FINANCE, PUBLIC

Second World War

The economic strength of the country, with its financial capacity to bear the cost of war, had improved a great deal since 1918. On the other hand, it was realised that modern warfare would be exceedingly costly. The Government therefore decided to tax to the economic limit for war purposes and borrow for essential productive works and for any balance of war requirements (Budget, 1940). This would limit the accretion of unproductive debt.

A ready method of levying more tax was at hand; the principle of the social security tax was extended to a national security tax, first at 1s. in the pound of income, then at 1s. 6d. This was the most productive war tax. An excess profits tax and surcharges on income tax (the peak was 33 1/3 per cent), sales tax raised from 5 to 20 per cent on most items, (except essential household commodities), death duties (at new high rates entirely devoted to war finance), and on customs and beer duty provided most of the remaining war taxes. By 1945–46, the last year of hostilities, war taxation had reached £51.4 million, more than treble that of 1940–41 (£15.7 million), the first complete year. Out of this £51 million, the national security tax, borne by virtually every income earner, accounted for 42 per cent; sales tax, 20 per cent; income tax, 17 per cent; and death duties, 10 per cent. In comparison, ordinary taxation totalled £63.5 million in 1945–46, 40 per cent greater than that of 1940–41 (£45.6 million). Superimposed on a tax level already increased to meet the recent expansion of social security, the amount of war taxation was impressive, but not excessively burdensome in the circumstances. It was largely the proven capacity of the country to bear such a load that led to further increases in welfare expenditure after the war.

As in the previous war, overseas costs were to be financed in the first instance by United Kingdom Government loans: interest was to be the same as that paid by the United Kingdom itself on its war loans. The experience of the depression in servicing a large external debt was too recent to be ignored; at the outset it was resolved to meet out of export earnings as much as possible of the overseas costs of war. In the end, the Government went further and, by March 1946, had repaid the entire £61 million borrowed from the United Kingdom, leaving only the net balance of internal loans (£221 million) as the deadweight burden of the war.

One attempt was made at a compulsory loan, with an interest-free period and then a rate of 2½ per cent, the minimum contribution being related to income. Inevitably in the circumstances of rapidly increasing war expenditure, some recourse was had to Reserve Bank credit. Though Treasury bills increased by £30 million during the war, some of this, however, was for civilian housing. War loans were raised internally in the ordinary way at 2½ per cent short term and 3 per cent long term, supplemented by national savings from 1940, by the Post Office Savings Bank, and by investment of the surplus (“stabilisation”) funds of the dairy and meat industries.

Up to March 1946, £614 million of war (and rehabilitation) expenditure had been incurred, including £81 million reverse lend-lease. Of this, war taxation provided 37 per cent, general taxation provided another 4 per cent and met the interest on war loans, making an overall tax contribution of about 45 per cent. Internal loans provided 36 per cent. Starting in 1942–43, American lend-lease and Canadian mutual aid quickly reached massive proportions and contributed 18 per cent. The peak of annual war expenditure was reached in 1943–44 at £153 million. After 1945–46, war taxes ceased and the declining expenditure was financed from various sources, such as the sale of war assets.

Transactions of an unusual nature took place during and just after the war. In recognition of the disparity between prices of United Kingdom exports to us and our exports to United Kingdom (all the major primary products were sold wholly to United Kingdom on Government to Government contracts), the United Kingdom Government made, in 1944–45, a lump-sum payment of £20 million and undertook to pay £5 million annually for the remaining three years of a new four-year contract. These sums were used for the redemption of war debt.

In addition to paying off the remaining external war debt in 1945–46, the Government took advantage of abundant exchange reserves to redeem £29.6 million of ordinary 4 per cent and 5 per cent external debt, and thus reduced external interest; the 2½ per cent counterpart stock issued internally was taken up by the Reserve Bank and Treasury accounts. Another unusual transaction was a gift of £12.5 million to the United Kingdom Government in 1946–47.

Economic Stabilisation Scheme

An integral and important part of the war effort was the Economic Stabilisation Scheme, which commenced early in 1943, absorbing some preliminary phases such as price control and a limited range of subsidies. By a complex and far-reaching system of economic and financial controls, costs were held in check and the national effort directed into the most urgent and productive channels. Some of the more significant effects were:

1. Restrained costs affected the prices of produce sold under contract to the United Kingdom. Some financial recognition of this was, however, received.

2. From 1944 especially, large farm-industry reserves were accumulated from the difference between overseas contract prices and the internal level of payments under stabilisation policy. The investment of these large and increasing reserves in Government stock was a major factor in post-war Government finance. The reserves, £17 million in July 1946, rose to £63 million at July 1951, by which time surpluses on wool were having a large effect.

3. The second consequence of these reserves has been the underpinning of wool, meat, and dairy prices. The Wool and Meat Boards still rely entirely on their own funds, but Government assistance has been necessary at times to maintain the dairy price-support. Meat reserves have also helped finance producer-owned enterprises.

4. Stabilisation policy kept land prices at 1942 values for nearly 10 years. Thus, in contrast to the unreal boom in land prices just after the First World War, ex-servicemen of the Second World War found rehabilitation, in any case very soundly administered, a great deal easier; those taking up farms at 1942 values were virtually presented with a large capital reserve. When land-sales control was abolished, values generally doubled.

5. Probably the most far-reaching inheritance from stabilisation policy is the system of general wage orders, originally devised to bring controlled wage levels into line with the controlled cost of living.

6. As a *quid pro quo* for wage restraint (wages were held at award rates), the prices of essential foodstuffs and clothing were held down by price control and subsidies. Most of the main food subsidies are still in operation, long after the counterpart has ceased to operate. Their continuance is now part of welfare state policy.

Next Part: Social Services

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