1
The overall picture

The performance of the British economy since 1945 has been the subject of an enormous amount of commentary and analysis. Much of it has been in the nature of self-examination: not least because the achievement of a high rate of economic growth became the central aim of political endeavour. Failure to match performance to expectations has developed into something of a national neurosis.

The literature throws into sharp relief the essential dichotomy in the approach to this issue between economics and economic history. Economic historians, in contrast to economists, are wholly concerned with the explanation of events in the real world over real time and in which irrationality and inconsistency, arising from imperfect knowledge or blind prejudice, are frequently dominant elements which cannot be assumed away by means of such abstractions as *ceteris paribus* (other things being equal) and rational time. These differences do not mean that economic historians are cast adrift in a sea of events: they possess the potentially powerful faculty of hindsight, though it can easily be a powerfully deluding one. For this reason the present analysis does not go beyond the mid 1970s. Not only does this give sufficient length of focus, it happens to match an important break in post-war economic experience, for Britain and for the world at large.

For almost the whole of the period under review, the prevalent and strongly held belief was that Britain, in common with other major economies, had climbed out of the economic slough of the interwar years and was set on a broad and permanent path of rising prosperity and full employment. Economic growth was both the watchword and the mechanism of this advance (Arndt, 1978; Kregel, 1972; Worswick and Ady, 1962). Economics provided the calculus for measuring it and the rules for its satisfactory regulation. These rules stated that the economic world was Keynesian – equally in the sense that Keynes had explained the fundamental laws of economic motion and that in the process he had provided the prescriptions which would render high unemployment and stagnation as things of the past (Posner, 1978). In the UK and the USA economists were transformed from being the apostles of the dismal science into the prophets of the new economic enlightenment.

Economic historians writing during this period did not escape these powerful influences. Past problems – in particular in the interwar depression – were analysed within a framework which might be termed a Keynesian hindsight model (Pollard, 1969; 1983). Post-war success, to the early 1970s, was credited to the skilful practice of Keynesian demand management (Maddison, 1964). Even the most circumspective analyst was optimistic in tone (Dow, 1964). But since the late 1970s these same events have come to be viewed somewhat differently (Morris, 1979; Wright, 1979). The devaluation of the dollar in 1971 and the oil crisis which came soon after it ushered in high unemployment and economic stagnation (Beckerman, 1979; Blackaby, 1979). For Keynesian economists confusion was further confounded when these were accompanied by galloping inflation. From 1955 to 1969 inflation averaged just under 2.8 per cent per annum. Between 1969 and 1973 the rate rose to 5.6 per cent, and to 24 per cent in 1975 (Graham, 1979). Ingenuity did not desert economists, however, and they diagnosed the new disease of stagflation (Meade, 1982).

It now seems more probable that until the beginning of the 1970s there was a combination of elements favourable to rapid economic growth in the major economies, particularly those of Europe and Japan. The main ones were post-war reconstruction, a productivity gap between the USA and the rest which drew American dollars and know-how into Europe and Japan, a sharp upward shift in peacetime levels of public expenditure (caused by defence needs and welfare transfer payments) and the absence of general synchronisation in the downswings which occurred in the major economies from time to time. Arising out of these conditions, and at the same time reinforcing them, was a widespread and buoyant expectation of continuous growth which was powerful enough to ride out random shocks (Allsop, 1979). Over the late 1960s, however, these elements began to weaken: the largely once-for-all gains from the first three had been absorbed whilst the fourth was ceasing to hold. Furthermore, the very economic success of Western European countries and Japan amounted to a major shift in the international balance of economic power in which the position of the USA was transformed from one of hegemony into one of *primus inter pares*. This was matched by increasing synchronisation in economic fluctuations such that the crises of 1971 and 1973 reverberated throughout the whole system with an effect stronger than anything experienced in peacetime for nearly half a century. Any assessment of Britain's economic performance has to take account of these powerful external forces.

In political terms economic growth involved the commitment to 'a high and stable' level of employment (Employment Policy, 1944). Performance itself soon established norms which by 1950 were higher than had been hoped for in 1945; and then, as European recovery got underway, the standard became even more precise and, for Britain, more formidable. Full employment gradually came to be thought of as a fact of life whilst percentage rates of growth of this or that economic measure became the punctuation of political rhetoric. Indeed, political argument, policy-making and economic analysis were suffused with an increasing flow of statistical data which in range and scale was quite unlike anything which had been experienced before: to such a degree that by the end of the period under review the rate at which data were being generated exceeded, probably by a wide margin, the capacity to apply them in practical economic action.

Historically the marked increase in the flow and quality of economic statistics was a valuable outcome of the war effort. The needs of war, however, were clear cut. Economic management was largely a matter of measuring resources of manpower and materials and adjudicating between bids made for them by the armed services and the major industries. How different have been the needs of peacetime (Robbins, 1947). An ever increasing flow of economic data has been matched only by the multifarious ways in which it can be interpreted and applied in relation to economic policy. Moreover, any extrapolation from data as a basis for policy runs the high risk that the demonstration of a relationship will sooner or later cause a modification of the actions which determine it. Thus policy based on statistical forecasts can easily be rendered counterproductive. But almost certainly the biggest problem is reliability. Close examination of even the main data series which form the canon of economic management soon reveals that they are subject to significant margins of error. In theoretical terms there are acutely difficult (and often insoluble) index number problems. In practical terms there is an age-old problem of accurate recording. Figures for the balance of payments, which have been at the heart of much policy discussion since the war, are an outstanding example of most of these difficulties (Dow, 1964; Cairncross, 1985).

With these reservations in mind, the following tables provide some broad measures of Britain's economic performance since 1945. They cover mainly the period since 1950 in order to allow for the full return to peacetime economic conditions which occurred largely during the reconstruction period after 1945. Nevertheless, it will be argued below that the nature and form of economic reconstruction had a powerful, long-term influence on British economic performance. Accordingly, detailed statistics for the years 1945 to 1950 are provided in Chapter 2. The basic measures of domestic economic performance are set out in Table I. The figures present something of a paradox. By previous standards they register a marked improvement and to this extent justify post-war hopes: in the interwar period GDP had grown at approximately 2 per cent p.a. (Matthews *et al.*, 1982) In comparative terms, however, they testify to a poor record, the cumulative effect of which was a decline in Britain's international economic status to a level undreamt of even as late as 1955 (Kravis, 1976; Stout, 1979).

Trade figures, despite the fact that they show a sustained increase in the volume of exports, tell a particularly sad story of relative decline for a once dominant trading nation (Table II).

The most controversial figures, yet the most crucial for the analysis of Britain's growth record, concern the elusive concept of productivity. The main aggregate measures are shown in Table III.

Table I *UK comparative economic performance 1950–73*

	(i) Average % growth in GDP per annum				
	1950–5	1955–60	1960–4	1964–9	1969–73
UK	2.9	2.5	3.1	2.5	3.0
France	4.4	4.8	6.0	5.9	6.1
Germany	9.1	6.4	5.1	4.6	4.5
Italy	6.3	5.4	5.5	5.6	4.1
Japan	7.1	9.0	11.7	10.9	9.3[a]
USA	4.2	2.4	4.4	4.3	4.4

Sources: A. Cairncross, 'The Postwar Years 1945–77', in R. Floud and D. McCloskey, *The Economic History of Britain since 1700*. Vol. 2 (Cambridge, 1981), p. 376; (Jones, 1976, 80).
[a] GNP

	(ii) National income per head 1960 and 1973 UK = 100					
	UK	France	Germany	Italy	Japan	USA
1960	100	92	91	51	34	206
1973	100	124	144	68	94	164

Source: Prest and Coppock, 1982, *197*.

Table II *UK comparative trade performance 1945–75*

	(i) % shares of world exports of manufactures				
	1950	1960	1965	1970	1975
United Kingdom	25.5	16.5	13.9	10.8	9.3
France	9.9	9.6	8.8	8.7	10.2
Germany	7.3	19.3	19.1	19.8	20.3
Japan	3.4	6.9	9.4	11.7	13.6
USA	27.3	21.6	20.3	18.5	17.7

Source: (Blackaby, 1979, *241*)

(ii) Volume of UK exports 1963 = 100			
1945	20	1965	108
1950	75	1970	140
1955	80	1975	182
1960	90		

Source: Economic Trends.

Table III *Comparative productivity measures 1955–73 (Average % rates of growth per annum)*

	(i) GDP per person employed						
	UK	Austria	Belgium	France	Germany	Italy	Netherlands
1955–60	1.8	4.2	2.1	4.9	5.0	4.6	3.5
1960–4	2.2	4.6	4.1	5.0	4.7	6.3	3.4
1964–9	2.5	5.2	3.6	5.2	5.0	6.3	4.8
1969–73	2.8	6.4	4.2	5.0	4.2	4.5	4.4

(*Source:* Jones, 1976, p. 82)

	(ii) GDP per man year	
	USA	Japan
1951–64	2.5	7.6
1964–73	1.6	8.4

Source: (Matthews *et al.*, 1982, *31*).

The most exhaustive exercise of this kind centres on measuring productivity growth by methods developed by economists in the 1950s and 1960s (Denison, 1968; Matthews *et al.*, 1982). The sources of growth of gross domestic product (GDP) are divided into labour, capital and productivity. The difference (positive or negative) between the rate of growth of GDP and the combined, weighted rate of growth of inputs of labour and capital, known as total factor input (TFI), gives the rate of growth of productivity. The difference is defined as total factor productivity (TFP) because it is the change in output resulting from changes in the way in which quantities of capital and labour are employed and not from changes in the quantities themselves (Table IV).

As a broad measure of economic performance this analysis has some value. It exposes, for example, marked differences between the pre- and post-war periods in the UK. But the severe limitations of this technique become clear when account is taken of the conditions which would have to hold in order to render the results accurate. (Totally homogenous capital and labour markets; constant returns to scale over all ranges of output; marginal productivity pricing for all factors; continuous variable relationships between factors over time; land as an insignificant input.) Quite

Table IV *UK growth of total factor productivity 1924–73 (Average % growth per annum)*

(i) The economy as a whole

	Labour (man hours)	Capital Gross	Capital Net	Total factor input Gross capital	Total factor input Net capital	GDP	Total factor productivity Gross capital	Total factor productivity Net capital
1924–37	1.5	1.8	2.0	1.5	1.6	2.2	0.7	0.6
1937–51	0.1	1.1	1.3	0.4	0.5	1.8	1.4	1.3
1951–73	−0.5	3.2	3.9	0.5	0.7	2.8	2.3	2.1

(ii) Manufacturing industry

	Labour (man hours)	Capital (gross)	Total factor input[a]	Output	Total factor productivity
1937–51	1.0	2.9	1.6	2.5	0.9
1951–64	0.2	3.3	1.2	3.2	2.0
1964–73	−1.6	3.3	−0.1	3.0	3.1

Source: (Matthews *et al.*, 1982, *208*, *228–9*).
[a] Weighted combination of labour and capital.

apart from these constraints there are more familiar problems associated with compound growth calculations: the weighting of capital and labour is on the crude basis of their respective shares in gross domestic income; the technique of weighting from year to year is, as always, a compromise between different types of index; compound rates of change are constant over a given period and, therefore, may not adequately reflect sharp movements within the period. In terms of historical explanation the last difficulty is particularly important since TFP analysis pulsates to the rhythm of the sub-period and, as subsequent discussion will show, this constitutes a major problem for the so-called war period of 1937–51.

While recognising these problems practitioners of TFP analysis still claim that TFI and TFP, taken together, can tell us useful things about economic performance. But precisely how are the results to be interpreted? What is presented, like much in economic analysis, is an identity (TFI + TFP = GDP) and not a causal relationship. Any one or pair of these elements can be causal, and these relationships may change within the period being measured. Realistically, the process is multiplicative and not additive and it is subject to a complexity of varying lags. More specifically, considerable ambiguity attaches to the meaning of the term total factor productivity. In early studies it was called the residual – as such, it had more direct meaning, being no more nor less than a bundle of factors which cannot be quantified individually. It includes advances in knowledge, personal characteristics such as effort and experience, union power, government regulations. What are these other than the very stuff of economic development? And the striking, though perhaps not surprising fact, is that the residual (TFP) is usually the largest term in the identity.

The remaining measure of economic performance is aggregate domestic investment. Since 1945, Britain's record has been consistently better than that which she achieved in the interwar years – an average of 20 per cent of GDP as compared with 11 per cent (Matthews *et al.*, 1982). Yet again, however, in international terms Britain's record is far less impressive – over the late 1960s and early 1970s the averages were Japan 39%, West Germany 28%, France 27%, Netherlands 27%, Belgium 25%, Italy 21%, USA 18% (Caves and Krause, 1980). Moreover, the low figure for the

USA has to be seen against a much higher level of *per capita* income. It is necessary to stress, however, two specific problems connected with these figures. First, the collection of data depends heavily on published financial accounts which are produced for the quite different purpose of minimising company taxation, with corresponding differences in the definition of capital. From a national accounting viewpoint the distortions arising from this are probably large. Secondly, there are enormous index number problems in constructing price series for capital goods.

In sum, Britain's economic record since 1945 represents a notable improvement on the interwar period, but increasingly it fell well short of current expectations and the achievements of our major competitors. How this shortfall is to be accounted for forms the focus of the survey and analysis which follow. Moreover, it is not just a matter of explaining comparative failure. The degree of failure has led to differences in absolute levels of economic performance between Britain and most of the advanced economies, which have begun to alter the relationship between them.

As has been indicated above, there is a vast array of literature on the topic of Britain's post-war economic performance. Our analysis will seek to show, however, that much of the literature is concerned either with providing different (often ingenious) ways of measuring the fairly obvious symptoms of economic malaise, or with reports on how the 'British disease' of low growth and low productivity has affected various parts of the economy. In medicine, measurement and observation often lead to diagnosis and cure, though not invariably so. Certainly the British economy still awaits a convincing diagnosis of its ills.

The various statistical measures of performance which have been produced have indirectly served to reveal the crucial and probably dominant role of non-quantifiable influences in economic performance. Hence, our analysis will cover such issues as social and cultural attitudes, social structure, the role of economic ideology, the nature of the educational system, and the nature and operation of business corporations, the senior civil service and trade unions. It will be shown, however, that clear understanding of how, precisely, these factors affect economic performance is extremely difficult. But before turning specifically to this task, we must examine a little more closely the events of the immediate post-war years.

2
Post-war crises and reconstruction

Britain, alone among the European nations, joined in the military victory of the USA over the Axis powers. But in economic terms the relationship was different. Britain, in common with Europe and Japan, faced the daunting task of promoting economic recovery. By contrast, in the act of saving Europe from itself, the USA stimulated its own economic recovery from the collapse of the 1930s to such a level that by 1945 its economic strength presented the major barrier to economic recovery for the industrialised world.

The war caused a massive distortion in the deployment of resources when compared with peacetime conditions. For obvious reasons the use of manpower was particularly affected. Accordingly, manpower budgeting became the central task of wartime planning. Table V shows the main changes which occurred as a result of this activity. The armed forces absorbed way above the equivalent of both the natural and stimulated increase in the labour force. As between civil occupations, there was a massive shift of workers into war-related jobs. Some industries lost heavily. Building and civil engineering experienced virtually a 50 per cent reduction, whilst even the clothing industry suffered the loss of over one-third of its pre-war workforce. These and the other changes presented enormous difficulties in the immediate post-war years. Manpower shortages were acute in agriculture, textiles and coal-mining – the last of which had not performed well during the war mainly, though not entirely, as a result of a shortage of miners and an ageing labour force.

Substantial readjustments had occurred by 1948, as Table V shows. Even so, the process operated under conditions of acute