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FOREIGN LENDING, INDUSTRIALIZATION AND THE CLEARING UNION

The following memorandum is not intended to be in any sense critical of the Clearing Union. In the author's opinion, the draft scheme provides a most admirable introduction to the conversations on Article VII. It is evident, however, that it leaves some questions unsettled, it is probable that they will be raised at an early stage, if not by us, by the Americans, and it is the thesis of this paper that they involve certain points on which we ought to have very clear ideas if we are to safeguard our own interests and do our best for world prosperity.

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1. Apart from the sanctions of 7 (5)(c) which, if more than exceptional, would be evidence that the system was failing, and apart from provisions to prevent debtor countries further aggravating their condition by exporting capital, changes in the foreign exchange rates provide the sole explicit means in the draft scheme for securing an equilibrium of payments between nations.

Now, valuable as the system of flexible exchanges would be, it will probably not be argued by anyone that these movements would be potent enough by themselves to secure an even balance of payments on current or income account; and it is probable that such a balance is not desired. (It will sometimes be called "balance of trade" for brevity, hereafter).

To the balance on income account foreign lending must be added to arrive at the balance on total account. The question at once arises - is there anything in the scheme tending to secure that there shall be sufficient commercial lending to produce a balance on total account? If not, the debit quotas will be exhausted in due course and either the debit countries will be impelled to protect themselves by deflation, or trade barriers, or both - and the system is supposedly designed to avoid the necessity for either - or half the world will become liable to sanctions; in fact, the system will have broken down.

I do not think it can be argued that the system guarantees a sufficiency of commercial lending. Is it our plan, then, that commercial lending shall be supplemented either by additional lending through the machinery of the Union, e.g. by the debit quotas being progressively raised, or by additional lending planned by some affiliated International Body?

If it is the plan to foster additional foreign lending, it is our duty to ask ourselves what kind of developments we ought thereby to promote and we shall be expected to explain to the Americans our views upon this matter, both in their bearing on world prosperity and our own advantage.

2. An alternative idea should, however, first be considered, namely, that we should aim at reaching an even balance of trade at the earliest possible date, with each nation self-supporting on capital account. One attraction of this is that it would free our minds from the obsessing question - what is to be the end of all this lending? The obsession may, however, not be a very profitable one, since it is idle to plan for more than, say, thirty years. Far-reaching social and economic developments may occur within that period giving rise to quite new relations and problems. We know how Bolingbroke despaired of the future of his country because Walpole let the National Debt continue to grow when it stood at about £40 million! Again, it seems a little hard-hearted to deny to the rest of the world any benefits which

they might reap from the disposal of the surplus savings of the richer countries.

However, we must consider what would be the method and effect of aiming at an even balance of trade.

It appears that a sharp distinction ought to be drawn according as whether the measures to secure an even balance are taken by the credit or by the debit countries. Let us first consider measures by the credit countries.

It is important to remember that the persistent tendency to an export surplus is due to there being insufficient vent for savings at home. This situation has no necessary connection with a protectionist policy. Thus, Great Britain had a large continuous export surplus for more than half a century while adhering to rigid free trade.

It is sometimes argued - why should such a country as the United States wish to press her exports upon the world, when she has such a magnificent market at her own doors? This is an altogether fallacious way of regarding the matter. If the citizens of the United States did not save she could certainly find employment for her whole people in producing for the home market. The trouble is that her citizens do save, and the tendency to an export surplus is an expression of the existence of surplus saving. Such a country can only cut down her export surplus without causing unemployment and depression if she can find an outlet at home not for additional consumption goods but for additional capital goods (or for consumption financed by "deficiency spending"). Unemployment and depression is an unsatisfactory alternative, and we cannot present it for American agreement as the right way of obtaining equilibrium.

In regard to finding a vent for surplus saving at home, we must remember that the United States has already gone far on these lines, though not so far as to solve her unemployment problem. She has had an Administration which for a number of years has eschewed further tariff building and sought an internal remedy by public works and all manner of "deficiency spending " How much further can we expect her to go?

Professor Hansen, in his recent stay, explained that he was anxious for an international body to be authorised to advise governments on their internal policy, in order to strengthen those elements in the credit countries which favour public works expenditure. We should certainly favour such a policy.

But we cannot count upon such measures being sufficient to produce an even balance. Furthermore, we must not make our system for international equilibrium depend on nations adopting internal measures such as Public Works and "deficiency spending", which may be the subject of domestic political controversies. That would constitute a very precarious international system. This method of reducing disequilibrium, then, should be favoured. But we cannot rely upon its being completely efficacious.

3. The matter is very different when we consider measures which might be taken by debit countries to secure an even balance of trade. It is agreed that we do not wish them to adopt deflation or trade barriers. But faced with a continuing debit position and the prospect of their quotas being exhausted, they might think it proper to take measures to subvent industries which, albeit uneconomic in themselves, were of a kind likely to assist their balance; the appropriate International Body might even think it proper to aid them in this task.

It is most important that this principle should be roundly condemned. Any artificial assistance to such industries would have the same effect on the world balance as protectionist barriers. It does not make sense to frown upon the latter while encouraging the former.

In so far as the credit countries succeed in taking internal measures adequate to reduce or eliminate their credit positions, the debit positions will automatically disappear without any balance-of-trade planning by the debit countries. In so far as the credit countries fail, attempts to rectify the balance made outside them will gravely embarrass them. Such attempts will provoke an unemployment crisis in the credit countries. This state of affairs will put them under the strongest inducement to be disloyal to the international system, Faced with unemployment, having taken all measures that seem economically or politically feasible to stimulate activity internally, and seeing other countries taking measures which have the effect of diminishing their exports, they will not for long resist the temptation, whatever their previous protestations, to raise their own trade barriers (and possibly subsidise their exports). It is essential that the credit countries should adopt a liberal attitude. It is no good advocating a policy which will embarrass them and drive them, despite their best intentions, in the opposite direction.

British interests are also vitally concerned here. The same industries which will assist the debit countries to reduce their debit relation to, say, the United States, will make it more difficult for us to export. It would be the greatest folly if, out of a tender anxiety that the United States should not continue indefinitely to be in a credit position - an anxiety for which they would have no reason to thank us - we should deprive ourselves of our very means of life.

It is, therefore, most important that we should, ourselves, understand and do our utmost to propagate the principle that if a credit/debit position arises, all measures of internal expansion by the credit countries to rectify the situation are to be welcomed but autarkic measures by the debit countries are to be condemned as tending to disrupt any "expansionist" system.

So far as our interests are concerned, there is all the difference in the world between a growth of local industry, which becomes remunerative because the pressure to an export surplus of the credit countries wanes (owing to their man-power being so heavily engaged on domestic expansion) and the artificial fostering of local industry designed to displace imports. In the former case the local industries take the places left vacant by the declining export pressure of the credit countries and do not tend to squeeze our own exports. In the latter case, being aimed at reducing imports as such, they will injure British trade as much as that of the credit countries.

It is therefore important that our system be so devised as to remove from the minds of the debit countries anxieties which will make them strive to put an end to their debit position on income account. The Clearing Union should <u>not</u> be regarded as a sort of glorified moratorium giving a breathing space within which debit countries must put their houses in order and cease to be debit countries on income account. There are two reasons why some may hesitate to accept this doctrine with which I shall deal in turn.

4. Our minds are naturally focussed upon our own affairs. In view of our prospective difficulties we are apt to think of ourselves as a debit country, but in the long run this cannot be right. It cannot be healthy for the second richest and probably most capital sated country in the world to be a borrower. Our own debit problem is one of the transition and it is quite right for <u>us</u> to think of the Clearing Union as giving a moratorium within which we are to put our affairs in order. It will lead us into the greatest confusion if, in assessing the principles to be applied to debit countries generally, we think of our own case.

Are we not then, to get anything out of the Clearing Union in the long run? Is it not to be an ever-ready fairy godmother? Yes, it certainly is. But not because it is to let us go on borrowing for an indefinite period, but because it is to keep our export markets buoyant. In thinking of debit countries we should think always not of ourselves but of our markets.

It is no permanent solution of our difficulties to borrow. When the transition period is over we shall have more capital than we know what to do with. We hope to derive assistance for our exports through the rest of the world being more expansionist and less autarkic. For the rest, we have got to see that our costs are not too high to exclude us from our markets. That is really a problem for the Internal Reconstruction Committee. There is no dodge by which we can evade it.

5. Secondly, it may be thought that the principle of discouraging debit countries from autarkic measures shows too reckless a complaisance and that we need a sterner discipline. To meet this objection it appears essential to recognise the difference not merely in degree but in kind between ordinary debit countries and what may be called "excess debit" countries. The debit positions of the former merely constitute a mirror image of the credit positions of the credit countries; by the principle that an attempt to correct credit positions otherwise than by internal measures in the credit countries will be an embarrassment to them and run counter to the "expansionist" aims of the system, the ordinary debit countries should be discouraged from trying to put an end to their debit positions. The "excess debit" countries are those which whether owing to abnormal improvidence or abnormal impecuniosity are running into debt at a rate substantially greater than the average. Such countries will merit special treatment, the improvident, such sanctions as are specified in 7(5)(c), the impecunious, salvage measures.

It should be possible to devise a formula based upon the accounts of the Clearing Union which will segregate the "excess debit" countries. These should by definition constitute only a minority of all debit countries. The formula is discussed in the Appendix.

If this segregation can be effected with precision, it should be possible to combine that leniency to debit countries, which is required by "expansionism" with the discipline required to prevent abuses.

6. To return from the digression and recapitulate the argument of the first three sections. If certain countries find it difficult to plough back all their savings at home, they will tend to develop an export surplus. If this is covered by ordinary commercial lending equilibrium will be maintained; but if commercial lending falls short, debit countries will be embarrassed and be impelled to deflation or autarkic measures. These will react back upon the credit countries causing depression there and driving them also towards greater protection. Thus we should be involved in the vicious spiral of deflation and/or the vicious spiral of trade barriers. From this point of view it is important that we should find means of transfering the surplus saving in the most painless possible manner to the debit countries.

There are two distinct reasons why commercial lending may fall short of what is required to maintain an "expansionist" world economy and it is very important to keep them distinct in our minds. It may fall short because although there are perfectly sound and paying outlets for additional saving in the debit countries, distance, political and language difference and the absence of a common banking system may impede the free flow of lending from the country of origin to the country where it might be profitably used. Or, it may fall short because there is a tendency to surplus saving in the world as a whole considered as a single unit. How far this latter tendency is in fact likely to be endemic is not agreed; but it is generally accepted that it normally operates in the recession phases of the trade cycle.

7. It is a familiar point that the tendency to a universal dissemination of manufacturing industry is inimical to our interests and injurious to our standard of living. The tendency is ineluctable and constitutes an adverse factor with which we have to reckon. We may console ourselves with the idea that we shall be able to retain a lead in quality replacing lost markets by the sale of goods of higher grade. There is probably an element of wishful thinking here. This beneficient principle may have worked fairly well when our lead was great and our position as suppliers almost monopolistic; it will be less fruitful for us as the levelling up becomes general.

While the tendency is ineluctable its tempo maybe influenced by post-war arrangements. Those concerned with post-war plans clearly have a responsibility to our own people, in virtue of which they are bound to ask whether we can do anything and whether we ought to do anything to influence this tempo.

How far we should be entitled, were we able, to press this point against the general interest is a question of political morality which I do not propose to discuss. As there seems to be some danger that we shall not press it as far as is perfectly consistent with the world interest, I shall confine myself in what follows to that.

8. An all wise benevolent world economic dictator would not direct people in region A to produce goods which could be produced more cheaply, as assessed by the law of comparative costs, in region B. On the other hand the government of A may have other motives for encouraging its citizens to produce, of which in the case of manufacturing industry three very important ones are (i) to rectify the balance of trade, (ii) prestige and (iii) to provide the sinews of war.

We should seek to devise our system in such a way to remove the first motive. The argument from the best use of world resources, the requirements of an expansionist system and our own particular interests all work together to the conclusion that debit countries should not be under pressure to introduce autarkic measures in order to eliminate their debit positions.

The prestige and political security motives are more difficult. The policing authority may have something to say about the latter. Agreements designed to secure the progressive reduction of trade barriers may make it more difficult for governments to give free play to these motives, but they lie outside my subject. But there seems to be a danger that what we achieve by trade agreements may be undone by misguided notions about the way in which the International Authority should organise the lending required, in supplement to ordinary commercial lending, to secure equilibrium.

9. It was explained in paragraph 6 that the world system may fail to be expansionist either (i) because there are obstacles preventing surplus savings in credit countries being applied to paying projects in debit countries or (ii) because there are not enough paying projects in the world to absorb all the savings. An International Investment Board is clearly needed to deal with the second of these ailments. In the case of the first ailment there is another possibility namely that the savings should be transferred by the agency of the Clearing Union itself. By progressive enlargement of the debit "quotas" or by re-defining the allowed quota not as a cumulative amount of debit but as the maximum amount of increase of debit allowed to a country each year, commercial lending could be supplemented by Clearing Union lending.

One advantage of this method is that the Clearing Union overdrafts being perfectly liquid would carry low rates of interest. If necessary, these could be reduced to a nominal level. Consequently the money could be used - and this is what is needed - for any increase of real capital in the debit countries that was paying without regard to whether such increase would generate additional exports. Rates on Investment Board loans would have to be appreciable, albeit below commercial rates, and presumably provision would have to be made for redemption. Consequently the Board would have to select projects likely to generate additional exports. This would unnecessarily limit the scope of the additional capital creation and might twist it from more to less urgent needs. Again, still more important, once the investing body has to consider whether a project will add to exports, it will be very difficult if not impossible to draw the line between exports merely required to pay interest on and redeem the loan and exports tending to make the debit country less debit on income account. But the whole foregoing argument has been that any plan to make the debit country less debit on income account by subventing unremunerative projects will tend to make the system less expansionist, embarrass the credit countries and be injurious to our special interests.

Again, it is important to recognise that the money which goes in to the debit countries by way of Clearing Union overdraft is automatically applied to paying projects. There is no need to think up some scheme to apply it to; it is already applied when the overdraft comes into existence. The funds flow through the ordinary channels of banking and commerce to where they are most needed. They are dispersed in small revulets. There would be a little extra investible money well distributed among all the minor trades and occupations, allowing a little extra expansion here and there, whether of plant or stock in trade, as required, allowing the country to develop its own resources in its own way according to its natural bent and in directions which those on the spot know from experience to be economic. All this happens simultaneously with and not subsequently to the appearance of overdrafts at the Union. Surely this is not only more healthy from our point of view but also more likely to be genuinely helpful to the debit country itself, than a few large schemes planned from outside by a board of alien and unsympathetic officials or bankers.

It may be argued that banking on the easement provided by the Clearing Union the government or other authorities inside the country may subvent the creation of autarkic industries which we might regard as undesirable. But these will increase the debit position in the short run; they may cause the country to become an "excess debit" country for the time being; and this they will wish to avoid. And the Clearing Union system will itself remove one very important motive - the foreign exchange one - for artificially fostering the trend to autarky.

This plan of transferring surplus savings to debit countries by liberalising further the debit provisions of the Union would implement the idea that the Clearing Union would internationalise the advantages of deposit banking. By that system the small savings in one part of the country are gathered together and made available for uses, each perhaps small in itself but in total substantial, in another part of the country. The Clearing Union would apply this principle internationally.

Might the credit countries object to this system? Might they press for the funding of some of this lending in order to see a little profit on it? This would be unreasonable. We do not compel them to have an export surplus. We do not debar them from commercial foreign lending. But we do say that if they cannot find enough commercial outlet to cover their export surplus, then they must be content to forego interest on the residue. No individual in the credit country would be in any way damnified; for in the last analysis the individuals who are providing this liquid capital for use in the debit countries are those who perfectly voluntarily choose to have their own money at the bank at home.

Under the old system the credit countries had to take the residue, (the excess of their export surplus over their commercial lending) in gold, which did not yield interest. We offer them bancor instead. Bancor is perhaps an inferior asset. But then the option of taking gold was fast disappearing. The breakdown of the gold system meant that the pressure on the debit countries, driving them to deflation and autarky, was depriving the credit countries of the option of being credit countries at all and plunging them by consequence into depression. Bancor restores that option to them. It would really be too exacting of them to expect to get interest on their bancor or on that part of their export surplus on which in the old system they could find no means of earning interest.

The practical upshot of this reasoning is that in the forthcoming discussions we should seek to liberalise the debit provisions of the Union. It may well have been wise to present the system in the first instance as it is. But as underlying problems are brought to the surface in discussion, we should press the logic of the case to persuade them that if the system is to work in the long run it must be made a little more radical.

10. We may now turn to the second reason why the world system may fail to be expansionist, namely that there may not be enough paying projects to absorb world savings. This phenomenon is likely to manifest itself in the recession phase of the trade cycle; but it may also be present, albeit in a less intense form, in periods of more active business. This problem is not solved by making the surplus saving of credit countries available for paying propositions in debit countries. It requires for its handling something in the nature of an International Investment Board, which, to avoid confusion, had perhaps better be called International Public Works Board.

This Board would stand in the same relation to the world economy that a national Public Works Board does to a national economy. It would be its duty to seek out development projects, which, although unremunerative on a strictly commercial basis, may be deemed to have sufficiently favourable indirect economic effects to justify them.

If its function is stated thus, it at once becomes evident that it would be both improper and in the long run ineffective for it to assist the development of new industries to produce goods which enter into trade; it should confine itself to capital yielding services and to consumers' capital. Just as it would not do for a national Public Works Board to set up a boot and shoe factory in one part of the country to compete with those in another, so the International Body must not set up capacity to produce tradable goods in a particular country when there is capacity in other parts of the world.

One great advantage in making the Clearing Union solely responsible for settling the credit/debit relation between countries and facilitating a sufficient flow of capital to finance all paying projects is that it makes it possible to give an unequivocal definition of the duties of the Public Works Board. Once that board starts meddling with the credit/debit problem it will get deflected from its proper terms of reference and consider settling up uneconomic steel works in countries which happen to have a debit balance, in order to give them a more favourable balance.

The Board would have the problem of where to locate its projects. The following appear to be the four most important considerations. (i) Some governments are more able and willing than others to finance public works in their own countries. Some governments might resent the intrusion of an international body. The Board would concentrate its attention upon those countries whose governments found difficulty in raising money for such purposes and welcomed outside assistance. (ii) Its main economic criterion would be the presence of unemployment in the region proposed for a development project. It would not locate its works where employment was good, for by so doing it might create local inflation even if depression was prevalent in the world as a whole. (iii) The inherent usefulness of alternative projects should be carefully weighed. (iv) Since its rates of interest would be below the commercial level, countries might regard it as a favour to be chosen for projects and the Board should therefore take care that, so far as the other criteria allowed, the favours should be distributed even-handedly among the different countries.

None of these criteria point particularly to debit countries. There is certainly no reason to suppose that unemployment is in proportion to the size of the debit position; indeed the presumption is rather the other way. The Board might take the debit position into account as a subsidiary criterion, but its main contribution here would not be by fixing the place of expenditure but by fixing the place where its money was raised; if it had to issue bonds (see R.P.(42)2, Appendix 3) it would confine tenders to the citizens or public bodies of credit countries.

An exception might be allowed to the embargo on industrial undertakings, namely in favour of those "excess debit" countries whose condition was due to a genuine lack of resources and not to disorderly finance or inflation. Just as a national Public Works Board might even go so far as to set up a boot and shoe factory in a "distressed area", so the International Board might break its rules in favour of an exceptionally distressed country, always providing that the criterion of distress were defined with precision in such a way that only a small minority of countries came under it.

The practical conclusion of this is that if the question of an International Investment Board comes forward for discussion, as it is most likely to, we should press for a strict "public works" definition of its functions.

11. I submit for consideration that we ought to refer to our private interest in reducing the tempo of industrialization at a fairly early stage in the conversations with America, certainly before the door is thrown open to Russia and China. I give three reasons:-

(i) It would appear to be lacking in candour not to do so. The Americans must think that we have this consideration at the back of our minds. Although a remarkable fecklessness about our own interests may be deeply rooted in our nature, foreigners will never succeed in appreciating its full extent.

Now while it is quite true that the division of functions between the Clearing Union and the International Investment Board that I have proposed can be justified on purely altruistic grounds and that we should propose something much more radical if we were seeking to enlist the Americans as partners in selfishness, still the division of functions does suit our selfish interests. If we do not mention them explicitly the Americans will think our arguments from principle a mere mask. This will have a doubly evil effect. They will suspect us for our lack of openness and give the arguments from principle less weight than they deserve.

(ii) Broadly, it seems to me, we have a joint interest with America. Although they are not so vitally dependent as we are on the continuance of exports, yet this continuance would be a great convenience to the steady development of their economy. For them too it would be short-sighted to distribute capital goods over the world too rapidly and wind up the markets for their consumption goods.

There are probably two opinions in America. I suspect that the majority opinion, including both plain men and thoughtful men, would incline to our view, and that the missionary notion of Americans going forth among nations to equip and instruct them in American methods of production, the home country enjoying thereby a great but transient boom, is confined to hot-headed idealists, whose voice in post-war planning may be out of proportion to their backing in the country. If we put our case strongly, certainly not in the form of an ultimatum but for the give and take of ideas upon it, we may deflate the missionary zeal; for the missionaries may know that they lack sufficient backing at home and would have difficulty in implementing their ideas in Congress.

(iii) We can put this case to the Americans, because it is based on sound economic doctrine, but it is doubtful if we can put it to anyone else. On economic grounds other nations would not have reason to dislike it and might even be persuaded not to, provided that they were satisfied with the arrangements for securing their balance of trade and for world "expansionism". But it does not touch the prestige and political security motives for the desire to foster manufacturing industry. There is no reason in international ethics why we should pander to those motives or offer assistance to all who wish to give them play. But it may be very undiplomatic to mention that we are unwilling to do so.

That is one reason why it seems to me very important to reach agreement with the Americans upon certain basic features of the system that we wish to propose to the world, in particular the anti-autarkic features. Just as we signed the Mutual Aid Agreement before offering it to other powers for adhesion, so we might both sign charters of international institutions, which, while they deliberately left much vague and open to discussion in a wider forum would be sufficiently specific to ensure the anti-autarkic character of the resulting system.

12. I have only discussed our interest in slowing down the tempo of industrialization in its bearing upon the functions of the Clearing Union and any proposal for an International Investment Board. It will be still more relevant when we come to the problem, set for discussion in Article VII, of means for reducing trade barriers. This intesest should make us favour the most comprehensive possible agreement for lower tariffs.

There is another point worth considering in this connexion to which I referred in U.S.E.(42) 18, paragraph 10. We are told that the Americans may raise the question of international combines for discussion. One powerful cause increasing the dissemination of manufacturing industry has been the tendency of companies to set up subsidiaries in foreign parts in order to be in a position to supply their markets without paying their tariffs. In pursuance of the policy of Article VII one might reach agreement to debar the parent companies from setting up subsidiaries in countries which refused to join a low tariff agreement. This would make it illegal for the companies to set up subsidiaries save where the inducement to do so was small.

There is no doubt that the plain man would regard this policy of the companies as unpatriotic; this kind of sentiment finds expression in the Federal anti-trust prosecutions which have recently been very strongly pressed. A proposal which was in harmony both with this sentiment and with the trade views of the State Department would surely make some appeal to the United States Administration.

APPENDIX

Definition of "excess debit" countries

1. I think it will assist thought about this matter if we define the "quota" as the amount of debit which a country may not exceed without becoming liable to the sanctions specified in 7(5)(c) and call a country which exceeds its "quota" an "excess debit" country. Thus to exhaust one's quota, to become liable to sanctions and to be an "excess debit" country would mean one and the same thing. (Sanctions should not necessarily be applied in every case where a country was liable to them, since if its condition was due to exceptionally exigent circumstances the International Investment Board might be asked to devise salvage measures and the sanctions be suspended meanwhile).

2. When one is considering any improvement of the provisions of 7(4)(5) and (6) the first thing, I think, that comes to notice is that the criterion for the various restorative measures is, save for one provision, the amount of accumulated debit (or credit) outstanding. Is this really right? The accumulated debit constitutes a record of all that has happened in the past. But this is not necessarily relevant to present action. Thus a country which had been accumulating debit rapidly for some years but had recently greatly improved her position in this regard might be brought within the arm of sanctions (or some of the milder measures) by a very small recent addition to her debit, which would thus constitute a sort of last straw. In fact the measures might become mandatory just at the moment when they were no longer needed and when, because not needed, they might be harmful and disturb an equilibrium painfully achieved.

3. I submit consequently that if the relation of the actual debit to the quota and its various fractions and multiplies is to be the criterion for action, the quota should be defined not as something which a country may reach by accumulation, but as a current annual amount. Thus if a country's quota were £x, she would become liable to sanctions if she had increased her debit in the immediately preceding year by £x. Similarly a country would be entitled to depreciate her currency if her debit had increased in the preceding year by a £$^1/_3$x and could be required to depreciate it if her debit had increased in the preceding year by £$^2/_3$x. Or again a credit country would discuss certain measures with the Governing Board (as under 7(6)) if her credit had increased by £$^2/_3$x. (The fractions here are the same as those proposed in the draft scheme, modified however to make the sanctions point that at which debit = quota instead of, as in the draft, that at which debit = $\frac{3}{4}$ quota. The amount of the quota itself, however, would of course have to be much smaller.)

4. I have advisedly used the phrase "increase of debit" and not any such phrase as "amount of current deficiency". A decrease of credit would entail a current deficiency and some might hold that in logic this required the same remedial measures as an increase of debit. But this would perhaps be pushing logic too far. It is understood that a country

which acquires a credit is entitled to work it off in subsequent years, and in order to implement this it would be necessary to allow a credit country to run an annual deficiency without applying corrective measures until after the credit had been reduced to zero. Conversely in the case of a debit country which had a current favourable balance.

5. This simple amendment to the notion of the quota would, I think, by itself liberalise the system sufficiently to satisfy the requirements of the memorandum. And an "excess debit" country could simply be one which in the last preceding year had exhausted her quota. Furthermore the amendment seems required by the technical argument of paragraph 2 above.

6. As a further amendment I suggest that in any year designated by the World Economic Advisory Council (if one may assume the existence of some such body) as one of trade recession all quotas should automatically be doubled.

7. While these amendments would probably suffice and commend themselves by their simplicity, it may be interesting to consider whether it would not be possible to implement more precisely the notion that debits are legitimate in so far as they merely reflect credit positions and only become, so to say, culpable when particular debit countries get out of step with the average of debit countries.

8. In the draft scheme it is left open what fraction or multiple of a country's recent average turnover shall constitute her quota (or whether other considerations shall be introduced in determining her quota). (7(3)). This fraction might be fixed by reference to the actual sum of all credits and debits accruing in the last preceding year, or, to give time for book-keeping and due notice, in the last preceding year but one. Let us call the annual increase of debit which entitles a country to depreciate her exchange rate (7(5)(a)) her "normal allowable debit". I suggest that the sum of the "normal allowable debits" of all countries should be fixed at 10% above the sum of all credits and debits in the last preceding year but one. The 10% is to allow for secular increase and because the point at which depreciation is desirable should presumably be a little above the debit level considered desirable. This sum should be divided among the countries in proportion to their turnover in the three preceding years, as in the draft scheme. Thus each country would have her specific "normal allowable debit". Again following the provisions of the draft scheme, the quota would be three times the normal allowable debit. This proposal may appear a little complicated on first reading, but is in essence simple. It would not be practical to implement it immediately after the war, but it might be introduced at a subsequent stage.

Foreign lending, industrialisation and the Clearing Union.

Preamble

It may be convenient to enumerate certain questions, likely to arise in the "conversations" to which the arguments in the following memorandum are relevant.

I assume that we are at present planning to create an "expansionist" system. If "natural forces" prove in the long run to be themselves sufficiently or even excessively "expansionist", deflationary measures may be desirable. There should of course be provision for this in any plan. I do not dwell upon this aspect, because the deflationary technique is well understood, while the right way to get world expansionism presents an intellectual problem not hitherto solved.

The provision of debit quotas gives an <u>initial</u> expansionist fillip, but no more. When the force of this is exhausted, the same tendencies to deflation and autarky will appear under the Clearing Union as under the gold standard, unless we introduce further provisions.

World expansionism may be assisted by internal expansionist measures in the credit countries; these are no doubt desirable but they would be equally possible if there were no Clearing Union at all, and cannot be relied on as sufficient in themselves to secure world expansionism. In so far as they are insufficient, the debit countries must be allowed to expand their own economies even at the cost of perpetuating their debit position. How is this, in so far as it is not covered by ordinary commercial lending, to be financed?

Quite apart from this problem we may expect to be asked by the Americans what our ideas are about organised foreign lending.

The following questions seem to arise:-

1. Do we wish whatever additional lending may be needed, in order to maintain expansionism, to go to the debit countries in liquid form through the Clearing Union itself, e.g. by a progressive enlargement of quotas? Or do we wish it to be funded by an International Investment Board? (See para.).

2. One way of implementing the former alternative would be to re-define quotas on the lines proposed in the Appendix. Is this acceptable? Is so, at what stage should it be proposed to the Americans and how argued?

3. If there is to be an International Investment Board should this be restricted by the Public Works principle, i.e. debarred from subsidising plants to produce goods in competition with those produced elsewhere?

These questions are bound to come up in the conversations in any case; a fortiori, if the idea of making the system "expansionist" is taken seriously. The right answers depend in part on how far we regard the establishment of uneconomic industries as an evil. These questions then appear.

4. Do we wish to come out definitely on the side of the international division of labour as opposed to autarky? If so,

is it expedient to refer explicitly to our private interest in this matter (which is any any case obvious)?

5. The question of the international division of labour comes up in other connexions. For instance, should we propose to debar trusts from planting affiliates abroad to avoid tariffs, or, if allowing them to do so, to tax the parent companies on such ventures sufficiently to remove the incentive provided by the tariff?