per year is received from other countries, the total value of resources available to the British in a typical year will be 7.50 billion pounds. On the assumption that consumption is restricted to the 1944 level by means of rationing, the resources devoted to this purpose will amount to 4.18 billion pounds, leaving 3.32 billion pounds for reconstruction, other capital development, military and other governmental expenditures. Non-military government expenditures on goods and services in 1944 were approximately 0.5 billion pounds. It may be assumed that this rate will continue into the post-war years. While military expenditures are much more difficult to estimate, it is generally believed that they will be about one-fourth of the war-time peak, or approximately 1.2 billion pounds per year. Thus total government expenditures on goods and services may be about 1.7 billion pounds, leaving 1.6 billion pounds for reconstruction and other capital development. At this rate of development, the domestic war losses could be replaced in approximately 2.5 years. But such a rapid rate of reconstruction is hardly to be expected. It seems more likely that the British will permit their standard of living to increase somewhat above the 1944 level, and will restore their war losses in perhaps four years.

The figures just presented are summarized in the table below:

		(In billions of pounds)
Net national income in a typical transition year		7.00
Loans from abroad		.50
Total resources available to the U.K.		<u>7.50</u>
Less: Consumption		<u>4.18</u>
Resources available for other purposes		<u>3.32</u>
Less: Government expenditure of resources		
Military	1.20	
Non-military	.50	1.70
Balance available for capital development		<u><u>1.62</u></u>

The general impression created by these figures is that foreign assistance, even on a generous scale, is a relatively small factor in the total British recovery program. The actual importance of foreign aid, however, is no doubt greater than these figures indicate. To some extent, the products received in foreign trade are essential to the maintenance of national output. The textile industry, for example, cannot operate without the cotton received from abroad. Similarly, the food industries are highly dependent upon importation of foodstuffs. In view of this inflexibility, it cannot be inferred that elimination of foreign aid from the figures above would simply reduce the possible level of capital development from 1.6 billion pounds to 1.1 billion pounds. Actually, the resulting shortage of raw materials would probably reduce the national income below the figure suggested above, and the rate of capital development would be correspondingly reduced.

Even after making allowances for inflexibility, however, the fact remains that the British standard of living is by no means entirely dependent upon the international position of the United Kingdom. On the contrary, the standard of living is far more dependent upon the productive ability of domestic industry than upon foreign trade. This means that the British have considerably greater freedom in the choice of a post-war foreign economic policy than is sometimes believed to be the case. If financial arrangements are made which are satisfactory to both the lending countries and the United Kingdom, the rate of British recovery will be accelerated and the standard of living will return more rapidly to its normal level. But if such financial assistance is not given, and the United Kingdom relies more heavily upon domestic industries and upon countries of the sterling area, the final outcome will by no means be catastrophic to the British standard of living. Thus a loan to the British is important not so much because it enables the United Kingdom to restore living standards rapidly as because it provides the only means of eliminating the barriers to international trade which have developed during the war. There can be little doubt that the British national income will rise steadily in the post-war years even without assistance from the United States. But unless a means can be found of providing financial aid in the transition years, the rise of British income will inevitably be accompanied by a continuation and strengthening of barriers to foreign trade.