Offices of the War Cabinet,
Great George Street,
London, S.W. 1.

11th May, 1942.

Dear Hopkins,

I have read through the draft on buffer stocks, which I find most excellent and persuasive. But of course I am convinced in advance of the desirability of something of this kind. May I make four comments.

1. As you know, I have for some time been pressing that the United States and the British Empire should get together and take the inititative by operating internationally in certain fields. In a letter to Keynes dated 4th May, of which I sent you a copy, I tried to define precisely the proper scope of action of this "Anglo-American Service" and the proper scope for a more universal body. Therefore, I naturally ask into which division this scheme should fall. It seems to me clear that it belongs to the former division.

In the first place, we may consider what is the minimum amount of international intervention required to make a real difference in the world to take us beyond paper work, to provide the bare framework of what might be called an international system. The clearing union might be both a foundation and a lubricant; it would provide confidence; but by itself it is too passive, it does not set the machinery going. Its influence might not be much felt at first. The buffer stock scheme keeps the flow of purchasing power circulating. I cannot think of any other way of diffusing so wide and widely appreciated a benefit. Failing other proposals, I suggest that should be regarded as part of the minimum "core" of action required to secure a tangible improvement in world economic affairs.

Secondly, there is no doubt that the scheme requires resolution, efficiency and promptitude in its operation.

Thirdly, we may ask of any scheme whether it requires an onerous commitment or abrogation of sovereignty by each separate nation. The buffer stock scheme does not appear to do so, though co-operation in matters of detail may be needed to perfect it, e.g. if, after all, it has to be supplemented by restriction schemes in certain cases. But what is essential has to be done by an agency operating internationally. (Contrast the case of an all round tariff reduction, where what is essential, the reduction of tariffs, has to be done by each separate nation).

And so, if we take each of the three criteria, by which I would divide the work of the Anglo-American Service from that of a broader based international consilium, namely,

(i) whether it belongs to the central core of action needed if we are to have any system at all;

(ii) whether it requires quick, efficient and resolute action, and

(iii) whether it imposes onerous commitments or any abrogation of sovereignty on the separate nations,

by each of these tests the buffer stock scheme belongs to the Anglo-American Service.

It is true of course, that it will be very important to obtain the goodwill and co-operation of the separate nations. Their interests as producers and consumers will be variously and differently affected in the case of each commodity. I suppose that each control will have its own appropriate international composition. But the scheme should be part of the Anglo-American Service, in that the two great powers would be responsible for (i) initiation, (ii) the charter, and amendments to it, setting out the general rules within which the controls would act, (iii) finance, and (iv) such matters (or some of such matters) as would fall to the "general Council for Commodity Controls" referred to in 7(xiv). I should contemplate, instead of that council, an Anglo-American Governing Body, assisted by an International Advisory Council.

The inclusion of the scheme within the Service would not entail many amendments in your draft.

2. In 7(vii) I want to amend the 5% in "downward revisions should not normally exceed 5%" to 2%. This might appear to be a point of detail which we could discuss with the Americans. We could discuss it with the Americans, but I do not think it a matter of detail, nor that 5% ought to appear in any draft we put to them. They will not altogether like the scheme and the 5% might prejudice them hopelessly against it. I have had some correspondence with Keynes on this subject, but neither of us appears to have convinced the other.

Imagine a three year slump. There is the normal margin of 20% fluctuation. This, supposing the price to have been at the top in the boom, together with 5% per annum, gives a downward movement of 35%. This is too much, and might deprive the scheme of its curative effect. Even 26% (viz: 20% + 2% x 3) is dangerously large.

And what conceivable purpose has this 5% latitude? Revisions in the basic price are meant to be adjustments to long period trends. The object of the scheme is to get stability in the short period, and we are allowing a 20% margin of fluctuation anyhow.

Taking a ten-year period, 2% per annum gives us a latitude of nearly 20% and in a twenty-year period nearly 40%. Does anyone pretend that this is not sufficient to cover any probable change in the long run economic price?

I admit three exceptions:-

(1) We might make a big mistake initially and set the price quite wrong. There should be a special provision for a revision by an amount in excess of normal within a defined interval from zero hour. Lest this undermined confidence, it could also be provided that in the case of such a revision, there should be a more than usually elaborate consultation with producers.

(2) In the case of certain substances, exceptional circumstances might arise, e.g. by the discovery of a totally new type of mineral deposit. It is recognised that the schemes for different commodities should not be absolutely uniform; a special provision could be made for this type of case.

(3) In the event of monetary inflation (or deflation) 2% might be insufficient. But in that case, 5% would probably be almost equally so. It is hoped that the stability of bancor (or of sterling and the dollar) will be maintained. To meet the opposite possibility, there would have to be a special clause allowing an adjustment in accordance with substantial fluctuations in the value of money.

Thus from a short period point of view the 5% is destructive, from a long period point of view, absolutely pointless.

This is not a trifling matter. We must remember that producers will be rather suspicious of all this. We have to woo them away from their first love, restriction. For the scheme to work at all, the price set will have to be lower than they like. That is one reason why we like it. Our strong card, and I think it is a very strong card, is that our system happens to be the rational one in the long run and consonant with the professions of the Atlantic Charter. If we were to tell the plain man that the principal plank in the programme of world reconstruction was universal restriction of the output of food and raw materials, he would be extremely indignant.

We have right on our side. But the producers have a good deal of power. Now what we do and can offer them as an inducement and allurement is the prospect of stability, which they do very much like. And I think we can show them that our assurance of stability would be much firmer than anything they can get under their own restriction schemes. But it must be a decent stability. 2% downward revision does not sound too bad; it amounts to more in fact than they would like, or, possibly, appreciate at first; it would be rather a ramp from their point of view, but we might get away with it. But 5% would be an open ramp, in fact an insult! And I do not think we should put it forward.

3. I suggest the deletion of 7(vi). I do not altogether understand it. For why should a country sacrifice 20% of value in order to get its domestic stocks held? Or is this its permanent reserve? But in that case the restriction does not meet the situation. For it could build up its permanent reserve by gradual stages.

The trouble is that the provision contains the principle of limited liability which is fatal to any stabilisation scheme. No one ever maintained the gold standard by professing willingness to buy or sell a limited quantity of gold. Even if the provision was not expected to come into operation save in very exceptional circumstances it would undermine confidence in the scheme. It might also impose unnecessary burdens on it. Thus there might be a rush of sales to the control, by nervous producers anxious to get inside the quota in time, which would not in the absence of the limitation, have taken place at all.

4. I am opposed to 7(viii)(2). I think it is proper for us to argue that excessive subsidisation of production is inconsistent with the idea of an economic international division of labour, though we should recognise the desire of high standard countries to maintain some agriculture to balance their economy. We must remember that such subsidies, though logically untidy, are a source of ultimate gain to us by depressing the "economic" price. At the same time, we must get countries to realise that subsidisation, if pushed too far, would work in a vicious circle by requiring a progressive downward revision of the economic price.

So far so good. But I do not think we should, at this stage, propose final measures (viz: reduction of quotas, if we are driven to quotas) against countries giving subsidies. This would be a hard slap in the face for the Americans. And I do not think the slap is justified by the logic either of self-interest or idealism. This whole scheme is rather a nasty pill for the Americans in any case; do not let us coat it with a nauseous but inoperative substance.

ir Richard V.N. Hopkins, G.C.B.,
Treasury.