Published Weekly by
AMERICAN INSTITUTE
for ECONOMIC RESEARCH
Great Barrington, Massachusetts 01230

RESEARCH REPORTS

Vol. XLIV No. 14 April 4, 1977

Britannia Cannot Waive The Rules

On September 28, 1976, the British Prime Minister, Mr. James Callaghan, addressed the Labor Party Conference at Blackpool, England. The Labor Party is the socialist party of Great Britain. Speaking in his role as the leader of that party, many of his remarks concerned the conference itself and specific programs of his cabinet. However, a major portion of his speech was devoted to the fundamental problems facing his country, and several aspects of his remarks may reflect significant changes in the approach of the British Labor Party to the economic situation in Great Britain. Therefore, Mr. Callaghan's remarks may prove to be very significant for the future of Great Britian. We are publishing the following excerpts from his speech for this reason and because his views accurately describe the policies responsible for Great Britain's economic ruin.

Less than 100 years ago, Great Britain ruled the waves with its economic power as its base. Now that nation is struggling just to sustain itself. No matter what the initial economic power of a nation, policies of deficit financing, inflating, and income redistribution eventually have brought privation. This relationship could not be waived by Great Britain, nor will it be successfully waived by the United States.

Mr. Callaghan's Remarks

"For too long, perhaps ever since the war, we postponed facing up to fundamental choices and fundamental changes in our society and in our economy. That is, . . . we have been living on borrowed time. For too long this country has trodden the primrose path and borrowed money abroad to maintain our standards of life, instead of grappling with the fundamental problems of British industry. Governments of both parties have failed to ignite the fires of industrial growth in the ways that countries with very different political and economic philosophies have done. Take Germany, France, Japan – different countries, different philosophies.

"We are, as you know, still borrowing money. But this time we are not borrowing – if the Government continues on its present course – to pay for yet another short-lived consumer boom of the kind which used to buy success at the polls – or so we were told – but which never bought success in the world's markets or at the work place. We are borrowing now partly to pay for our huge investment in the North Sea. We are borrowing too, because other industrial nations volunteer credits, so that our strategy and our proposals for regenerating British industry need not be thwarted by short-term speculative movements of sterling balances – a load we have still been unable to shed. We are determined that this borrowing will be used to act and to press on with the task of rebuilding a regenerated manufacturing industry. This time we are not going for a consumer boom on borrowed money: we are going to invest it in our future.

"The cosy world we were told would go on forever, where full employment would be guaranteed by a stroke of the Chancellor's pen, cutting taxes, deficit spending, that cosy world is gone. Yesterday delegates pointed to the first sorry fruits: a high rate of unemployment. The rate of unemployment today – there is no need for me to say this to you – cannot be justified on any grounds, least of all the human dignity of those involved. But Mr. Chairman and comrades, I did not become a member of our Party, still less did I become the Leader of our Party, to propound shallow analyses and false remedies for fundamental economic and social problems.

"When we reject unemployment as an economic instrument – as we do – and when we reject also superficial remedies, as socialists must, then we must ask ourselves unflinchingly what is the cause of high unemployment. Quite simply and unequivocally, it is caused by paying ourselves more than the value of what we produce. There are no scapegoats. This is as true in a mixed economy under a Labour Government as it is under capitalism or under communism. It is an absolute fact of life which no Government, be it left or right, can alter. Of course in Eastern Europe you cannot price yourself out of your job, because you cannot withdraw your labour. So those Governments can at least guarantee the appearance of full employment. But that is not the democratic way."

Inflating Is No Cure for Unemployment

"We used to think that you could spend your way out of a recession, and increase employment by cutting taxes and boosting Government spending. I tell you in all candour that that option no longer exists, and that in so far as it ever did exist, it only worked on each occasion since the war by injecting a bigger dose of inflation into the economy, followed by a higher level of unemployment as the next step. Higher inflation followed by higher unemployment. We have just escaped from the highest rate of inflation this country has known: we have not yet escaped from the consequences: high unemployment.

"That is the history of the last 20 years. Each time we did this the twin evils of unemployment and inflation have hit hardest those least able to stand them. Not those with the strongest bargaining power, no, it has not hit those. It has hit the poor, the old and the sick. We have struggled, as a Party, to try to maintain their standards, and indeed to improve them, against the strength of the free collective bargaining power that we have seen exerted as some people have tried to maintain their standards against this economic policy.

"Now we must get back to fundamentals. First, overcoming unemployment now unambiguously depends on our labour costs being at least comparable with those of our major competitors. Second, we can only become competitive by having the right kind of investment at the right kind of level, and by significantly improving the productivity of both labour and capital. Third, we will fail — and I say this to those who have been pressing about public expenditure, to which I will come back — if we think we can buy our way out by printing what Denis Healey* calls 'confetti money' to pay ourselves more than we produce. . . . The moral I want to draw is this: that whatever system we live under, these fundamentals are at the heart of the standard of life of the people of the country concerned, and we ignore them at our peril. They are also at the heart of the Social Contract and of our industrial strategy.†

"Britain is now at a watershed. We have the chance to make real and fundamental choices about priorities which are absolutely necessary to achieve a growing and prosperous manufacturing industry, with all the advantages and easements that can follow.

. . . . .

". . . The first priority of the Labour Government must be a determined attack on inflation. That remains: we have halved it in the last twelve months but we must do more yet. The Government's objective must be to reach inflation rates comparable with those of our major competitors by the end of next year. We are already getting there."

The Elementary Facts

"Let me add one more thing about how to get a strong manufacturing sector of industry. Hold on to your seats. The willingness of industry to invest in new plant and machinery requires, of course, that we overcome inflation, but also that industry is left with sufficient funds and has sufficient confidence to make the new investments. When I say they must have sufficient funds, I mean they must be able to earn a surplus and that is a euphemism for saying they must be able to make a profit.

"Whether you call it a surplus or a profit, it is necessary for a healthy industrial system, whether it operates in a socialist economy, a mixed economy or a capitalist economy. If industry cannot retain and generate sufficient funds as a result of its operations, and replace old plant and machinery, then you will whistle in vain for the investment and we shall continue to slide downhill. These are elementary facts of life. They are known to every trade unionist. Who would they sooner go and negotiate with when they want an increase in pay: a firm that is bankrupt or a firm that is doing well and generating a good surplus?"

Creating and Distributing Wealth

"The primary concern of our industrial strategy and our economic policy for the next three years is quite simple. The strategy and the priority is to create more wealth, and to do it with the agreement and the support of the trade union movement. Our social policy is concerned with the distribution of wealth. These two aspects of policy should not be regarded as being in conflict, nor should we put them in conflict with each other. They must be harmonised. The wealth must be created before it is distributed. This is where I believe a misunderstanding, or perhaps something worse, has arisen between the Government and the Party on the question of public expenditure.

"You know we have not been creating wealth as fast as we have been distributing it. Over the last three years you know that our domestic product has risen by 2 per cent and the increase in our public expenditure, including central and local government, has increased by 18 per cent. We have made shift to meet this, yes, by higher taxation at some points, borrowing from abroad and, worst of all, by printing money. Now we have to get back into balance again. Of course it cannot be done in twelve months. Our creditors understand this. Those with whom we discuss these matters in other countries understand this, because the disruption would be too great for the social system to bear. But it would be folly to continue to borrow at the present rate of £10 billion a year even if we could find the lenders — and we are not always very polite to them.

"Whatever we do in the short term, the only long-term cure for unemployment is to create a healthy manufacturing industry that will hold its own overseas, and in doing so it will then certainly be able to retain its grip on the domestic market. It is by a healthy and expanding manufacturing industry that we shall be able, in due course, to resume the growth and improvement of our social services and also create the jobs that are necessary if we are to reach what we all desperately require: our full employment targets.

"Like everyone in the Labour Movement, I believe in a high level of public expenditure. But I part company with those who believe we can rely indefinitely on foreign borrowing to provide for greater social expenditure, a better welfare service, better hospitals, better education, the renewal of our inner cities and so on. In the end these things, comrades, are only provided by our own efforts."

Comment

Taken at face value, Mr. Callaghan's statements represent an outright rejection of Keynesianism. As a socialist, Mr. Callaghan can afford to do this politically, inasmuch as Keynes is not one of his party's heroes (Keynes was a Liberal). Moreover, events in Great Britain have provided sufficient evidence that the Keynesian "spend-for-prosperity" policies have been a complete failure. If future events reveal that the British government in fact now rejects the so-called Phillips curve, (the alleged tradeoff between the rate of unemployment and the rate of increase in the general price level) as a guide to its policies, this change also would reflect a willingness to confront the facts.

Other aspects of Mr. Callaghan's speech were directed to long-established socialist principles, which is why he instructed the delegates to "hold on to your seats" as he proceeded to describe the need for profits and other "elementary facts," such as the inability of anyone to re-distribute wealth if there is none.

Of course, words alone will not solve anything for the British. A cynic might argue that Mr. Callaghan's remarks were prompted only by the need to soothe Britain's creditors, rather than from any real conviction. The budget presented to Parliament on March 30 by Chancellor Healey provided for a \$2.5-billion reduction in taxes. However, this reduction apparently was not accompanied by any reduction in expected expenditures, and the estimated new British budget deficit of \$14.5 billion (comparable to a U.S. deficit of about \$55 billion) is only slightly less than that for the current fiscal year. Interestingly, the current British agreement with the International Monetary Fund entered into in connection with loans to Great Britain stipulates that the British deficit will not exceed \$14.8 billion. This raises the question of whether the international lenders, the British government, or both are the source of direction for any trend toward soundness in British policy that may become evident.

*Britain's Chancellor of the Exchequer. — Ed.

†These terms apparently refer to the Labor government's policy of direct wage and price controls and its attempts to curtail work stoppages. The successful imposition of these policies seems to rest on the close alliance between the Labor Party and the trade unions; i.e., the unions will support policies of the Labor Party that they would oppose if proposed by the Conservative Party. — Ed.

Whatever the situation, the ongoing experiment in Great Britain should be educational for those ready to learn.

STATISTICAL INDICATORS

Among the primary leading indicators of business-cycle changes, the layoff rate in manufacturing was unchanged during February, and the cyclical status of that series remains indeterminate. The percentage of primary leaders appraised as expanding cyclically remains 67.

No new data were received for any of the primary roughly coincident or primary lagging series, of which 100 percent and 83 percent, respectively, are expanding cyclically.

That eight of the twelve primary leading indicators appear to be expanding cyclically and only one primary leader apparently is contracting warrants the conclusion that general business activity will continue to expand during the next few months.

DEMAND

RETAIL SALES

Note: All data are adjusted for seasonal variations and trading-day differences.

According to the Department of Commerce, retail sales totaled $170.0 billion during the 3 months ended in January. This amount was 4.1 percent more than that during the preceding 3-month period and 10.5 percent more than that during the 3 months ended in January 1976. The trend of retail sales in constant dollars also has been upward during recent months. Such sales during the 3 months ended in January were 3.4 percent and 6.7 percent more, respectively, than those during the preceding and year-earlier 3-month periods.

Although the trends of both current-dollar and constant-dollar retail sales have been upward from cyclical troughs reached in November 1974, the rate of increase of retail sales in constant dollars has been substantially less than that in current dollars. Rapidly increasing prices were responsible for about one-half the 26.6-percent increase in current-dollar retail sales from November 1974 through January 1977, and constant-dollar retail sales increased a more moderate 14.1 percent then. Furthermore, although current-dollar retail sales have been at record amounts during nearly every month since April 1975, the estimated physical volume of such sales did not exceed the February 1973 record volume until December 1976.

As the data in the accompanying table indicate, the rate of increase in retail sales in both current dollars and constant dollars accelerated during the most recent 3 months. Sales of both durable and nondurable goods have accelerated; however, sales of durable-goods stores increased much more rapidly than sales of nondurable-goods stores.

PERCENT CHANGE IN SALES OF RETAIL STORES

	*Nov. 1976 through Aug.-Oct. 1976**	*Jan. 1977 from Nov. 1975-Jan. 1977*
Current Dollars		
Total retail stores	+17.3	+10.5
Durable-goods stores	+29.8	+15.2
Nondurable-goods stores	+11.7	+ 8.3
Constant Dollars		
Total retail stores	+14.1	+ 6.7
Durable-goods stores	+25.2	+ 8.5
Nondurable-goods stores	+ 8.8	+ 5.5

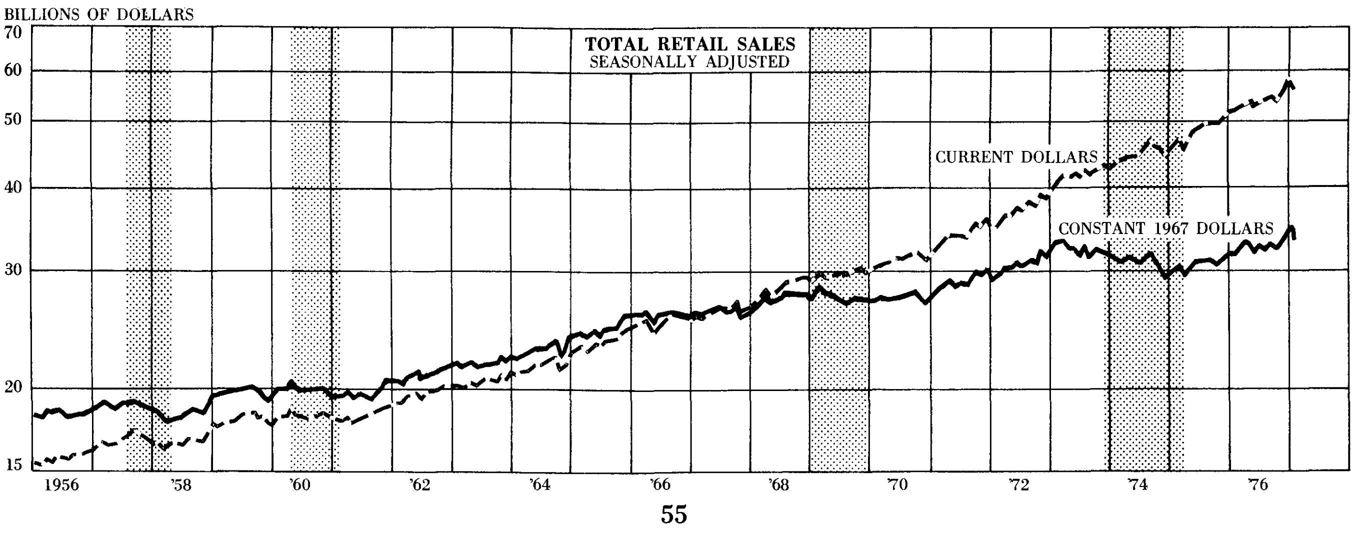
*Compound annual rate.

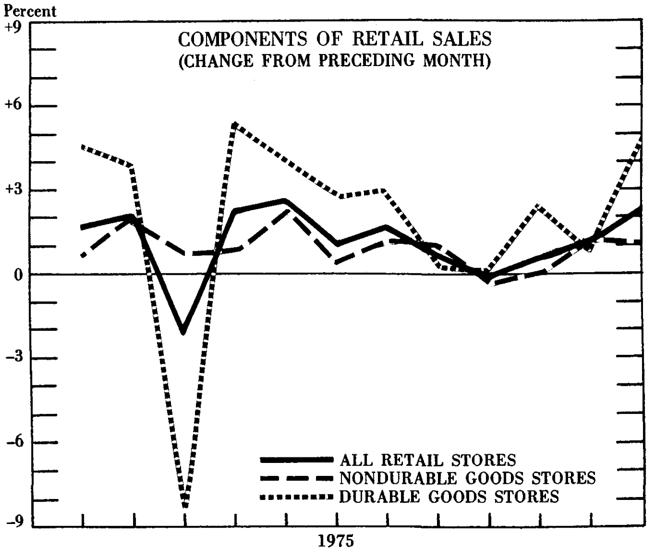
Much of the larger increase in the sales of durable goods during the 3 months ended in January was attributable to a 46.3-percent annual rate of increase in the sales of automotive stores then. Such sales had decreased during the preceding 3 months, apparently because of a lack of availability of some models of new automobiles due to a strike at the Ford Motor Company then. The rapid rate of increase in the sales of automotive stores during the November-January period probably reflected a "catch-up" of automobile sales then, following the end of the strike.

Over 3-month spans, retail sales of nonautomotive durable goods (which account for about 40 percent of all durable-goods retail sales) increased at unsustainable double-digit annual rates from June 1975 through May 1976. During the subsequent 2 months the annual rate of increase in such sales slowed to 3.2 percent in July. However, the rate of increase thereafter accelerated regularly, reaching 13.5 percent in December, and then diminished slightly to 9.2 percent in January. These data indicate that the pace of nonautomotive durable-goods retail sales is encouraging and was such during the months that all durable-goods retail sales were adversely affected by the strike at Ford Motor Company.

Sales of nondurable-goods stores in both current dollars and constant dollars continued to increase during the most recent 3 months. Such sales do not fluctuate as much as sales of durable-goods stores. The 3-month moving average of sales of nondurable-goods stores in current dollars has not decreased since December 1974.

Many economists have forecast that the income-tax rebate of $50 per person proposed by President Carter will stimulate the economy by increasing retail sales. They assert that most of the rebate will be spent on consumer goods. During 1975 a similar rebate was made. At that





time (April 1975) retail sales had been increasing from a trough reached in November 1974; nevertheless, Congress voted to stimulate demand further. However, the data indicate that in spite of the rebates, retail-sales increases did not accelerate. As the accompanying chart shows, the rate of increase in retail sales *decelerated* after the rebates reached the public in June 1975. If the total of the rebates plus the concomitant increased payments to Social Security recipients had been spent on goods, retail sales subsequently would have increased about 20 percent. Some analysts have blamed the "restrictive" monetary policy pursued by the Federal Reserve Board at the time of the 1975 rebates for the failure of the rebates to stimulate sales, which of course implies that rebates simply are a means of disguising a policy of inflating. Dr. Arthur Burns, Chairman of the Fed's Board of Governors, recently asserted that monetary policy will be less restrictive if and when the currently planned rebates are made to the public. If Congress agrees to the rebate plan, the results should be instructive. However, to expect that the proposed rebates this year will substantially affect retail sales when such sales have been expanding rapidly for more than 2 years seems unreasonable.

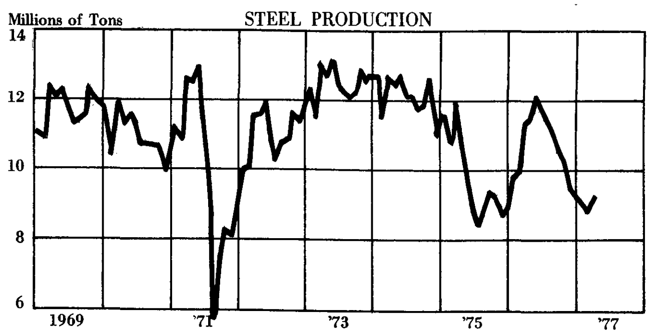
An advance-sample estimate of retail sales during February indicated that such sales in both current dollars and constant dollars increased then but did not exceed the record amounts during December 1976. However, advance-sample estimates often have been revised substantially after the full-sample data have been compiled. Nevertheless, because much of the large decrease in retail sales during January might have been largely attributable to the severe weather and natural gas shortages then that resulted in temporary closings of some establishments, retail sales during February most probably were larger than those during January.

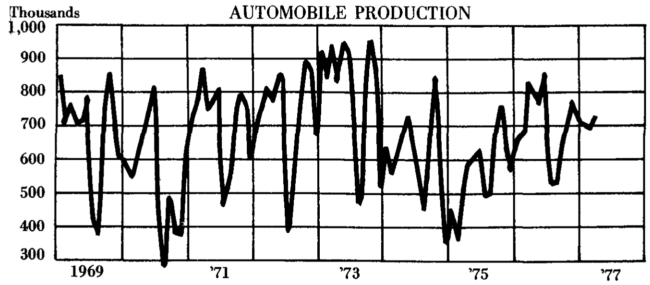
Increases in both current-dollar and constant-dollar amounts of retail sales are probable during the next few months, although the rates of increase probably will not be as large as those during November and December.

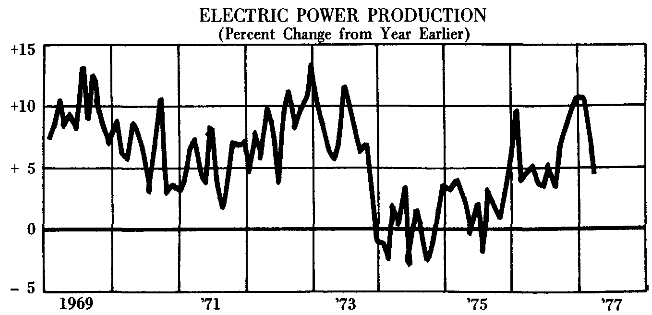
Latest Weekly Data

Estimates of retail sales during the most recent week and 4 weeks compare with such sales during the corresponding periods a year earlier as follows:

Period	*Percent change*
Week ended March 26	+11
Four weeks ended March 26	+10







SUPPLY

INDUSTRIAL PRODUCTION

Production of steel, automobiles, and electric power (1) in the 1- and 4-week periods ended on the indicated dates in the current year and (2) in the corresponding periods of earlier years was as follows:

Steel	*1972*	*1973*	*1974*	*1975*	*1976*	*1977*
Ingots (million tons)						
1 week: March 26	2.65	2.98	2.88	2.67	2.59	2.57
4 weeks: March 26	10.25	11.80	11.51	10.84	10.11	9.74
Automobiles						
Vehicles (thousands)						
1 week: March 26	184	213	151	106	185	203p
4 weeks: March 26	727	845	567	463	724	817p
Electric Power						
Kilowatt-hours (billions)						
1 week: March 26	31.4	34.2	34.4	34.1	36.0	38.7
4 weeks: March 26	129.1	135.8	137.8	141.1	147.3	153.9

Percent change from 4 weeks a year earlier: +4.5

p Preliminary.

PRICE OF GOLD

	1976	*1977*	
	Apr. 1	*Mar. 24*	*Mar. 31*
Final fixing in London	$129.20	$152.75	$148.90

Research Reports is published weekly at Great Barrington, Massachusetts 01230 by American Institute for Economic Research, a nonprofit, scientific, educational, and charitable organization. Second class postage paid at Great Barrington, Massachusetts 01230. Sustaining membership: $9 per quarter or $35 per year.