The spirit of ’45? Austerity then and now

Jim Tomlinson

The years of the Attlee government between 1945 and 1951 are commonly regarded as years of austerity, symbolised above all by the policies of Stafford Cripps, Chancellor of the Exchequer from 1947 to 1950. But austerity in the 1940s meant something very different from its use today. If we compare the two periods it is the differences rather than similarities that stand out. But analysing these differences helps us understand important aspects of the contemporary political economy of Britain.

Supply-side socialism in the 1940s

In the 1940s the meaning of austerity was quite clear. It meant holding back the growth of private consumption so that resources could be transferred from the war effort to civilian uses, with most of those resources flowing into exports and investment. In economic terms this policy was very successful; between 1946 and 1952 consumer spending rose by 5.9 per cent, but fixed investment by 57.9 per cent and exports by 77 per cent (Cairncross, 1985, 24). Politically the consequences were problematic for the Labour government. The holding back of consumption, and the rationing and controls which accompanied this restriction, allowed the Conservatives to mount an effective campaign to ‘set the people free’. This campaign mobilised the Conservative vote, and seems to have been especially effective amongst women who bore the daily brunt of dealing with austerity and the frustrations of shortages of goods for everyday consumption (Zweiniger-Bargielowska, 2000). Labour’s majority was minimal in the general election of 1950, and the government lost office in 1951.

The commitment to a rise in investment flowed from a strong sense in the Labour
Labour and the economy  Austerity then and now

leadership that their commitment to full employment and expanded welfare provision as the centre of the post-war settlement was only politically feasible in an expanding economy. Some of the investment was itself part of delivering on that settlement, most notably in housing, where construction was overwhelmingly concentrated in the public sector. While the number of houses built was impressive, reaching a peak of almost 200,000 per annum, the targets of 1945 were not achieved, and after 1947 the programme was cut back in order to release labour and timber for other uses (Cairncross, 1985, 451-2). The biggest increase in investment was in plant and machinery, and the sector that benefited most from the government’s priorities was manufacturing and construction (Cairncross, 1985, 456; Chick, 1998, 16-24).

Unlike today’s austerity, that of the 1940s was accompanied by expanding welfare provision. The 1940s were of course the years of the inauguration of the NHS, expansion of education, and a major increase in social security provision both through National Insurance and National Assistance. However, three points about this much-emphasised expansion of the welfare state are worth noting. First, because of buoyant demand for labour, expenditure on social security rose much more slowly than had been budgeted for in wartime planning; payments of unemployment pay and sickness benefit (demand for which rises when the labour market is slack) had been based on unemployment levels of 8.5 per cent, while the trend rate in the 1940s was around 2 per cent (Tomlinson, 1997, 254). Second, this expansion was of entitlement to very low standards of support. The newly-expanded National Insurance system, constrained to offer flat rate benefits for flat rate contributions, had to have contribution levels affordable by the low paid, and hence offered benefits which mean we can rightly talk of an ‘austerity welfare state’ (Tomlinson, 1998). Third, while entitlement to welfare greatly expanded in the 1940s, physical provision in the form of schools and hospitals, especially the latter, was heavily constrained by the priority given to industrial investment. Thus, for example, despite the hopes entertained at the founding of the NHS, no new district general hospitals were built until the 1960s.

What the above discussion should make clear is that in the 1940s austerity was driven by a macroeconomic problem of demand outrunning supply, and therefore the need to restrict private consumption in order to prioritise exports and investment. This excess demand accounts for the low unemployment levels, and also for the government’s supply-side initiatives, in areas such as subsidies for research and development, expansion of technical education and a drive to import what were perceived as the superior techniques of American industry for achieving high productivity; this was the 1940s version of ‘supply-side socialism’. This excess demand was countered not only by rationing and controls, but increasingly by tight fiscal policy, so that for most of its years in office the Attlee government was running a budget surplus, and reducing the national debt. The public sector was therefore a big contributor to aggregate savings in the economy, as was the company sector, which was highly liquid from accumulated wartime profits. The household sector also saved, but this was mainly driven by the unavailability of consumption goods, and as rationing and controls slackened, household savings fell sharply.
Rebalancing the economy?

The context for the austerity of the 2000s is plainly very different from that under Attlee. The economy is suffering from inadequate, not excess, demand, and at the centre of the Coalition’s strategy is the desire to cut public spending in order to reduce the fiscal deficit, and within those cuts to focus on reducing social security entitlements, especially amongst those of working age and their children. Notwithstanding these huge differences, there is a parallel to be drawn, best summarised in the aim to ‘rebalance’ the economy. Julie Froud and her colleagues have rightly suggested that recent emphasis in political rhetoric on ‘rebalancing’ has been ‘a shifting or more or less vacuous trope’ (Froud et al., 2011, 36), but the term has on occasion been used by the Coalition to suggest a strategy akin to that of the 1940s (1). In his first budget Osborne asserted that ‘our policy is to raise from the ruins of an economy built on debt, a new, balanced, economy where we save, invest and export’ (Osborne, 2010). While the 1940s was innocent of the term ‘rebalancing’, these proclaimed aims of the Coalition echo those of the 1940s, and we can helpfully compare the context and possibilities of achieving these aims across the two eras.

As regards aggregate savings in the economy, there is some initial similarity in the position regarding public sector saving. Both the Attlee government and the Coalition inherited large public sector deficits, the one from the war, the other largely the consequence of the operation of the automatic stabilisers during the 2008-10 slump (2). The Attlee government’s desire to run a budget surplus, both to reduce demand and pay off debt, was easily deliverable given the scale of cuts in military spending made possible by peace, coupled to the continuation of the very high tax rates imposed to pay for the war (though the trend in taxation under the Labour government was downwards). For the Coalition the problem is much greater, as there are no politically easy cuts to make in public spending. While there are still extravagant military programmes, for example the Trident replacement and new aircraft carriers, cutting these, even if politically plausible, would yield far less than the peace dividend of the 1940s. Reducing civilian programmes has focused on social security for those of working age, partly because so much other spending, on the NHS, schools, and above all social security for the elderly, has been ring-fenced against cuts. More broadly we can see that, in a political atmosphere wholly unlike the 1940s, cuts in benefit for those of working age can be allied with an electoral strategy of effectively treating all unemployment as voluntary, the result of ‘shirking’, and in this way further reducing the political salience of unemployment. (This is notably different from the Thatcher period, when, at least until the election of 1983, mass unemployment was assumed to be likely to have major adverse electoral consequences for the party in power) (3).

The other obvious fiscal contrast with the 1940s is the rapid post-war growth of the economy which yielded increased revenues (despite lower tax rates) and reduced expenditure on employment-related social security. Growth since 2010 has of course been much slower, when not negative, and so the Coalition has had to abandon its fiscal targets and accept a much slower fall in the deficit than initially aimed at. Doctrinally the two periods could not be more different; under Labour in the 1940s there was a slow, reluctant shift away from ‘planning’ as the key to improvement towards
Labour and the economy  Austerity then and now

Keynesian fiscal policies in order to put a lid on demand; by contrast, the Coalition has moved sharply away from New Labour’s Keynesian policy of pacing the reduction of the deficit to match the growth of the economy, to one of arguing that deficit reduction will cause faster growth. This difference is in turn embedded in a broader one: the Attlee government embodied the contemporary view that the War had demonstrated the efficacy of state action, while the Coalition partners are united in their desire to ‘roll back the state’.

But we need, as always, to be careful to assess the relationship between ideological commitment and policy outcomes. The desire to roll back the state is no doubt strongly held by both Conservatives and Liberal Democrats, but the long run story of Britain in recent decades is that in the wake of de-industrialisation the state has adopted an increasing role in providing employment, a process evident even in the Thatcher/Major years (Froud et al., 2011, 14-16). This phenomenon seems to reflect two long run forces. First, a continuing, if for Conservatives attenuated, concern with overall employment levels in a world where de-industrialisation has left the economy struggling to provide even minimum wage jobs for significant parts of the workforce. Second, on the demand side, powerful demographic and social pressures to provide ever-extending health facilities, social care and education, which are inherently highly labour-intensive services (Tomlinson, 2012). The effect of these pressures clashing with the desire to ‘roll back the state’ is likely to be increased out-sourcing and quasi-privatisation of such provision, where it will still be largely funded by the public sector but organised by charitable and private partnerships with poorer wages and conditions for those who provide these services.

Saving and investment

When we turn to household saving there is also a very sharp contrast between the 1940s and today. The Attlee government inherited an economy in which wartime full employment coupled with an absence of goods to buy had driven households to unprecedented levels of saving, much of it, especially amongst the working class, held in cash (Roodhouse, 2013). While this level of saving declined as goods became available, the contrast with today’s very high levels of household indebtedness is stark. The moralistic discourse about borrowing that is now common is often misplaced; a capitalist economy is founded on debt relations. Nevertheless, the scale and pattern of debt is economically significant.

In statistical terms the low level of household saving in the UK is simply the correlate of very high levels of consumption spending relative to income. These levels of consumption can be linked to a whole set of institutional, social and cultural changes which have unfolded since the 1940s (Offer, 2006, 2008). But a crucial underpinning has been an unintended consequence of the ‘property-owning democracy’ pursued by Conservative, and less enthusiastically, Labour governments. As a result of the subsequent growth of home ownership (and slow growth of the housing stock relative to population), housing in Britain has increasingly been treated as a financial asset, and with long-run upward movement of house prices this has enabled households to fund large volumes of consumption from equity withdrawal. To a startling extent this with-
drawal has underpinned much of the growth of the British economy since at least the 1970s, with peak levels in the 1980s and 2000s before the crash (Froud et al., 2011, 22). Housing has thus become not only a key political issue, but embedded in macroeconomic management; rising house prices have become a widely accepted index of economic prosperity.

Analysts of long-run trends in the British economy emphasise the need to raise the household savings ratio, arguing that the current levels are not sustainable, given the need to invest to fund future consumption, and the need to pay for the future costs of pensions; the rise in net saving probably needs to more than double from its level of 4.5 per cent of GDP in 2005 (Weale, 2012, 76). Osborne’s rhetoric, as indicated above, suggests support for this aspect of ‘rebalancing’. But the obstacles to achieving this are enormous. Attaining such an objective would require a much more severe squeeze on consumption standards than has already occurred in the wake of the crash, and which would have to be sustained during the recovery phase of the cycle. And even if the political will were there, the means of achievement are not at all clear. A programme of 1940s-style rationing and controls is hardly plausible, and curbs on household borrowing are at odds with the evident desire to rekindle house price inflation with subsidies to mortgages. The end of the distinction between banks and building societies has made insulating household borrowing for house purchase from that used for general consumption much more difficult. While there is no doubt much windy generalisation about the ‘consumer society’, the political significance of continuously rising consumption standards seems clear (4). Other government policies have also mitigated against increasing the savings ratio, most importantly the discouragement of contractual savings via pensions schemes by reducing the benefits of both private and public sector occupational schemes.

Both the late 1940s and the current austerity are periods of cheap money, which other things equal should stimulate private investment. However, in the 1940s there was much less reliance on this mechanism and investment decisions by the private sector, with around 50 per cent of fixed investment in the public sector, including both nationalised industries and direct spending by government. By the end of the century the first of these had largely disappeared, and the private sector accounted for over eighty per cent of all fixed investment. This poses severe problems about how to encourage fixed investment in long-lived, infrastructural assets, where rates of return are necessarily highly uncertain, without granting significant monopoly powers (Chick, 2010).

Widespread nationalisation did not give the Attlee government straightforward control over the nationalised industries’ investment, with the public corporation structure conferring considerable autonomy from the government. But control was helped by an overall strong excess demand for investment, so that the government was not in the position of stimulating investment, but curtailing the total and trying to shape the distribution, especially by the allocation of physical resources of labour, iron and steel, and timber. The curtailment of the total was largely to allow more resources to go into the production of exports, while the distribution tried to balance the urgent political demand for housing in particular against the need to expand the industrial economy in the broadest sense, including by a huge expansion of electricity generation (Cairncross, 1985, 446-62).

Private sector investment demand was very strong in the late 1940s, and while
monetary conditions helped this, the key stimulant was probably expectations of future profits, in part linked to new technologies developed out of the War. Contemporary policy also helped by committing governments to pursue ‘high and stable’ employment, in the words of the 1944 White Paper, *Employment Policy* (Matthews, 1968). Eventually this investment boom ran out of steam in the 1970s, and this was one motive for attempts to reverse the fall of the share of national income going to profits, which started to fall from the 1960s. But while the profit share of national income has indeed been increased following the anti-union and other liberalizing policies of the 1980s, there was no revival of the trend rate of investment, and the level has fallen sharply in the current crisis (Driver and Temple, 2012, 14-15).

In a service-dominated economy such as we now live in, a 1940s-style policy of focusing almost entirely on industrial investment is no longer appropriate, and there is a further argument in some of the literature that for the purposes of long-run growth investment in human capital, rather than physical capital, should be the focus (for example Crafts, 1991). But Osborne’s stated aim is to increase conventionally measured physical investment, including some ‘rebalancing’ towards manufacturing. However, the instruments to achieve this are very few in number under the current policy regime, most reliance being put on general macroeconomic and tax policies, rather than pursuing any discrimination in favour of manufacturing. Powerful doubts have also been expressed about whether, even if the government reversed its ideological opposition to ‘picking winners’, such a policy would do much to revive an indigenous manufacturing sector characterised by small scale and highly attenuated supply networks (Froud et al., 2011, 38-46).

‘Export or die’

Rebalancing towards exports is the third stated aim of the Coalition. This aim is not straightforward. While the Attlee government’s slogan of ‘export or die’ made the claim that exports were needed to pay for necessary imports of food, raw materials and machinery, this sense of a ‘balance of payments problem’ is no longer part of the policy discourse in Britain (Clift and Tomlinson, 2008). This is despite the fact that the current account of the balance of payments has shown a persistent deficit of around 2 per cent of GDP since the mid-1980s. This deficit has been funded from the net income from overseas foreign direct investment, a surplus arising both from British residents holding more overseas assets than non-Britons hold in Britain, and because the rate of return on these British-owned assets exceeds that on their foreign-owned counterparts. This surplus outweighs the net outwards interest flows on other kinds of foreign investment (Kuenzel, 2012, 83). This position carries risks, especially because of the size of the UK’s external balance sheet, which is roughly equivalent to seven times GDP (note that almost all the liabilities and the assets are with the private sector: most of the UK’s public sector debt is held domestically). These risks could only be diminished by reducing overseas debts, which would require higher domestic savings; as suggested above, for households at least this appears an unlikely prospect.

The current account deficit on the balance of payments arises from a deficit in manufactured goods, only partly offset by a surplus in invisible earnings, especially from
financial and business services. It has long been a view on the left that this manu-
facturing deficit is a major problem, which constrains the growth of the economy: that
Britain suffers from a balance of payments constraint which needs to be addressed
urgently (Driver and Temple, 2012, 54-70). The Coalition’s aim to ‘rebalance’ in favour of
exports does not seem to be based on the notion of such a constraint, though the
increasingly common rhetoric about the need to face up to a future of ‘intense Asian
competition’ suggests a vague notion that the balance of trade feeds back into
domestic prosperity. There is certainly no sign that this rhetoric is going to lead to a
fundamental rethink about economic policy, but seems rather to be linked to arguments
about the need for further ‘liberalisation’ of the economy.

Conclusion

The general conclusion from this discussion is that ‘austerity’ aimed at ‘rebalancing’ the
economy in favour of exports and investment and away from consumption is easier in
circumstances of excess demand, where government has leverage to direct resources
in the desired direction. In a situation of excess supply, taking resources out of public
consumption and from the incomes of the poor does nothing directly to encourage the
growth of exports or investment. There has been little sign of rebalancing so far. Despite
the fall in the exchange rate (around 25 per cent from its pre-crash level), there has been
no ‘export-led’ recovery. Investment continues to stagnate. There has been a rise in
household saving, but this is largely cyclical. In such unpropitious circumstances, the
most likely response by government to sustained excess supply is to take measures to
boost consumption, and the easiest way to do that in modern Britain is to ‘stoke-up’ the
housing market. This seems to be how the economy is beginning to recover from the
post-crash recession.

Jim Tomlinson is Professor of Economic and Social History at the University of
Glasgow.

References

future: the case of the United Kingdom since the 1970s’, unpublished paper, University of
Edinburgh.
The contingent (re)construction of British economic performance assessment’, British
Palgrave.
Froud, J., Johal, S., Law, J., Leaver, A. and Williams, K. (2011) Rebalancing the Economy (or
Buyer’s Remorse), CRESC, University of Manchester.
Labour and the economy  Austerity then and now


Notes

1. The economic strategy of the 1945 government has also been explicitly invoked as a model by Ed Miliband: Miliband, 2013.

2. Of course, the Coalition’s ‘big lie’ has been that the debt and deficit they inherited was due to Labour’s extravagance in office, but in fact nearly all of it was down to the effects of the crash. Prior to 2008 Labour was running a small current account public sector deficit of around 2 per cent of GDP, and the total debt was at lower levels than when they came to power in 1997.

3. Under Thatcher, to reduce registered unemployment, large numbers of the unemployed were encouraged to move on to sickness and disability benefit. Under the Coalition, the likely consequence of their policies is that increasing numbers of the unemployed will disappear entirely from official statistics, and derive their incomes, such as they are, from family, charity, the black economy and crime.

4. One example of the strength of ‘consumptionism’ is the way in which unrestricted access to imported consumer goods is taken for granted by all political parties in the UK – including UKIP, whose policies include no advocacy of restriction on imports in the name of domestic employment, as traditional economic nationalism would have urged.