



Managing the UK economy

Fiscal and monetary policy since 1945

Week 4 – 1945-51: Fiscal and monetary
policy of the post-war Labour governments

AY 2024-25

Department of Political
Economy

Instructor: Daniele Girardi

Historical context

1939-1945: World War II.

May 1945: End of war in Europe.

July 1945: UK general election

- Labour 393; Conservatives 203
- Attlee PM, Dalton Chancellor.

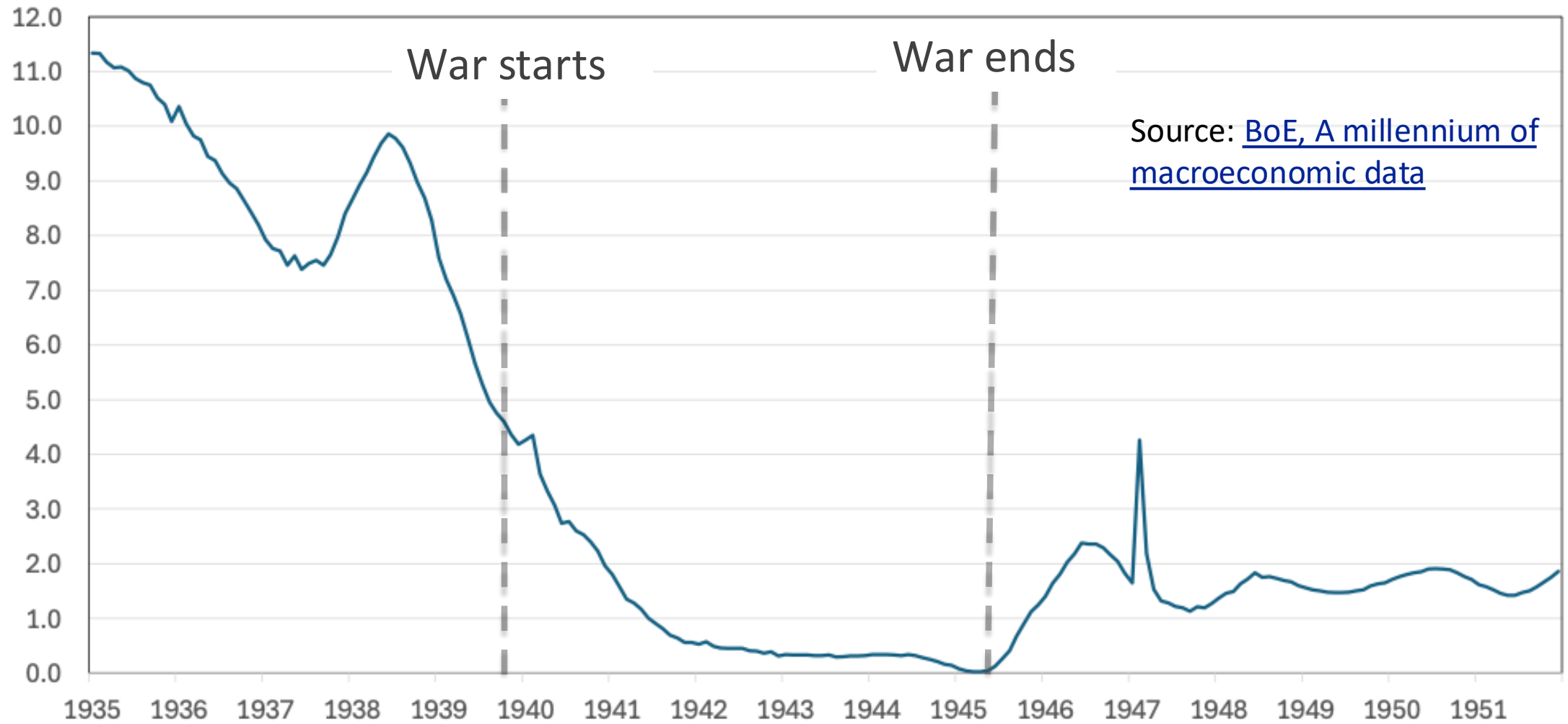
Aug 1945: End of war in East Asia.



The 1939-45 war economy

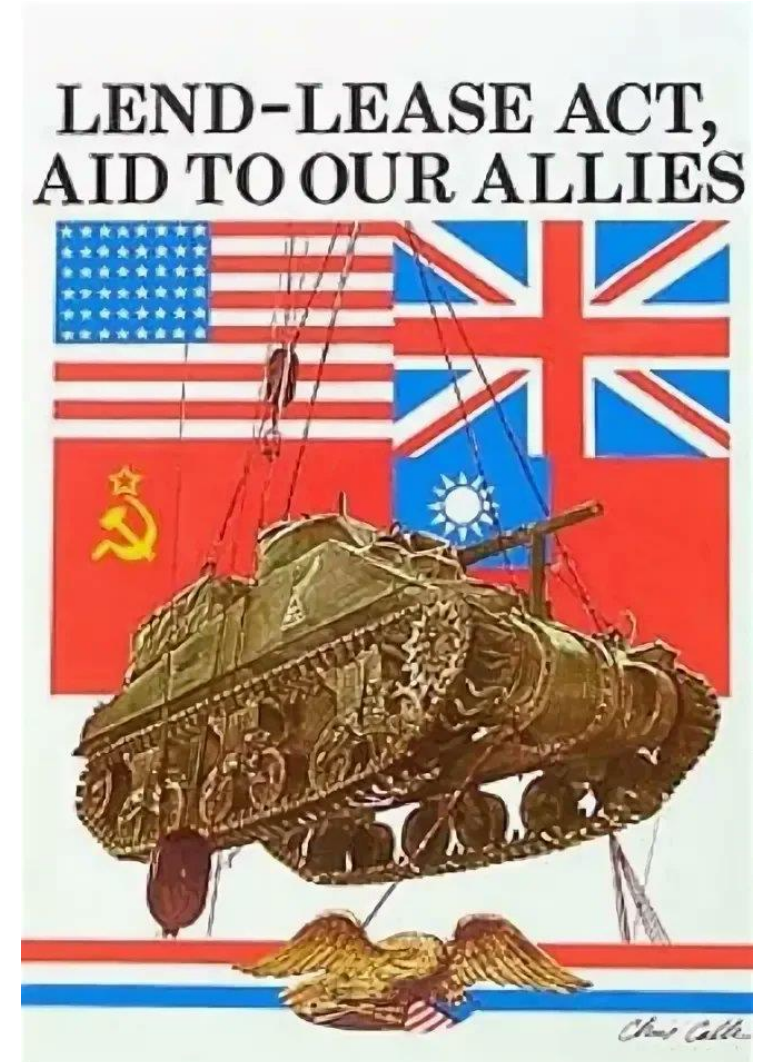
- Unprecedented government intervention
 - Military & industrial conscription, “Manpower budgets”.
 - Price controls, quantity controls, rationing, food subsidies.
 - Import & export controls.
- Productive capacity stretched to the limit
 - No unemployment, shortages of raw materials.
- Government spending almost 2/3 of GDP.
 - Almost all military or related.
 - Private consumption & total investment reduced to the minimum.

Monthly unemployment rate

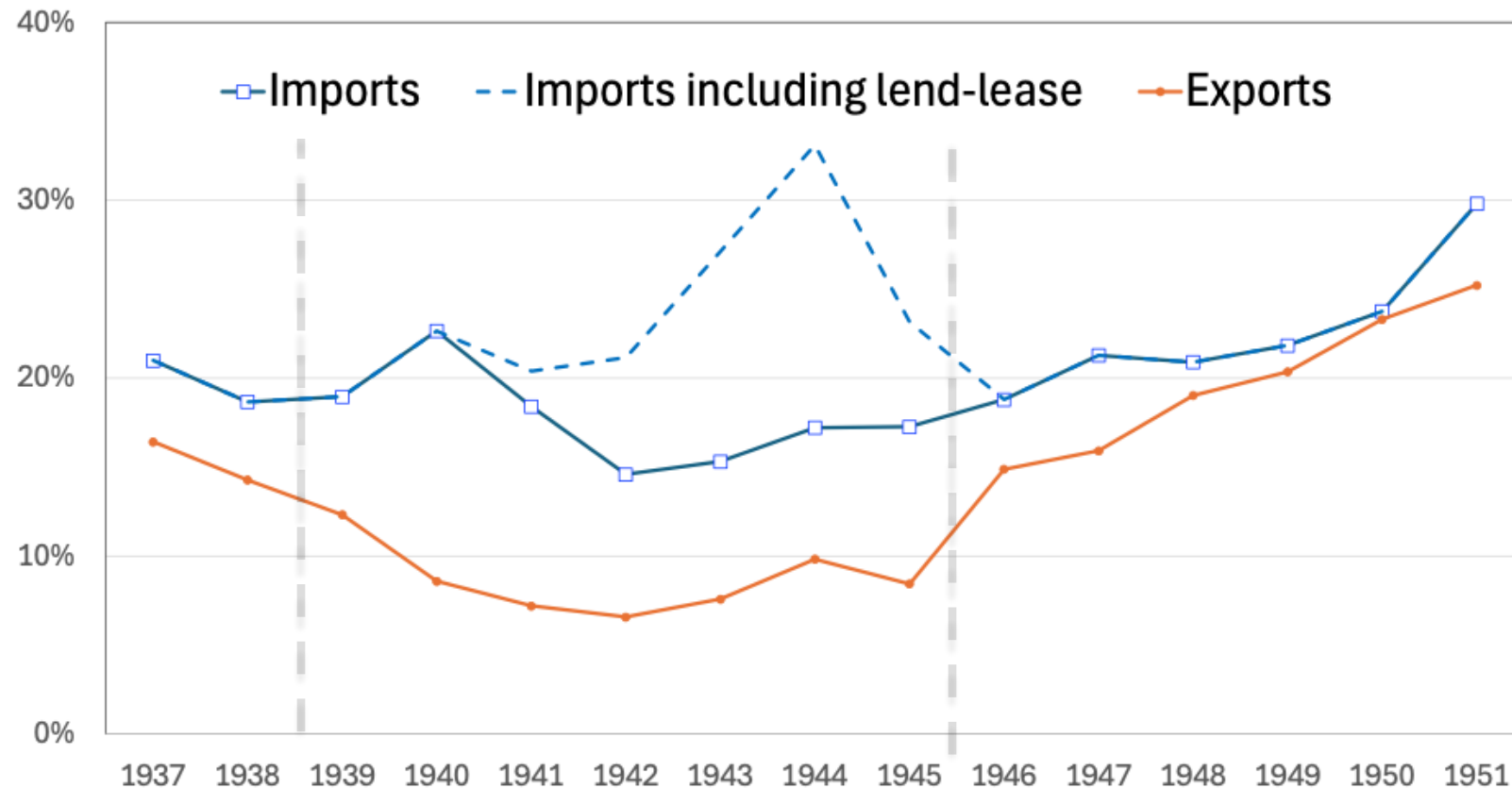


Lend-lease

- March 1941 - September 1945
- US shipments of essential goods at no cost.
- Allows UK a huge current account deficit & to direct even more resources to the military.
- Efficient division of war effort within the Allies.
- Further stimulated the ascendant US economy and further distorted & weakened UK non-military industries.



Imports & Exports (% of GDP)

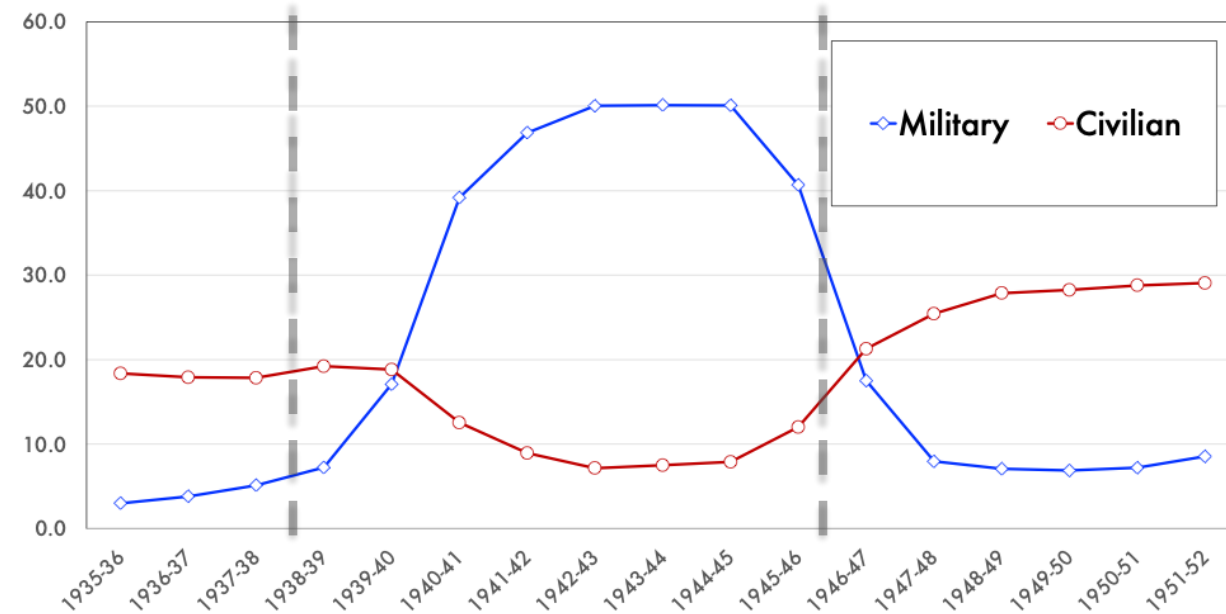
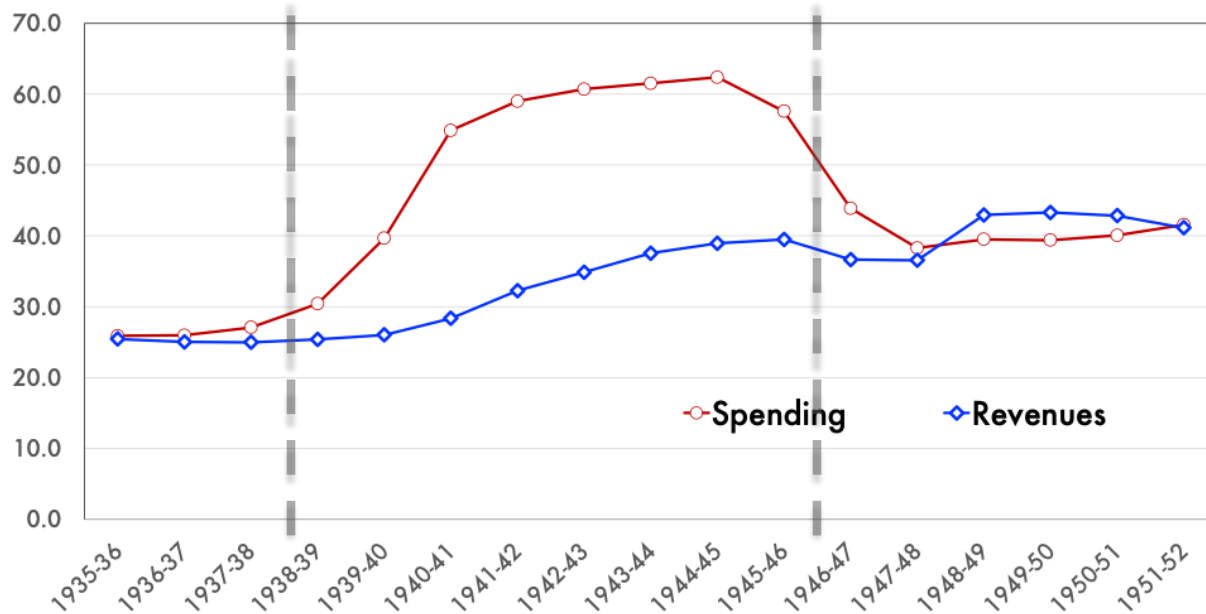


- Huge trade deficit
- Partly financed by selling UK assets abroad.
- Partly financed by contracting debts abroad.
- Partly just gifted by the US (lend-lease).

Source: [BoE, A millennium of macroeconomic data](#) and [Edgerton \(2023\)](#)

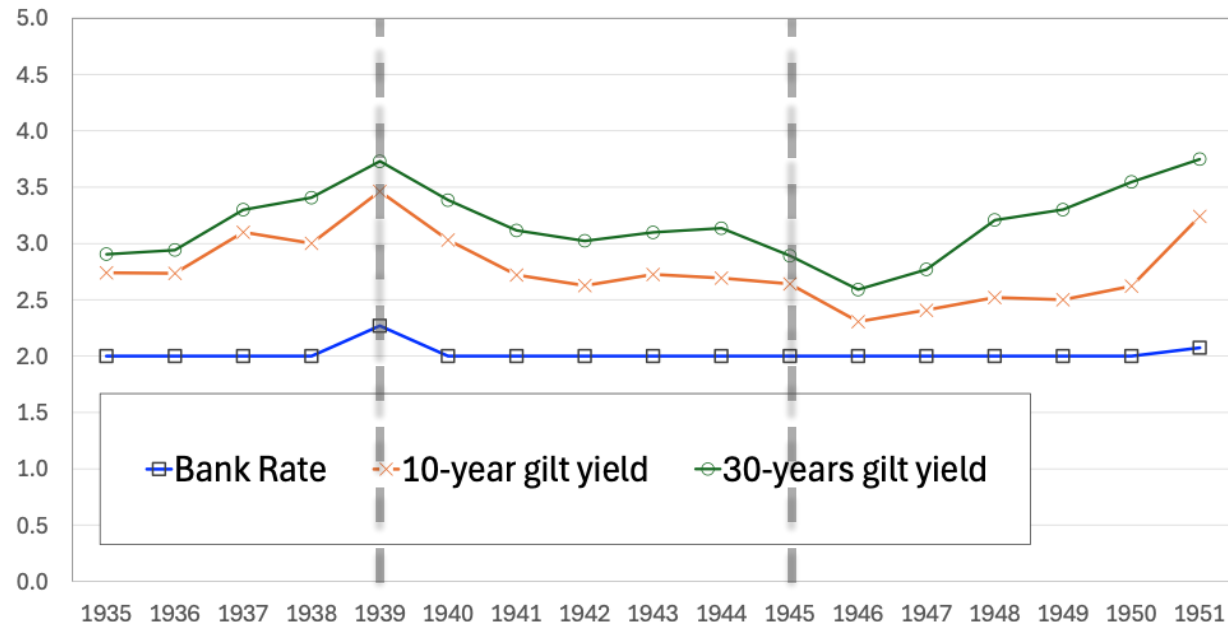
Public finance during the war

- Huge budget deficits driven by surge in military spending.
- Drop in civilian government spending (esp. investment).
- Increase in taxation + forced savings ('post-war credits').



Monetary policy during the war

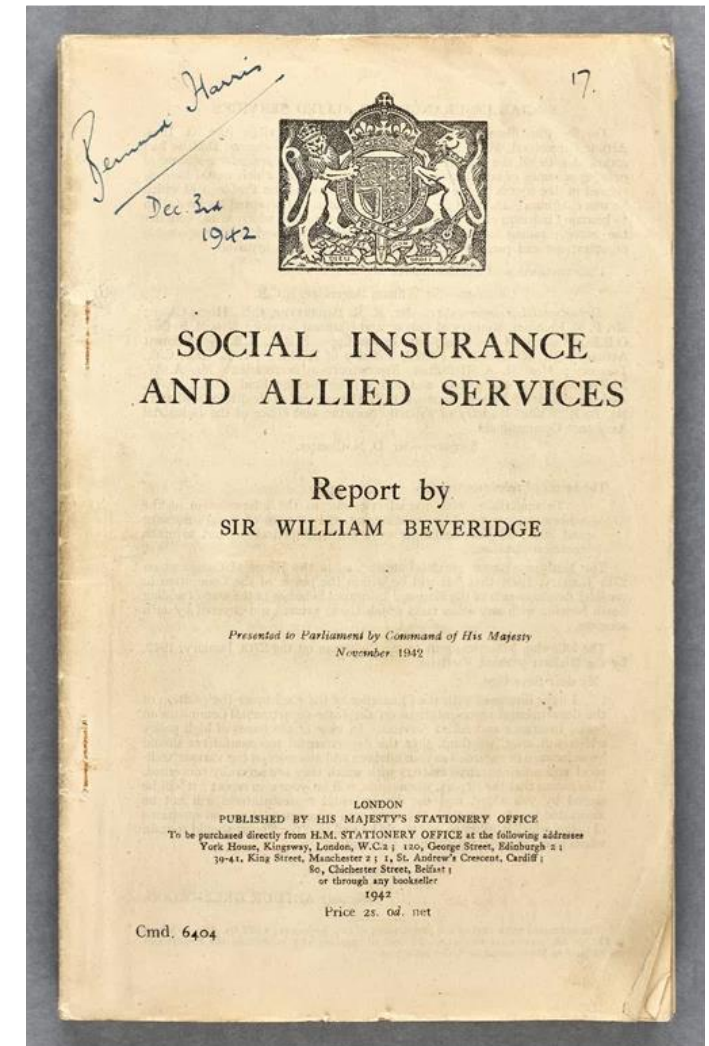
- Passive: very low (and fixed) interest rates.
- Inflation prevented by taxation (inc. forced savings), price controls & rationing.



Source: [BoE, A millennium of macroeconomic data](#)

The post-war settlement

- New consensus about the role of the state in the economy.
 - 1941 Budget
 - 1942 Beveridge report
 - 1944 White Paper on Employment Policy
- Rise of trade unions.
- Internationally: Bretton Woods system, International Monetary Fund.



Main themes of post-war policy

- Reconversion of the war economy.
 - Rebuilding non-military industries.
 - (Very) gradual de-control.
 - Restoring balance of payments equilibrium.
- Nationalizations & welfare state.
- Maintaining full employment after the war.
- Avoiding both inflation and deflation.

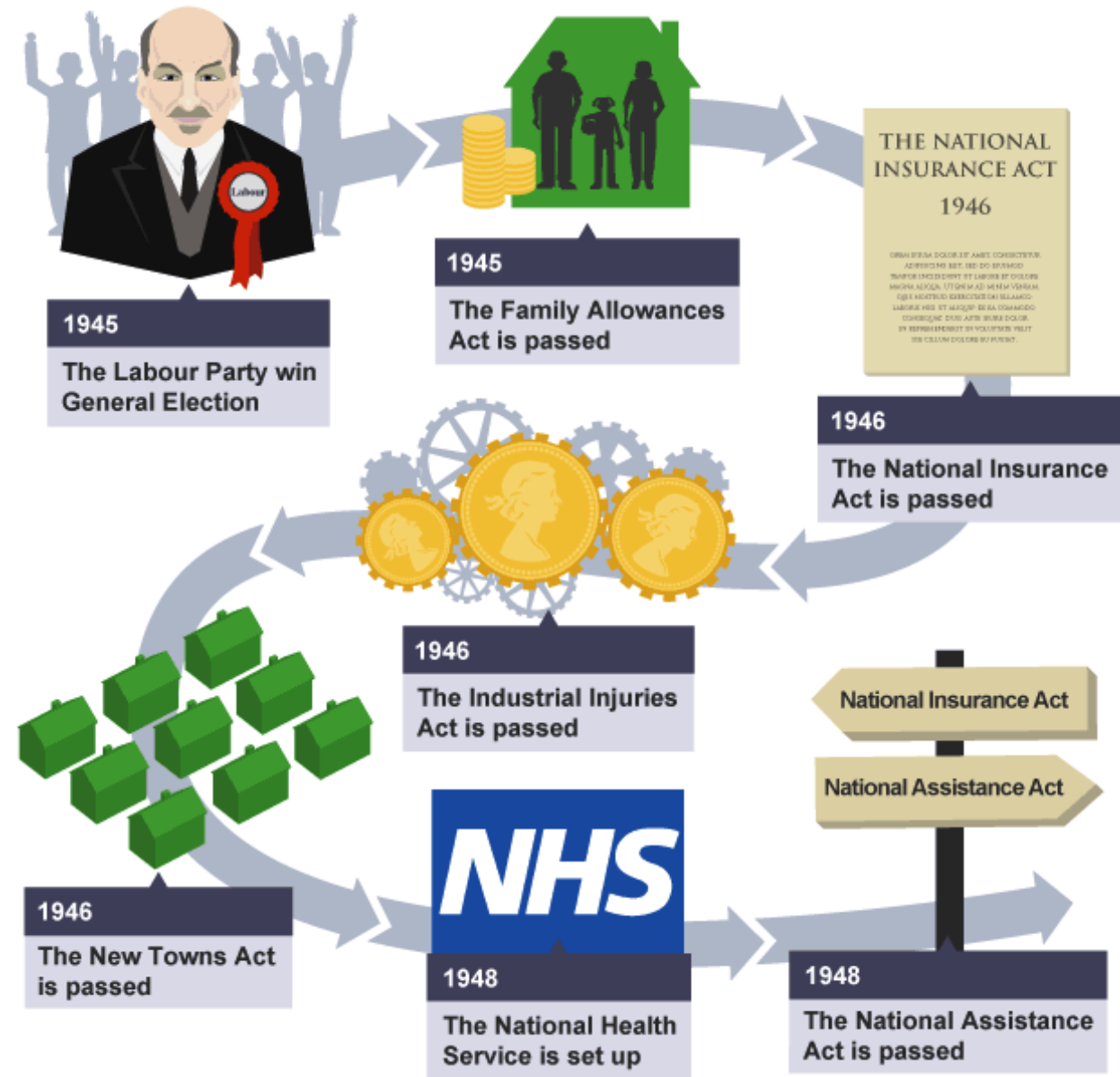


Nationalisations

- Bank of England (Mar 1946)
- Coal mines (Jan 1947)
- Railways (Jan 1948)
- Electricity (Apr 1948)
- Gas (May 1949)
- Iron & Steel (Feb 1951)



Welfare state



Bank of England nationalisation

1946 Bank of England Act.

3 main clauses:

1. Treasury appoints Bank leadership and can give Bank policy directions but only *“from time to time”* and *“in consultation with the Governor”*.
2. Bank retains power to give directives to clearing banks.
3. Operational independence: *“The affairs of the Bank shall be managed by the Court of Directors”*



Walking a tightrope between inflation & deflation

- Removal of controls could unleash inflation.
- But in the medium-run demobilization might cause deflation & high unemployment.
- Gov't initial (1945-46) strategy: retain controls; keep interest rates low & reduce taxation.
 - Dalton in 1945: *“the risk of inflation now is less than the risk of deflation later”*

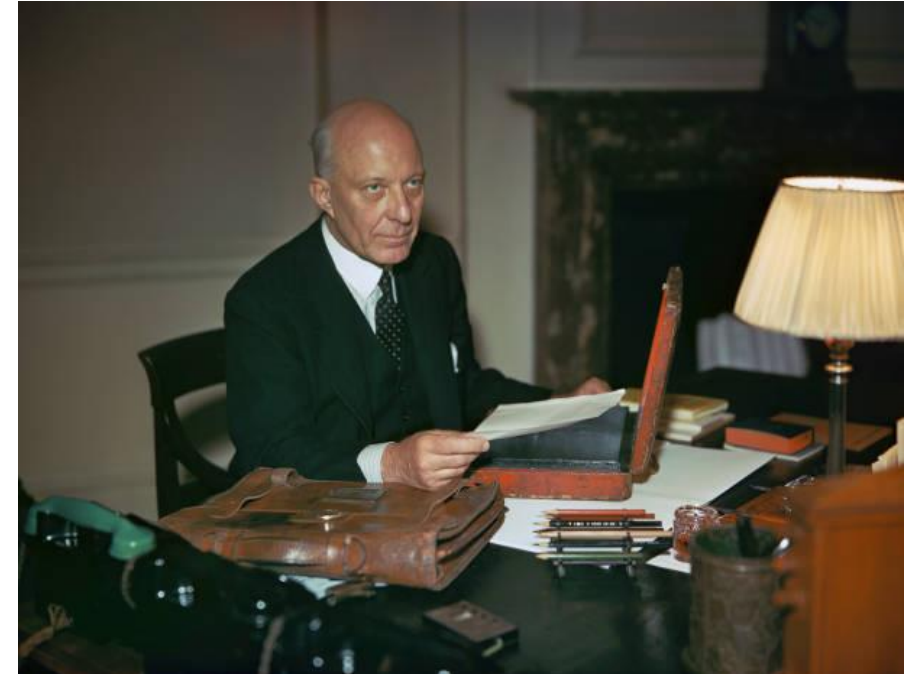
The 1945 balance of payments emergency

- Aug 1945: Lend-lease ends earlier than expected.
- Huge gap in UK balance of payments.
- 1946 American Loan
 - 5 billion USD
 - Favorable *financial* conditions.
 - *But* requires sterling convertibility by 15 July 1947



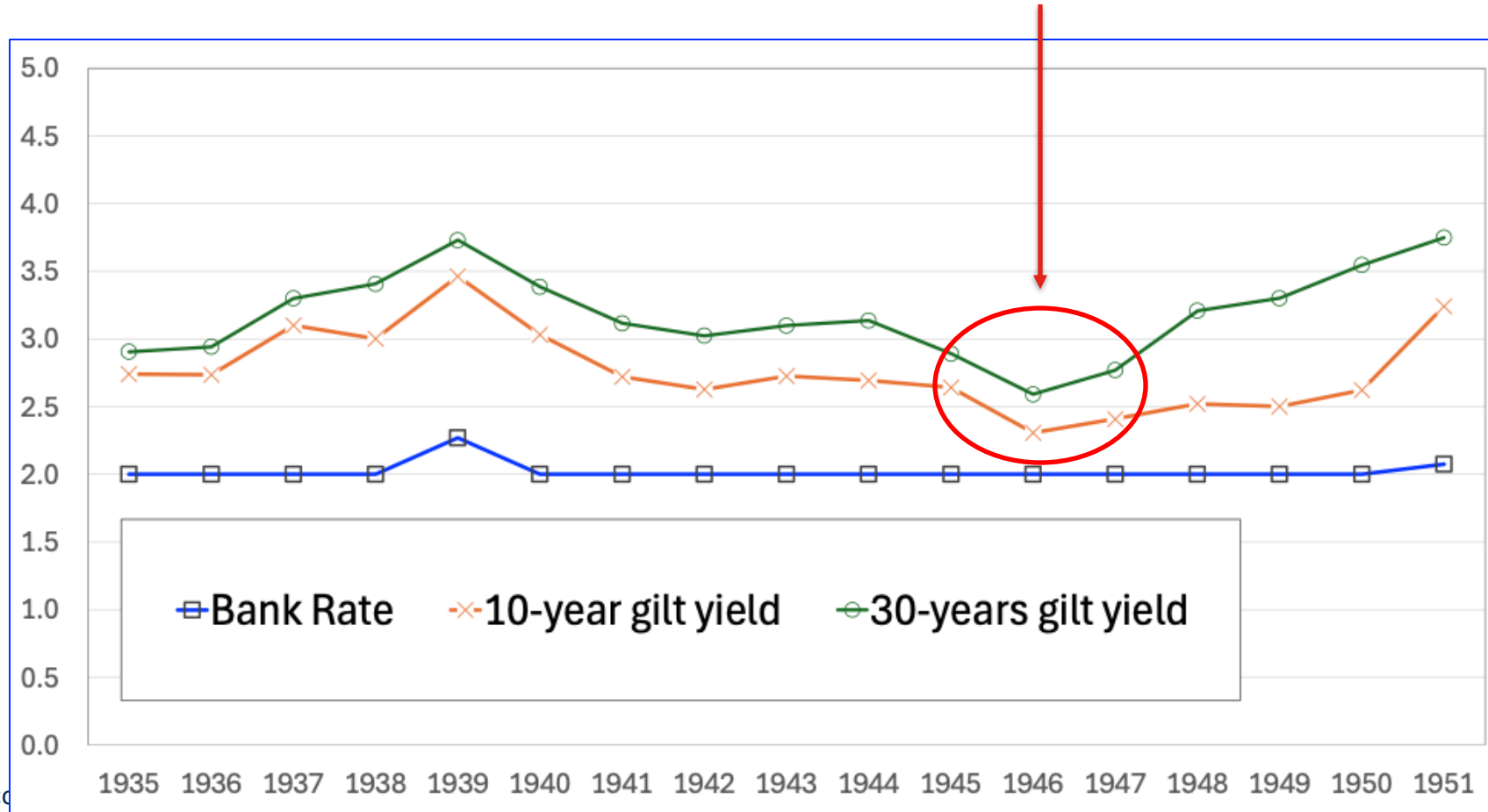
The 1945-46 budgets

- Oct 1945 + Apr 1946
- Taxes down by around 6% of GDP.
 - Personal income & profit taxes
- A cautious tax cut, given concomitant fall in military spending.
- Budget deficit will fall from 15% to 6.3%.



1945-47 monetary policy

- Monetary policy remains passive.
- Failed attempt to further lower long-term rates ('Daltons').



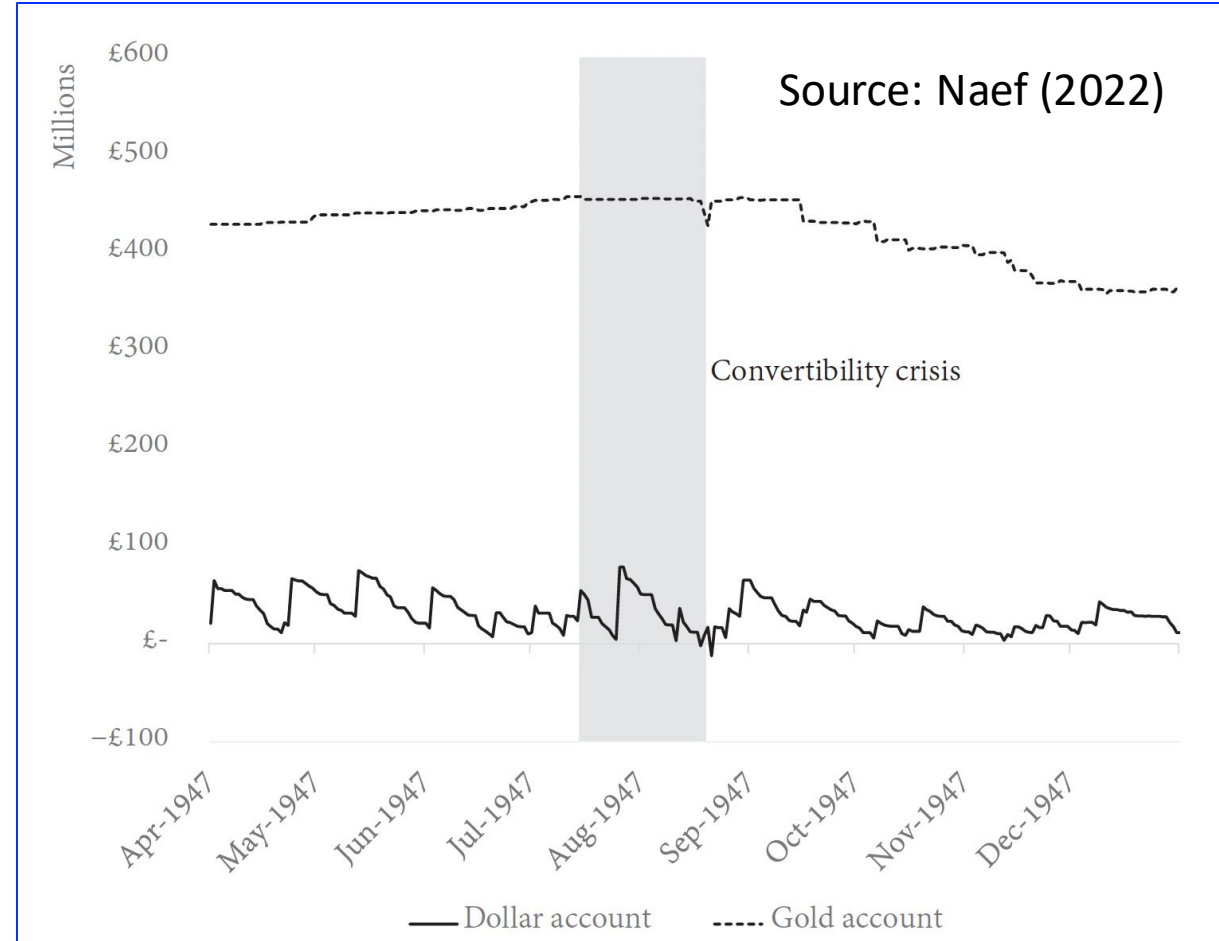
1947: A year of crises

Jan-Mar: Fuel crisis.

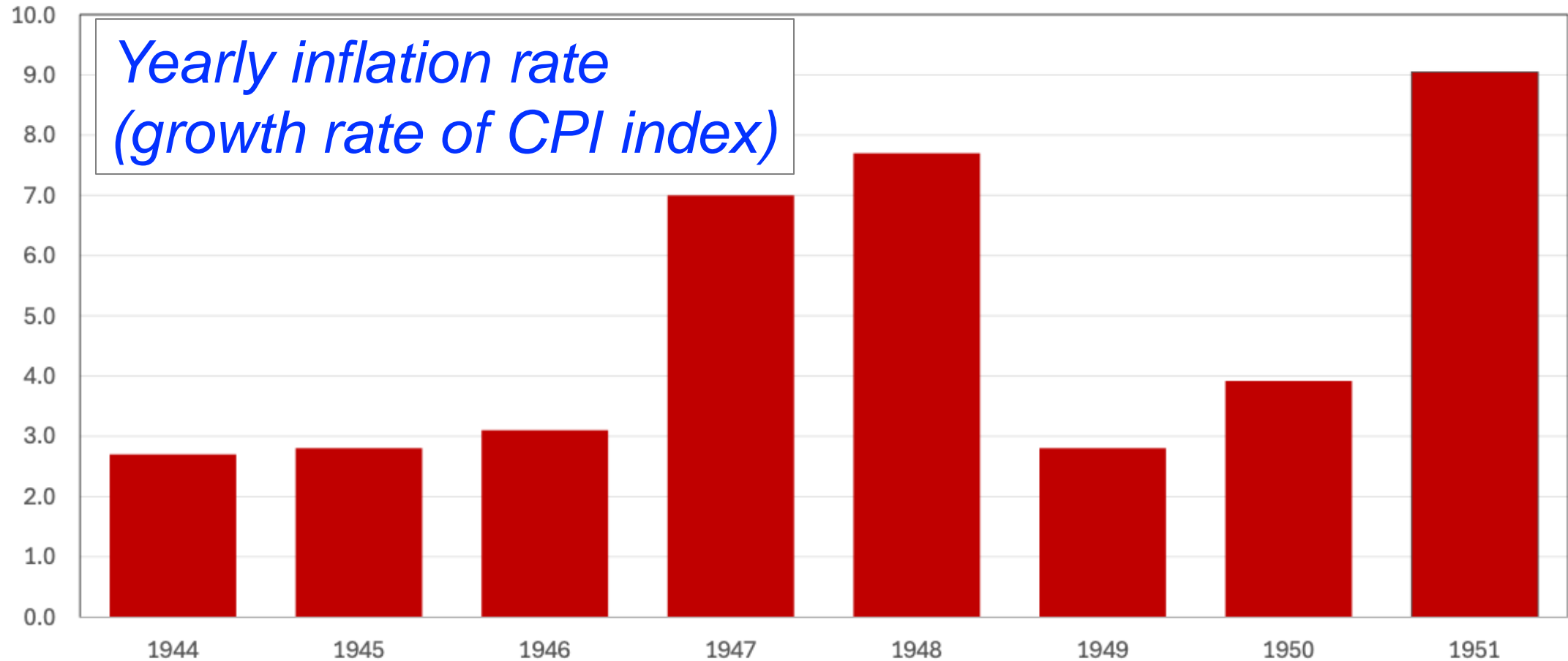
Mar-Aug: Dollar drain & convertibility crisis.

Aug: Convertibility suspended.

Apr 1948: Marshall Plan.



1947: A year of crises

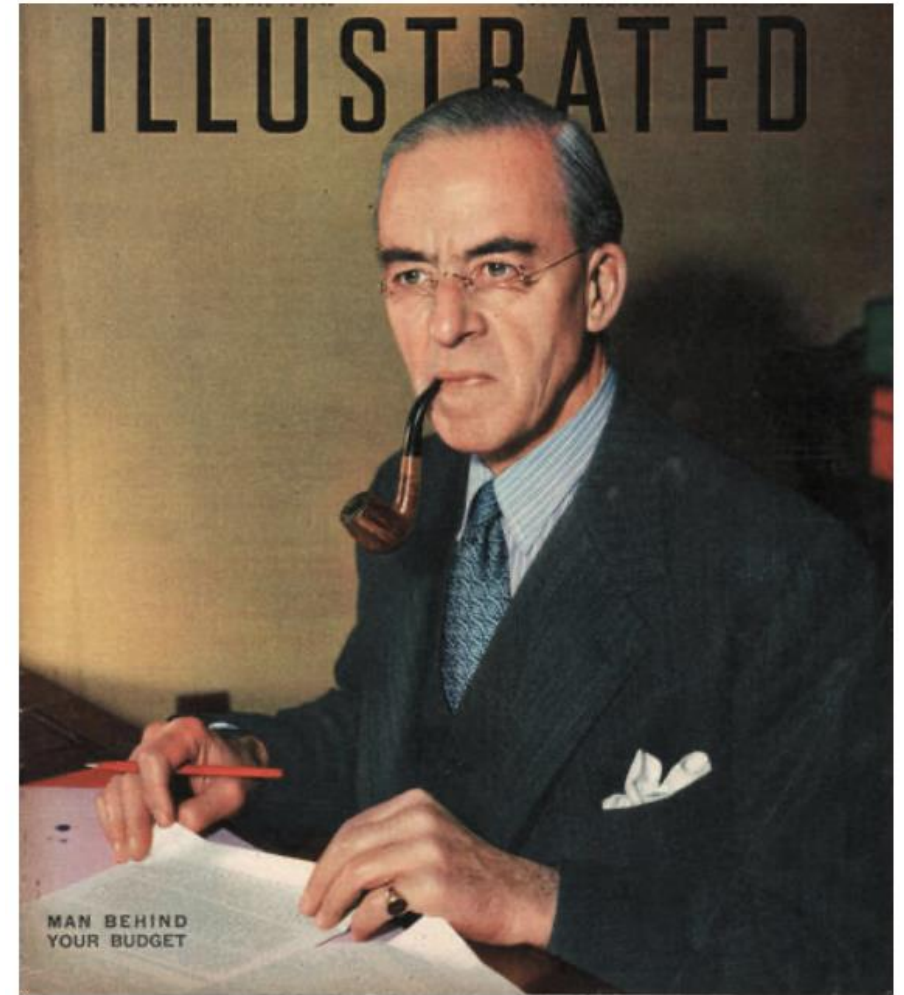


1947 budgets: Labour austerity

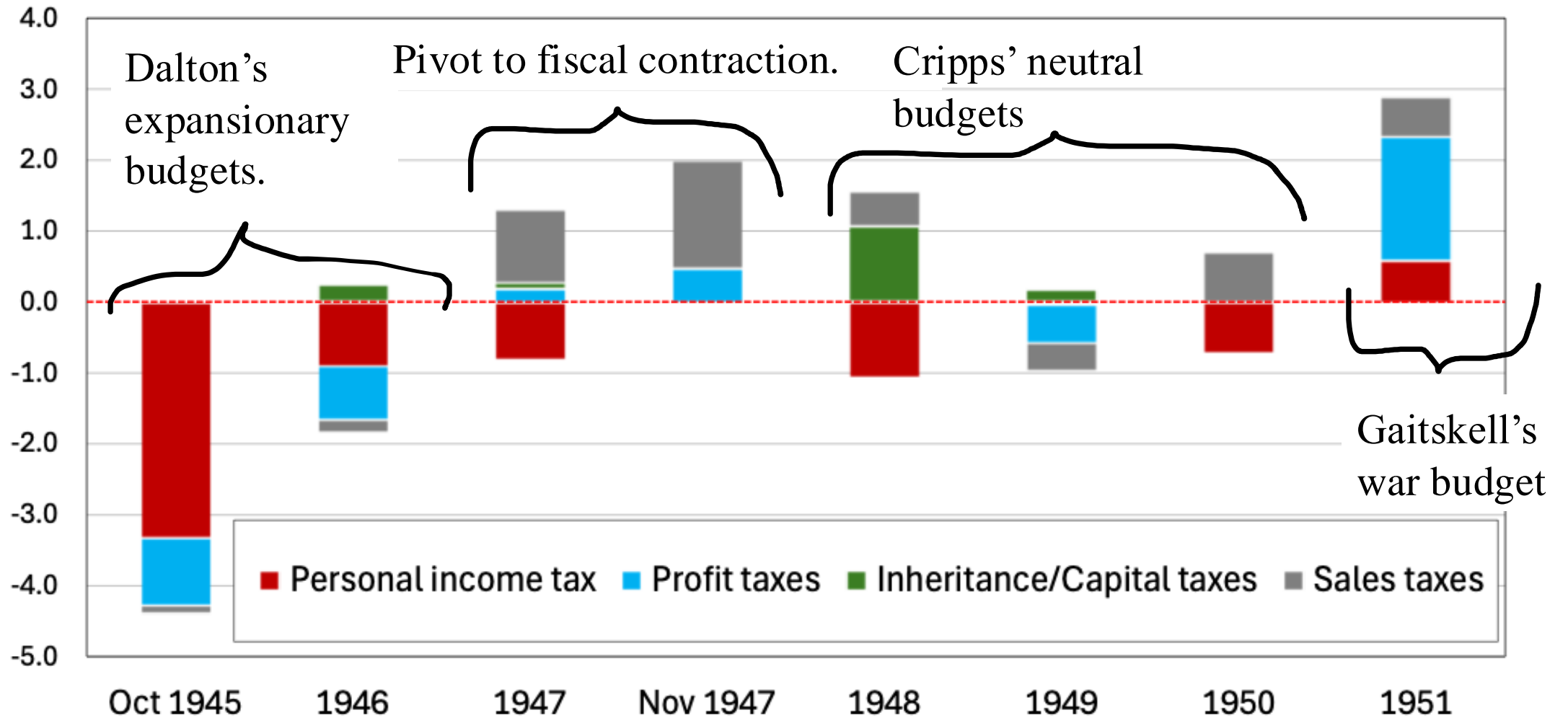
- 2 budgets: Apr & Nov.
- Inflation now the biggest threat.
 - *“deflation is no longer the immediate danger today. The immediate danger is of an inflation going beyond bounds, and breaking through the various controls that we have set up.”* (from Dalton budget speech)
- Taxes raised by 2.5% of GDP.
 - Sales, profits & inheritance taxes up.
 - Personal income tax further reduced.
- Large public investment cuts.
- Dalton resigns after inadvertent leak to the press.

Sir Stafford Cripps' 1948-50 budgets

- The face of Labour austerity (although Dalton started it).
- Overall, 1948 to 1950 are basically 'no-change' budgets.
 - 1948 'Special contribution' on wealth.
 - Personal income tax reduced further.
- Large budget surpluses.

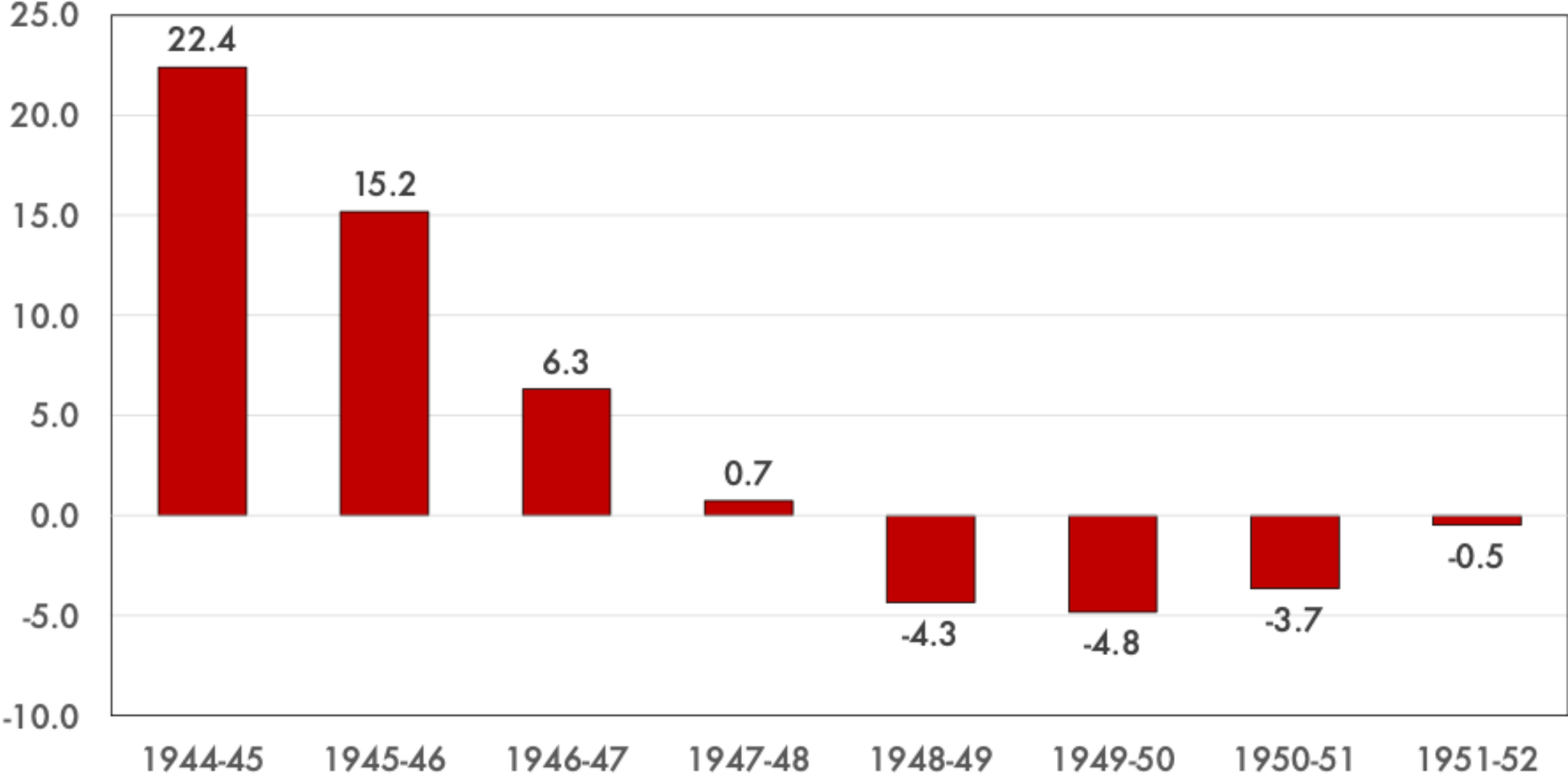


Budget tax changes 1945-51



Source: Dow (1964)

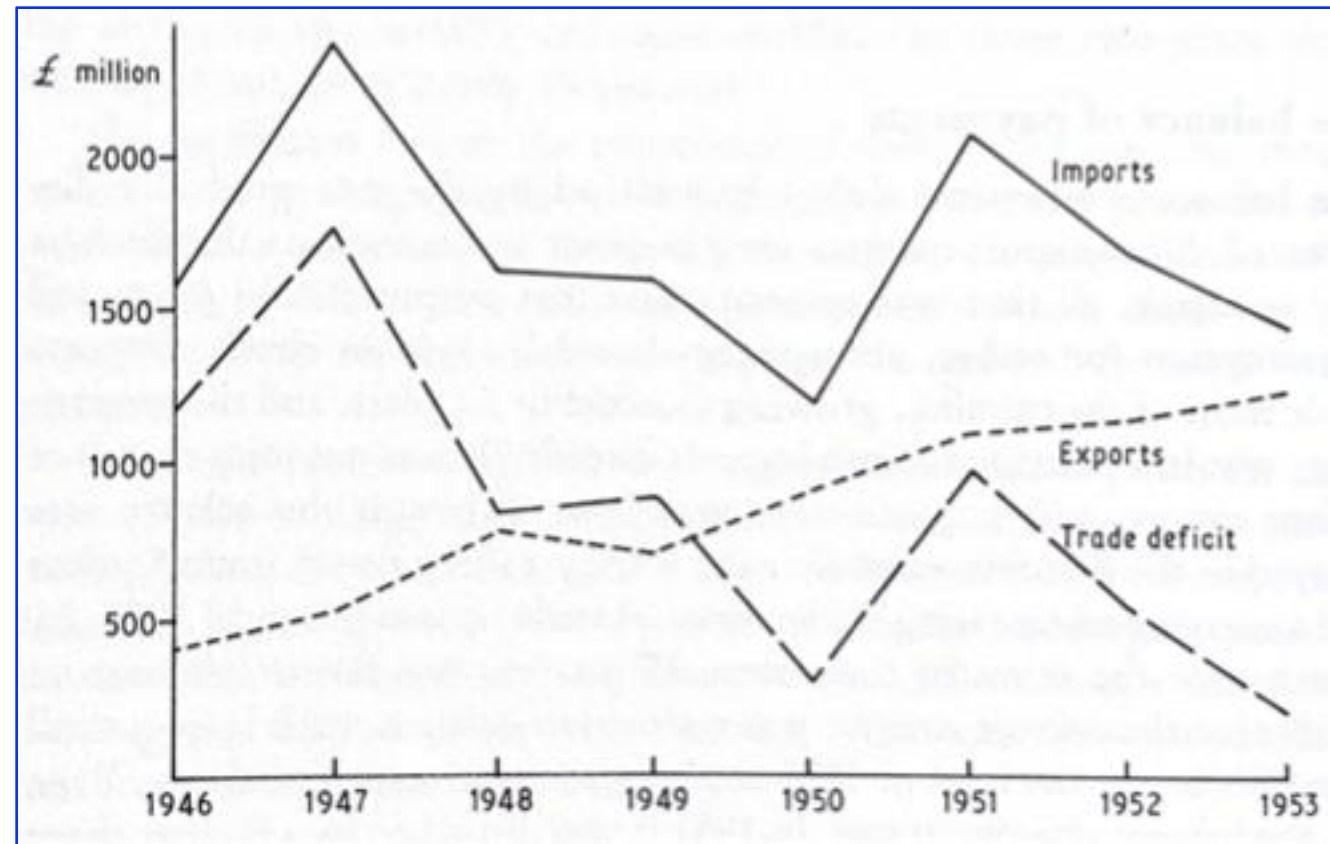
Public sector net borrowing (% of GDP)



The 1949 sterling crisis

- Deficit with \$ area persists.
- Debate on devaluation.
- Gov't decides against.
- Run on sterling forces devaluation in September.
 - \$4.03 -> \$2.80 (30.5%)
- Other countries follow suit.

UK trade with dollar area

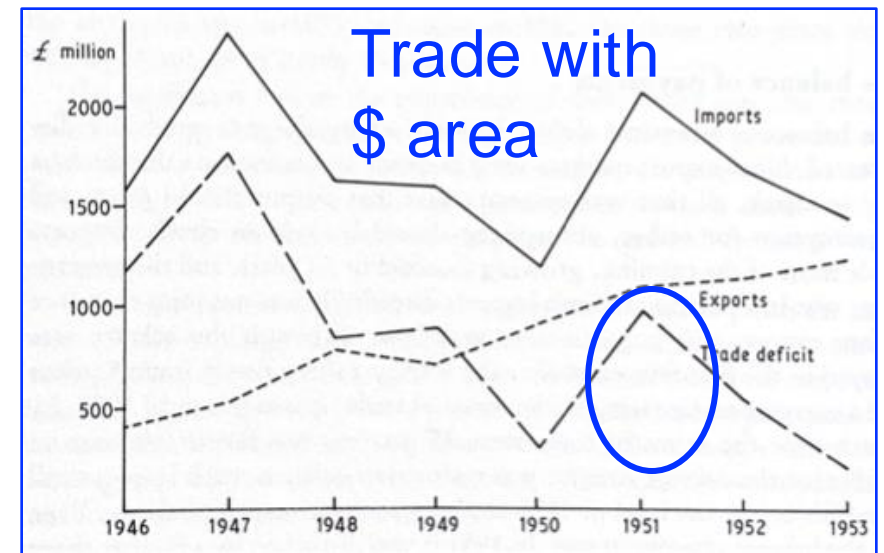
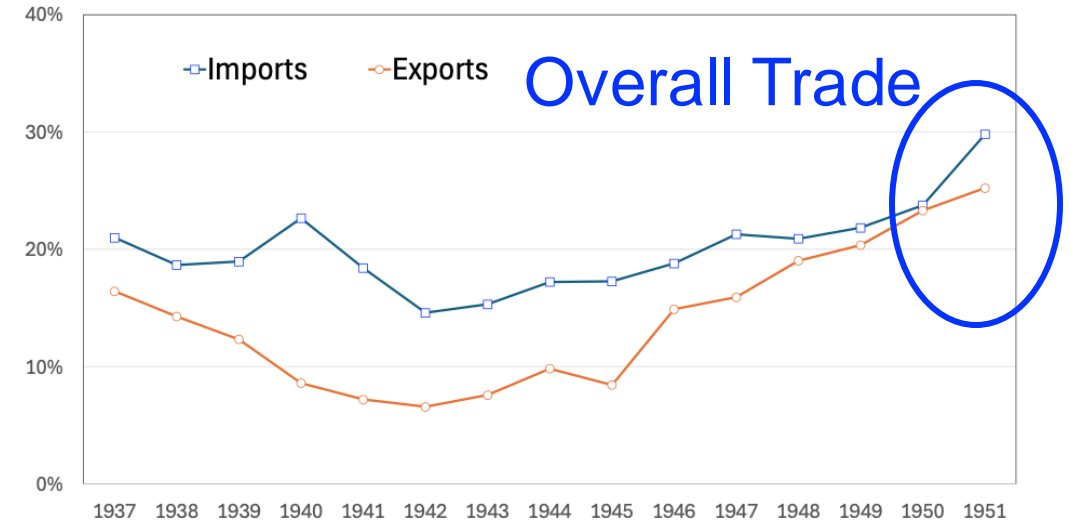
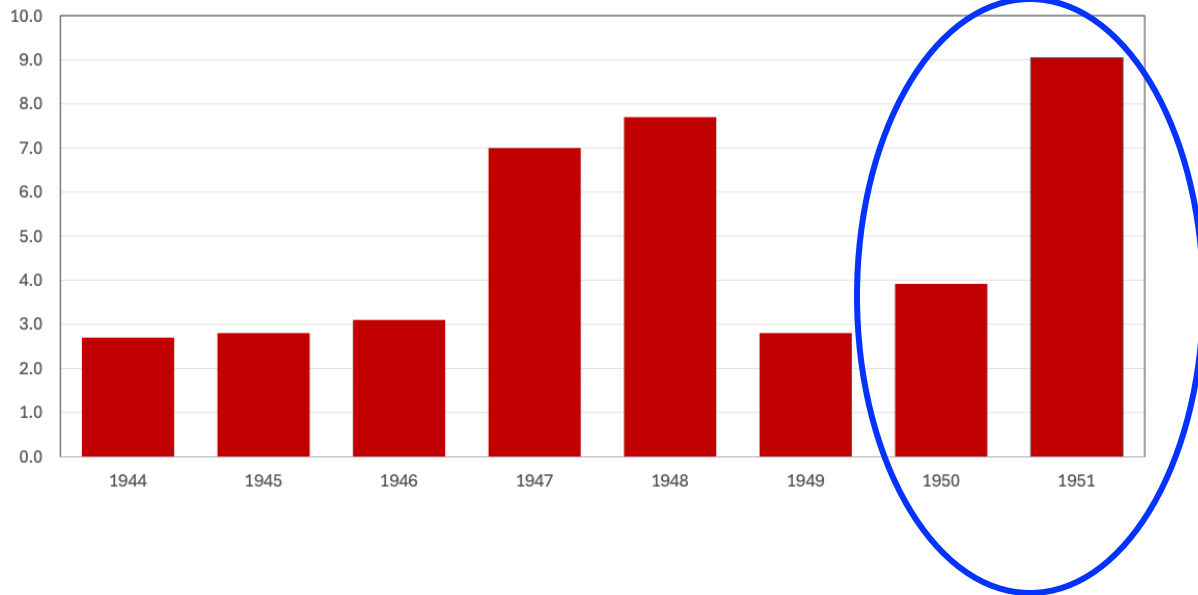


1950: Election & Korean War

- **Feb 1950 election:** Labour returned but thin majority.
 - PM Attlee & Chancellor Cripps stay.
- **Apr 1950:** 'no-change' budget.
- **Oct 1950:** Cripps resigns, Gaitskell Chancellor
- **Summer 1950:** Korean war starts.
 - Global rearmament → commodity price boom → inflation, trade deficit.
 - PM Attlee announces large UK rearmament program.

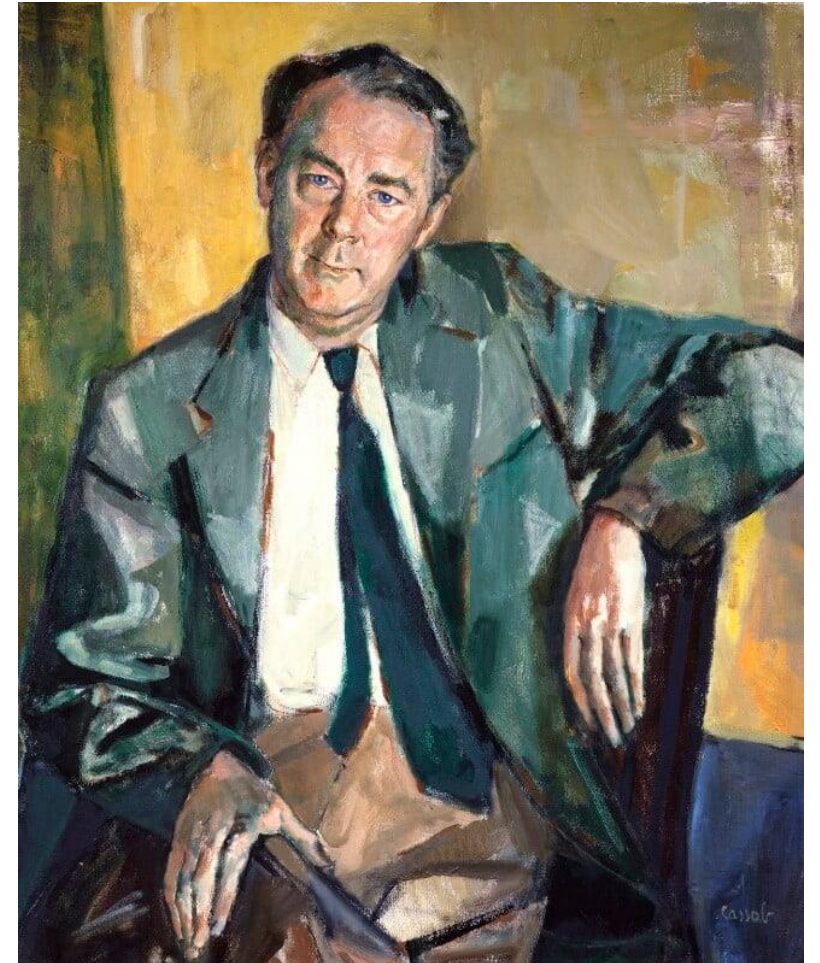
1951: Korean-war crisis

Inflation



Gaitskell's 1951 war budget

- Dominated by rearmament program.
 - +£700 million budgeted (5% of GDP).
- Large increase in taxation.
 - +387 million (2.9% of GDP)
 - Across the board, but especially profit tax
- Measures to limit NHS spending
 - Small (£13 to 25 m/year) but controversial.
- Monetary policy remains passive
 - Gaitskell resists Bank's proposed rate hike.



Labour splits over the budget

Harold Wilson & Nye Bevan resign over rearmament.



*“The Budget (...) included **a re-armament programme which I do not believe to be physically practicable** with the raw materials available to us. (...)*

If (...) rearmament runs beyond the physical resources that can be made available, then re-armament itself becomes the first casualty, the basis of our economy is disrupted and the standard of living (...) is endangered.” [Wilson resignation speech, 24/04/1951]

- Government falls, Oct 1951 election returns the Tories.
- Wilson proved right : By end of 1951 becomes clear that the intended scale of the program could not be achieved because of resource shortages.



Thank you for your attention