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24TH MARCH, 1942.

WAR CABINET.

COMMITTEE ON RECONSTRUCTION PROBLEMS.

EXTERNAL MONETARY AND ECONOMIC POLICY.

Note by the Secretary.

By direction of the Chairman  
I circulate herewith copy of a  
memorandum by the Treasury on  
Preliminary discussions with the  
United States.

(Signed) A. W. HURST.

Richmond Terrace, S.W.1.

24th March, 1942.

VERY SECRET.

Copy No. 91

**TO BE KEPT UNDER LOCK AND KEY.**

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**EXTERNAL MONETARY AND ECONOMIC POLICY.**

**ARTICLE VII OF THE MUTUAL AID AGREEMENT OF THE  
23rd FEBRUARY, 1942.**

**MEMORANDUM SUBMITTED BY THE TREASURY ON PRELIMINARY DISCUSSIONS WITH  
THE UNITED STATES.**

1. The starting-point of the forthcoming discussions with representatives of the United States Administration will do doubt lie in the relevant passages of the Atlantic Charter and the Mutual Aid Agreement as follows:—

Atlantic.  
Charter.

“ Fourth, they will endeavour, with due respect for their existing obligations, to further the enjoyment by all States, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity.

Fifth, they desire to bring about the fullest collaboration between all nations in the economic field, with the object of securing for all improved labour standards, economic advancement and social security.”

“ ARTICLE VII.

Mutual Aid.  
Agreement.

“ In the final determination of the benefits to be provided to the United States of America by the Government of the United Kingdom in return for aid furnished under the Act of Congress of the 11th March, 1941, the terms and conditions thereof shall be such as not to burden commerce between the two countries, but to promote mutually advantageous economic relations between them and the betterment of world-wide economic relations. To that end, they shall include provision for agreed action by the United States of America and the United Kingdom, open to participation by all other countries of like mind, directed to the expansion, by appropriate international and domestic measures, of production, employment, and the exchange and consumption of goods, which are the material foundations of the liberty and welfare of all peoples; to the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers; and, in general, to the attainment of all the economic objectives set forth in the Joint Declaration made on the 12th August, 1941, by the President of the United States of America and the Prime Minister of the United Kingdom.

At an early convenient date conversations shall be begun between the two Governments with a view to determining, in the light of governing economic conditions, the best means of attaining the above-stated objectives by their own agreed action and of seeking the agreed action of other like-minded Governments.”

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2. The primary objective underlying these declarations is the attainment of the greatest possible expansion of trade and especially of international trade. No country can have a greater interest than this country in such an objective. Lack of employment was for long before the war a continuing anxiety. This country also, with its dependence on overseas trade, has a vital interest in the prosperity of other nations, which is the most important single factor in the flow of international trade.

3. It is in the subsidiary points of the declaration, especially in regard to questions concerned with the elimination of so-called discriminatory practices and arrangements (including in particular Imperial Preference), that divergences of view may be expected to be found.

4. Of necessity the more general declarations are no more than aspirations until they have been clothed in policies calculated to attain them, and the object of the preliminary exploratory conversations must no doubt be to interchange views and seek points of agreement upon such policies. The present is, no doubt, the most favourable moment for initiating Anglo-American co-operation in relation to the expansion of international trade and other economic questions.

5. The attitude of the United States Administration is likely to be much influenced by our general approach to these discussions. If we start by accepting the desirability of restoring multilateral exchange and trade to the fullest possible extent, but explain the very serious practical difficulties which confront not only the United Kingdom but other countries before these objectives can be realised and the need to work out bold and constructive measures on an international basis which will help the world to make progress in overcoming these difficulties, it may be hoped that the United States Administration will be prepared to give full consideration both to the difficulties and to any solutions which we may have to propound.

6. The United States representatives, it may be assumed, will be aware of the general initial attitude of the Administration towards all these questions, and it seems probable that certain particularised proposals (referred to below) will be brought up at an early stage. Ministers will no doubt wish, without reaching final decisions upon any matters at this stage, to give to the United Kingdom representatives, for their guidance in discussion, broad indications of lines of exploration which they would *prima facie* regard as expedient and inexpedient respectively. The object of this note is to indicate some of the matters about which such guidance may be required.

7. So far as this country is concerned—and the same will probably be true of most countries—the new policies will fall to be applied in a period of unexampled economic difficulty in the external sphere. We shall start the period of peace with great liabilities and with small reserves both of exchange and of resources that could be turned into exchange. The Economic Section of the War Cabinet have made estimates which suggest that in the absence of corrective measures our adverse balance of payments over the first five years taken as a whole may be in the region of £1,000 millions.

8. The Treasury have in these circumstances prepared a note analysing these difficulties and discussing possible remedies, including, in particular, ambitious remedies designed to further the objects set out in the general declarations and to set up an expansionist trend in the trade of the world.

9. The declarations are especially concerned with expansion of production, interchange of goods and improved labour standards. But at the outset a general problem presents itself—that of exchange control. This instrument may be used for control of both capital movements and of current trade transactions: in the latter connection it is capable of being highly discriminatory to the extent that it is possible to refuse or allow exchange for particular trade transactions. Thus the relaxation and eventual abolition of the use of exchange control for regulating trade transactions must be an important objective. But the question remains whether its machinery ought not to be retained for use in connection with capital movements.

10. A principal factor of economic disturbance in recent pre-war years was the irresponsible mass movement of private speculative funds from one country

to another from fear of loss or hope of gain. There seems little prospect that after the war such complete security will be restored as to eliminate the underlying economic and political mistrusts which engendered these speculative movements and so long as this is the case some measure of governmental regulation appears to be the only means of checking the injury they cause. Such regulations may also be required to prevent private investment on foreign stock exchanges and private subscriptions to foreign loans being undertaken on a scale inconsistent with the country's balance of payments on current account.

11. To-day, in almost every country save the United States, the external movement of private capital is regulated. It is suggested that that regulation ought to continue, notwithstanding that without postal censorship the regulation cannot be fully effective and that for practical reasons it must involve centralisation of the management of exchange business and some degree of vexatious formality for all engaged in overseas transactions, including possibly those within the Empire. From our point of view it would be desirable, though it may well prove impracticable, that the United States should also establish such a regulative system. It is suggested that this is an important subject and should be explored as such in the forthcoming discussions.

12. The prevention of undesirable capital movements would be one important step towards ending, or at least mitigating, the immense currency malaise which afflicted European countries and many other countries in the nineteen thirties, which ended in the United States becoming the depository of the main part of the stock of monetary gold, and which contributed materially to the tying up of international trade in elaborate and harmful involutions. In addition, on any long view, there is great need for a new or improved system or organisation for the settlement of international balances on current account. Such a system or organisation would not of itself set at rest the immense disequilibria from which the world is likely to suffer at the end of the war, but it would provide a medium which, in conjunction with other agencies and actions, would give the best chance of a prosperous world.

13. There has accordingly been drawn in the Treasury an ambitious plan for a new organisation (styled for short a Clearing Union) which aims at substituting an expansionist for a contractionist pressure on world trade generally. Its objective is to provide in the international sphere an organisation which will perform for participating States the functions performed for individuals by the ordinary banking system, *i.e.*, the clearance of accounts, debit and credit, between different customers and the provision of overdrafts for those who need them. To this Clearing Union the principal countries of the world would adhere and it would have the function of settling international balances of payments, no longer by the delivery of gold, but by credits and debits in a new international currency (called *bancor*) which would have a fixed value in gold and would be accepted as in all respects the equivalent of gold. It has been provisionally assumed that any such organisation would be founded by the United States and United Kingdom, who would permanently retain the management and control. A member State which on balance owed to countries payments which it was not in a position to discharge would be given facilities in the nature of an overdraft. A member State, on the other hand, which on balance was owed money by the other member States could not recover it except by accepting goods or services from the rest of the world. The relative value of the currencies of member States would be determined in the first instance in agreement with the Governing Board and thereafter could (except under prescribed conditions) be varied only in agreement with that Board.

14. The debit or credit balance of member States with the Clearing Union would give a measure of the balance of payments of the countries concerned and this might well facilitate agreed undertakings to forgo certain types of trade restrictions subject to reservations relating to the protection of the country's balance of payments.

15. The Clearing Union would be a centre round which other international agencies could gather. It would provide convenient means for financing Post-War Relief, International Development Schemes and Commodity Control

Schemes. It could co-operate also in schemes to control the trade cycle and thus secure the maximum degree of employment.

16. Neither the full argument for such a scheme, nor the full details, nor a full indication of its difficulties can be explained in brief compass, though attention should perhaps be drawn to the fact that like all schemes for the creation of international institutions it raises difficult problems of permanent management and control.

17. It would appear unnecessary to attempt at this stage to form any final judgment on the practicability or desirability of such a plan. The question is rather whether the United Kingdom representatives in the preliminary discussions should put forward the general aims and characteristics of such a plan (perhaps using the plan as an illustration of a possible means of attaining the objectives) as a basis for discussion and exploration.

18. The United States Administration has shown itself greatly pre-occupied with schemes for the regulation of production, marketing and price of primary commodities. There is much to be said for an attempt at an international organisation for steadying the prices of primary products and the holding of buffer stocks—a plan designed, *inter alia*, to limit the necessity for individual restriction schemes with all the international friction they engender. The drawing of such a plan is now nearing completion, and when it is ready it is proposed to ask Ministers whether this subject should be introduced into the discussions.

19. Two American Professors, Messrs. Hansen and Gulick, have produced plans for attaining some of the general objectives, and of these plans more is likely to be heard.

20. Firstly, they propose an International Economic Board, with research staffs in various centres, to advise collaborating Governments in regard to internal policy to promote full employment, a rising standard of living and the world-wide use of productive resources, together with an International Resources Survey for exploring opportunities for internal and regional development projects throughout the world. If it should prove practicable to establish an Advisory Economic Board of this character at the outset, its first function might well be to advise participating Governments upon measures to avoid excesses of initial boom and subsequent slump in the early post-war period.

21. The second is a more ambitious and difficult proposal for the revival of international lending under international control through a corporation with capital stock subscribed by the United States Government, the British Government, the Dominion Governments and other participating Governments, and bonds privately subscribed under guarantee by the several Governments "in appropriate proportions."

22. The first of these proposals must, it is suggested, be discussed receptively; the second also has attractive features, though it may come to grief on difficulties of a severely practical kind. It is suggested, further, that if a Clearing Union plan is found to have prospects of fruition, methods of linking the second proposal with that Union should be explored with a view to overcoming some of the difficulties.

23. It is judged likely that among plans to secure the major objectives the United States representatives may bring up the question of nutritional policies (with their reactions on demand for primary commodities). There is, however, at present little evidence of the nature of probable proposals in this field. They may include such diverse questions as relaxation of agricultural protection (especially in the form of tariffs), encouragement of higher standards of consumption (either by a general lowering of prices of desirable foods or by special arrangements for distribution of such foods to poor consumers), and improvement of live-stock and diminution of cereal production.

24. The foregoing projects probably cover the main types of proposal likely to come forward to attain the general objectives of securing full employment and

general prosperity. There remain the questions raised by the second branch of Article VII—the aim of eliminating all forms of discriminatory treatment in international commerce and reducing tariffs and other trade barriers—and by the corresponding passage in the Atlantic Charter. The United States aim appears to be (a) the reduction (presumably on the basis of reciprocity) of trade restrictions which are not, or supposedly are not, discriminatory in their effect —“tariffs and trade barriers” are the words used—and (b) the elimination (presumably on a like basis) of trade restrictions which are, or supposedly are, discriminatory: control of current exchange transactions, payments agreements, import restrictions and quotas, and State trading systems will all probably come under discussion under this head.

25. The ambitious schemes mentioned earlier in this note do not profess to be automatic solutions of all the economic disorders with which the world will be afflicted after the war, nor do they get rid of the fundamental need to re-establish after the war a proper equilibrium in the international balance of payments. Whether they are adopted or not, there will remain grave doubt whether for some period after the war this country, or indeed many other countries, could afford to forgo various forms of control of trade and exchange without the most serious economic risks, including the risk of a currency collapse such as many countries experienced after the last war. Our own difficulties in this respect have been recognised by the United States Administration. There is also the question of Imperial Preference and the somewhat analogous question raised by regional economic arrangements possibly to be instituted in Europe or South America. Added to this is the problem how far the elimination of discriminatory practices can go without becoming incompatible with the trend of internal social and economic policy likely in future to prevail both in this country and elsewhere. There is also the question of the applicability of this policy in the relations of fully developed countries with low-cost producers such as Japan, or with countries, if any there be, still contemplating aggression.

26. It may well prove that the United States Administration will equally need to reserve powers which might be made the subject of objection. We shall have to explore with their representatives what should be the rules of the economic game in the post-war world. It is suggested that the exploratory discussions should include an explanation, on the United Kingdom side, of the dimensions of our special problem and discussion of the intrinsic difficulties involved in the total elimination of safeguarding devices, but that, if it should appear that a substantial clash of views is likely to arise, all question of the formal commitments we could afford to enter into on this subject should be deferred until after exploration of the constructive economic arrangements and new international institutions or practices which Anglo-American influence could be used to establish or encourage in the post-war world.

27. Both on political and economic grounds our policy must contemplate the co-operation of the Dominions and India with us in any new economic arrangements which may take shape. It is important, therefore, that we should endeavour to consult them and to carry them with us throughout. The Australian and New Zealand Governments have already made it clear that they expect to be given full opportunity of learning our views and presenting their own. Although representatives of the Dominions and India cannot conveniently participate in the initial stages of the exploratory discussions, it would seem very desirable that these discussions should not begin without the knowledge, and if possible, the active sympathy and support of Dominion Governments and the Government of India. It is assumed, therefore, that Ministers would wish a statement of their general attitude and initial standpoint to be communicated to those Governments forthwith.

28. It should be added that, at the International Labour Conference held in New York last November, which the Deputy Prime Minister attended, a Resolution on Reconstruction after the War, proposed by the United States Delegation, was passed unanimously. An Emergency Committee of the Governing Body of the I.L.O. is to meet in London on the 15th April to discuss the action to be taken on this Resolution.

29. The principal questions for consideration of Ministers arising out of this Memorandum appear to be—

- (a) Whether, in the preliminary discussions with the United States, the United Kingdom representatives should put forward the general aims and characteristics of a Clearing Union plan described in outline in paragraphs 13 to 16 (perhaps using the plan as an illustration of a possible means of attaining the objectives) as a basis for discussion and exploration.
- (b) Whether proposals, if they emerge from the American side, for the establishment of—
- (1) an Advisory International Economic Board, and
  - (2) an International Corporation for the revival of foreign lending
- should be discussed receptively, subject to the qualification in the second case that serious practical difficulties are undoubtedly involved.
- (c) Whether the question of the regulation of international movement of private capital, and especially of mass movement of speculative capital, should be brought up as an important objective for exploration.
- (d) Whether the general approach to the problem of "discriminatory treatment in international commerce" indicated in paragraphs 24 to 26 of this Memorandum is approved.
- (e) Whether there should be consultation with the Governments of the Dominions and of India designed, if possible, to secure their active sympathy and support as regards the general standpoint at the start of the preliminary discussions.

NOTE.—The following table indicates the paragraphs of the Treasury note which work out in detail questions mentioned in the several paragraphs of this Memorandum :—

Paragraph of this Memorandum.	Corresponding paragraphs of Treasury Note.
9—11	36—50
12—16	51—177
19—22	178—195
24	21—35
25—26	1—20 & 206—264

**EXTERNAL MONETARY AND ECONOMIC POLICY, WITH SPECIAL  
REFERENCE TO DISCUSSIONS WITH THE UNITED STATES  
ADMINISTRATION.**

NOTE BY THE TREASURY.

*Notes.*

- (i) The subject is too complex and difficult to be compressed within the ordinary limits of a memorandum.
- (ii) No one can prophesy with certainty. This note proceeds on the assumption that very serious difficulties will have to be faced by this country because both to economists and to officials that appears the probable hypothesis; the note does not assert that these difficulties will certainly occur; on the other hand, if they do it will be well to have attempted to envisage them and make preparations in advance.
- (iii) The problems are primarily of a monetary character. Although the terms of this note have been settled only after much consultation with interested Departments (especially the Board of Trade, the Economic Section and the Prime Minister's advisers), the Treasury take primary responsibility for it.
- (iv) This note does not attempt to deal with trade policy as a whole.
- (v) A note on the practicability of an international organisation for steadying the price of primary products and holding buffer stocks is in preparation.

*Summary of Contents.*

(The numbers in brackets refer to the paragraphs of the Note.)

*Section I* (1 to 20) outlines our probable exchange problem after the war.

The term "balance of payments" is explained (2 to 5). An estimate is given of the post-war deficit of the United Kingdom in its balance of payments with the rest of the world during the first five post-war years—some £1,000 million in all (6 to 14 and Appendix I).

The United States is likely to have a large favourable balance of payments (15). Other countries are likely to suffer from financial exhaustion (16).

The nature of the Sterling Area is described and the importance of maintaining it as an Empire link is indicated (17 to 19).

*Section II* (21 to 35) describes the United States attitude.

The United States desire to expand international trade (21 to 23), which is also the interest of the British Commonwealth (24). The United States view on "non-discrimination" is analysed (25 to 35).

*Section III* (36 to 50) deals with capital movements.

These may be due to speculation or search for high interest (37 to 39). The continued control of capital movements is desirable (40 to 41). This means maintaining an official exchange market and the general machinery of exchange control (42 to 43).

The abolition of censorship would encourage evasion (44), but control abroad would check it (45). We might have to extend capital control to movements within the Empire (46 and 47). It need not interfere with London's position as a financial centre (48). Similar action by the United States would help, but cannot be counted on (49 and 50).

*Section IV* (51 to 53 : 61 to 134) sets out proposals for an International Currency (or Clearing) Union.

The central feature is the establishment of a new international organisation (Clearing Union) to which the principal countries of the world would adhere, and which would have the function of settling international balances of payments by credits and debits in a new international currency (called



bancor) which would have a fixed value in gold and would be accepted as in all respects the equivalent of gold. Its Members would have overdraft facilities. The gold value of their currencies could only be varied (except under prescribed conditions) with the permission of the Governing Board (appointed by the Governments of the Member States).

The Clearing Union could finance Post-War Relief, International Development Schemes and Commodity Control Schemes. It could co-operate in schemes to control the trade cycle and stabilise prices and to maintain active employment everywhere (61 to 134).

*Section V* (135 to 177) contains critical observations on the Plan.

Its advantages are recapitulated (135 to 144). Comments are made as regards the position of the United States (146), the relation of the Plan to tariffs and discriminations (147 and 148), its relation to the immediate post-war situation (149 to 151), to currency stability (153 to 157), and control of capital movements (158).

The overdraft facilities are considered (159 and 160) and generally the difficulty of how far it should act by fixed rule and how far by discretion, its "supernational" functions and the nature of the management proposed raising political and psychological questions (161 to 165).

Next, the relation of the Plan to gold is discussed (166 to 168) and the nature of the Management (169).

The Plan is designed as a contribution to, but not as a complete solution of, the fundamental economic problems (171 to 174). Nothing can take the place of a sound internal policy (175 to 176).

In conclusion, the best method of presenting the Plan—as an ambitious scheme to be explored or by way of illustration of one possible means of achieving what is desired—is discussed (177).

*Section VI* (178 to 190) deals with the proposals of the American professors, Messrs. Hansen and Gulick for—

(i) An International Economic Board. These are summarised (178 to 183 and Appendix II) and commented on, it being suggested that the underlying principle of the proposal deserves respect (184 and 185); and

(ii) An International Development Corporation. These are also summarised (186 and 187) and commented on (188 to 190).

*Section VII* (191 to 195) deals with Mr. Harrod's detailed plan for associating the Hansen-Gulick proposals with the Clearing Union Plan. This is summarised (191 and 192 and Appendix III) and commented on (193 to 195).

*Section VIII* (196 to 205) refers to possible United States contributions to the solution of the problem.

We cannot tell how far the United States will act as fairy godmother to the post-war world (197). She might contribute by lending gold, make productive long-term foreign loans, reduce tariffs, finance post-war relief, maintain internal prosperity (to the general benefit) and refrain from a policy of raising her wheat, cotton, &c., prices to the rest of the world (198 to 205).

*Section IX* (206 to 256) deals with the question of Trade Controls in the United Kingdom.

We shall have largely to rely on our own efforts and our reserves will be small (206 and 207). We shall have to push our exports (208).

The limitations of exchange depreciation as a remedy are analysed (210). If matters are allowed to get out of hand painful readjustments of an internal nature may be necessary (211).

We may be thrown back on protective or regulative mechanisms (212 to 214).

Despite the general argument for unqualified multilateralism (215), there are a number of instances in which regulation of trade is likely to be expedient. These are enumerated (216 to 224).

The broader question is whether unqualified "multilateralism" (or non-regulation) is well adapted to the conditions likely to prevail in future. The case against universal non-regulation is set out (225 to 240).

Next, the dangers of bilateralism are considered—even when qualified by “triangular” arrangements. These dangers are both economic, international, and perhaps inter-Imperial (241 to 249).

Finally, the issues of policy are set out (250 to 256).

*Section X* (257 to 264) deals with monetary arrangements, more especially in the absence of a Currency Union:

Arrangements will be necessary between monetary authorities for day-to-day business in the absence of an outside market (257).

These might include understandings between Central Banks, covering perhaps short periods, to keep rates of exchange fixed and to hold each other's currencies (258 to 262). These arrangements are only tentatively suggested, pending the developments of events. They leave unsolved a number of difficulties (263). The first practical question will be how to adapt war-time payments agreements to post-war needs (264).

## I.

1. In both internal and external economic affairs, the return from war to peace conditions is likely to entail formidable problems. The internal problems, though they may prove in practice far from easy to solve, will not raise difficulties of the same fundamental character as will the external. The problem is rather to ensure the employment of resources specialised to foreign trade and surplus to domestic requirements. Despite the vast expenditure of wealth which war entails, there is no reason to doubt that our productive resources, when they have been redirected to civilian work, will prove fully adequate to produce all the goods required to maintain the standard of living, provided only that we can obtain the food and raw materials that we are accustomed to purchase from abroad. But, although nothing is certain in a kaleidoscopic world, our external exchange problems appear very formidable.

2. These difficulties centre round what is technically known as the "balance of payments," to which this note will frequently refer.

3. In any year money flows out of this country to countries overseas in payment for our imports, for current services received, &c., and money flows into this country from overseas in payment for our exports, for current services (*e.g.*, shipping services) rendered, &c. The excess of the one over the other, favourable or adverse as the case may be, is the balance of payments on current account. At the same time money flows out of this country in respect of capital sums which we lend to overseas countries, and money flows in in respect of capital moneys which are lent from overseas to us. The balance, favourable or adverse, is the balance of payments on capital account. The net aggregate of the two, favourable or adverse, is the balance of payments as a whole.

4. So long as gold is the accepted medium for clearing international balances (whether a gold standard be in force or not), a favourable balance of payments evidences itself in an inflow of gold and an adverse balance in an outflow.

5. The problem of dealing with inflow and outflow of money on capital account is dealt with later. The next following paragraphs deal with the inflow and outflow on current account.

6. Investigations (set out in detail in Appendix I) have been carried out by the Economic Section of the War Cabinet into the possible size of the United Kingdom adverse balance of payments on current account after the war on certain assumptions as to capital items. Obviously this problem presents special difficulties of statistical prophecy. The best the statisticians can do for us is to give a range of estimates, indicating the possible order of magnitude, on stated assumptions set forth in such a way that it is not too difficult to gauge the effect of modifying the particular assumptions. The results can be summarised as follows:—

7. The two years immediately after the termination of hostilities have been considered separately from the more settled subsequent period. The following assumptions have been made:—

- (a) The war is assumed to end on the 31st December, 1943.
- (b) The tonnage of our merchant fleet, which was about 83 per cent. of pre-war in mid-1941, is taken at about 60 per cent. of pre-war at end-1943. All lease-lend tonnage is excluded and all tonnage building in Canada is assumed to come into United States or Canadian ownership. One-third of our own new building is assumed transferred to our Allies to satisfy our undertakings of replenishment to them. No credit has been taken for the acquisition of enemy tonnage. Total world post-war tonnage is taken at about 90 per cent. of pre-war at end-1943, recovering to the pre-war figure by mid-1946.
- (c) It is assumed that shipping freight rates are high (*i.e.*, rather more than twice the level of 1938) but that they are subject to control and that we do not seek to profiteer in this field on the scale of 1919–20 (though very high shipping earnings in those years were an important aid in seeing us through). The net result of these assumptions as to tonnage and freight rates leads (after certain other adjustments) to our foreign

exchange earnings from shipping after the war being somewhat larger in terms of money than before (*i.e.*, £115 million on the average of 1944 and 1945, compared with £100 million in 1938).

- (d) Net earnings from foreign investment are presumed, in the case of equities, to benefit from higher prices. But in the immediate post-war period a large reduction is assumed from the areas affected by fighting. A time-lag is also expected in the recovery of our miscellaneous invisible earnings, whilst heavy Government expenditure abroad is assumed to continue. The temporary loss of net invisible earnings (other than shipping) recoverable later on is put at about £100 million a year in the first two years, of which half is due to exceptional Government expenditure abroad.
- (e) Prices of both imports and exports are taken at 50 per cent. higher than in 1938. If good markets enabled us to get abnormally good prices for exports in these two years, *e.g.*, 60 per cent. higher, whilst leaving import prices 50 per cent. higher, this would put the position £50 million a year *better* than the estimate for these two years.
- (f) The volume of imports in 1944 is assumed to be limited to about five-sixths of post-war normal by shipping difficulties (the tonnage will be more restricted), but apart from this no relief is taken from special restriction on consumption by continued rationing. The volume of exports in 1944-45 is assumed to be limited only by the capacity of our industries to recover and change over to peace-time production, and is therefore taken at 90 per cent. of 1938 in the first year and 120 per cent. in the second year.
- (g) No relief is assumed from using up stocks or, on the other hand, any aggravation from replenishing them. Nor is any credit taken for the facts that we shall own certain substantial stocks overseas unless we give them away for European relief, and that we have some long-term contracts for raw materials at favourable prices extending for a year after the war.
- (h) Lend-lease (and Canadian) assistance is assumed to terminate immediately.
- (i) No allowance is made for the financial effect of our contribution to European relief, as the demands upon us cannot be estimated.
- (j) It is assumed that the proceeds of our exports are wholly available to pay for current imports, and are not offset by withdrawals from the large end-war sterling balances in London.

8. On these assumptions the deficit over the two years taken together is put at £465 million. The resources and expedients out of which this could be met are:—

- (i) Better prices for exports as indicated above (and perhaps for freights also), not fully offset by higher prices for imports. The problem of the right price policy for our exports during these difficult two years, without doing injury to our later prospects, deserves special study.
- (ii) The depletion of stocks and the postponement of their replenishment.
- (iii) Some continuance of lend-lease and the like, and the incurring of further short-term overseas debt.
- (iv) The use of the modest gold reserves with which we hope to end the war.
- (v) Restrictions on civilian consumption with a view to reducing imports and increasing exports. As an illustration of the maximum possible scope of this, a restriction of civilian consumption to the 1941 level would save about £m500 in the two years taken together, which would rather more than cancel the deficit. In other words, on the stated assumptions, we shall be able to increase consumption above the 1941 level only to the extent that resources received under (i), (ii), (iii) and (iv) above allow.

9. For the subsequent post-war period the following assumptions have been made:—

- (a) A deterioration of 7 per cent. against us in terms of trade expressed in a rise of 50 per cent. over pre-war in import prices compared with a rise of only 40 per cent. in export prices.

- (b) A level of consumption and a use of raw materials corresponding to an increase in employment of 8 per cent. compared with 1938.
- (c) A saving of £m10 on imports of raw materials and of £m30 on imports of food as a result of larger production at home. The net result of (b) and (c) is to leave the *volume* of imports about the same as in 1938, the increase under (b) being offset by the decrease under (c) and by the fact that in 1938 there was some re-stocking.
- (d) Such good markets abroad that, apart from any new or special measures, the volume of our exports is 22 per cent. above 1938, rather a poor year, and 10 per cent. above 1937, the best recent year. On the assumption that, in spite of the adverse trend before the war and the large-scale abandonment of export markets forced on us during the war, we can in two years recover to the level where we left off with no such trend against us, together with the assumption of better world trade post-war than was enjoyed in any recent pre-war year, this figure is reasonable. It is, moreover, much below the figure for our exports in 1929 and earlier years. It is evident, nevertheless, that the above assumptions beg a good deal, especially if it is supposed that we rapidly reach this position as a jumping-off point for the still greater increase which the table below shows to be necessary, namely, an increase sufficient, in fact, to carry us back, not merely to the export markets of 1929, markets which we shall, by then, have lost for many years past, but to a volume only 7 per cent. below that of 1913.
- (e) No new measures (as compared with pre-war) to keep out imports. The amount of imports, with which we could dispense if necessary by producing ourselves at no undue inconvenience, is estimated at a maximum of £m60 at post-war prices. But no credit is taken for this below.

10. The resulting balance-sheet is as follows:—

	1938.	Post-war year.
	<i>£m.</i>	<i>£m.</i>
Net earnings from foreign investment ...	200	175*
Shipping earnings ... ..	100	125
Other net invisible income ... ..	22	30
Exports ... ..	471	810
	<hr/>	<hr/>
	793	1,140
Imports ... ..	858	1,290†
	<hr/>	<hr/>
Deficit ... ..	65	150‡

11. These calculations attempt to estimate the adverse balance of payments of the United Kingdom with the world as a whole. The currency and banking systems of many sterling countries, including the greater part of the Colonial Empire, are so intimately bound up with those of the United Kingdom that the balance of payments (favourable or unfavourable) of these countries has very similar consequences to those of the United Kingdom itself. It would be useful, if it were practicable, to calculate the balance of payments not only of the United Kingdom itself, but also that of a larger area comprising the United Kingdom and those sterling countries which have the Bank of England as their only Central Bank. The future balance of payments of the Colonial Empire would, however, be extremely difficult to calculate; there is no basis, for example, for computing the allowance that should be made for the consequences of the war-time occupation of Malaya. In the past, though the available statistical data leave a considerable margin for uncertainty, there is no reason to suppose that the balance of payments of the Colonial Empire with the outside world, including the United Kingdom, was either decidedly adverse or decidedly favourable. If this position is maintained after the war, the inclusion of the Colonial Empire would make no material difference to the calculation. No distinction has been drawn between

\* Allowing for further disinvestment equal to the estimated deficit in 1944-45.

† Made up of £m585 food, £m510 raw materials, £m75 petroleum, £m110 finished products and £m10 parcels post.

‡ The Appendix indicates that this final result is subject to a margin of error of some £m100 on either side.

any part of the United Kingdom adverse balance which may be with other countries in the Sterling Area and any part which may be with foreign countries, though the practical problems which arise under these two heads differ in important respects. The relations of the rest of the Sterling Area with the rest of the world raise a separate set of problems, which are likely to complicate our own position.

12. The validity of the estimate of the United Kingdom adverse balance is, of course, governed by the validity of the assumptions. While some of the assumptions may seem optimistic and others pessimistic, we think that on the whole it presents a very fair balance of probabilities. It should be stressed that (g), (h), (i) and (j) of paragraph 7 are statistical assumptions, and not an attempt at a forecast. Thus, the indication is that the aggregate adverse balance of the first five years, which we have to overcome by effort, will be *circa* £m1,000 with a large margin of error on either side.

13. This estimate, though alarming, is not surprising. The economic tendencies engendered by the last Great War turned a favourable current balance of this country, lying probably between £m100 and £m200 per annum, into a dubious equilibrium. The economic effects of the present war, similar in many respects to those of the last but probably acting with greater intensity, may well turn a doubtful equilibrium into an adverse current balance of very serious dimensions. Moreover, we shall this time find ourselves with few liquid reserves and therefore obliged to pay as we go.

14. It is more serious because the position of this country cannot be considered in isolation. Geographical position, commercial pre-eminence and financial experience have made it the focal point at which (a) European relations with the extra-European world, and (b) Sterling Area relations with the rest of the world tend to be balanced and cleared. Short of financial collapse, the focal position of this island is unlikely to be displaced. It is a source of material profit and augments our exchange resources, but it exposes the monetary system of the United Kingdom to special strains. It means also that the international economic structure is likely to suffer serious damage if the solidity of that monetary system is impaired.

15. A wider survey shows that our prospective disequilibrium is far from being the only disturbing factor in the post-war world. A second economic disturbance likely to be world-wide centres in the prospective disequilibrium in the balance of the payments of the United States *vis-à-vis* the outside world as a whole, including in particular this country and the Sterling Area. In collecting into its own coffers in the pre-war period most of the gold stocks of the world, the United States gave proof enough that its balance of payments was excessively favourable. This was largely due to the pouring into the United States of refugee capital which in a settled world—if there is to be a settled world—may in part pour out again, assuming that the United States Government do not restrain its flow. But in addition the United States, operating behind a high protection, enjoyed also an excessively favourable balance on current account, to the great injury of other countries. The probabilities are that after the war the United States, despite her entry into active hostilities, will still be in a position, if she chooses, to wield a predominance and maintain an excessively favourable balance in international trade without following any of those compensating policies such as overseas lending for productive purposes which made the British predominance of earlier generations fruitful rather than injurious to other countries. The pursuit of more favourable policies by the United States after the war is therefore of high importance.

16. There is also the question of the state of Europe, including Russia, and indeed all other countries whose economies have been seriously affected by the war. However skilful and successful the peace settlement may be, it would seem probable that many countries, at the outset, must suffer from financial weakness or exhaustion and be driven to conserve their individual foreign purchasing power by all those devices of protection and safeguarding which have been too well perfected in recent years.

17. There is also an Imperial aspect. The United Kingdom is the centre of the Commonwealth, or, perhaps more precisely in this connexion, the centre

of that ill-defined but important union of interests known as the Sterling Area. In a sense there has for generations past been a Sterling Area; the Empire countries (except Canada) banked in London, looked to this country as the source of loan capital, and in large measure amalgamated their balances of payments with ours. It was, however, after the economic blizzard and the suspension of the Gold Standard in 1931 that the term "Sterling Area" came into common use. It signified a group of countries, including the Dominions (except Canada) and India and the Colonies, and certain foreign countries which, generally speaking, found it convenient to base their currencies on sterling and to use our gold reserve as the common gold reserve into which their acquisitions of gold flowed and from which their requirements for gold were taken.

18. This loosely conceived Union sprang naturally, almost unnoticed, out of mutual convenience, and will not easily be held together except by mutual convenience. Though Canada has not been and is unlikely to wish to be a member of the Sterling Area, the maintenance of the general concept of the Sterling Area in an Empire sense clearly commends itself on general Imperial grounds.

19. Monetary considerations point in the same direction. It is true that the adherence of South Africa is already very incomplete. She is not disposed to hold balances in sterling; she cannot be relied on therefore to sell us any more of her gold output than is required to balance her external payments, and of this not much more remains with us than would come to us anyhow, even if she stood outside the Area altogether. Nevertheless the gold which she retains in her own possession is at least more accessible to us in times of emergency than if she had formed the habit of selling her whole output for dollars and keeping her reserve balances in that form. It is to our interest, therefore, that she should remain attached to the Sterling Area. Still more serious would be the defection of any of those parts of the Empire which, having a favourable balance of payments with the outside world, are disposed to pay the proceeds thereof into the common pool.

20. The problem of monetary policy after the war cannot be examined in isolation. It has to be considered against the background of the foregoing conditions as well as in the light of our own interests and of what the United States may expect of us in the forthcoming conversations

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## II.

21. There are a number of reasons for regarding early progress in the consideration of the underlying issues as desirable. In the first place, it can be argued that it is psychologically important for the Allies to have an answer of a positive character to the German "New Order" propaganda. To reach the basis of any agreed policy, however, discussions over a wide and difficult field will be necessary. Moreover, if any agreed policy is eventually to be applied, it ought to be settled and worked out well before the end of the war; otherwise we shall be overtaken by the pressure of events when that time comes. Over and above these considerations, the necessity to attempt a decision now on general policy arises primarily from the insistence of the United States Administration upon early discussions about Anglo-American co-operation, following on Article VII of the Mutual Aid Agreement signed on the 23rd February, 1942.

22. At the root of the United States general attitude lies a desire to secure the greatest possible expansion in international trade. This is an objective with which the United Kingdom Government can express their complete agreement. We are more dependent on imports than any other great country; they consist mainly of food and raw materials which cannot be forgone. The natural means of adjusting our balance of payments on current account is by increasing exports. Our exports are mainly manufactured goods. We have all the productive capacity and industrial skill for their production; the problem is to find markets. In many industries productive capacity is greatly in excess of the ability of the home market to absorb output. Similarly we have very great interest in the earnings of our shipping from international trade and the financing of international trade has been a function from which a valuable contribution has been regularly made to our invisible exports. Thus we depend in a unique degree on the prosperity of other nations, which is much the most important single factor in maintaining and increasing international trade.

23. Mr. Sumner Welles, in his address to the world at the World Trade Dinner on the 7th October, 1941, said that the purpose set forth in the Atlantic Declaration, to promote the economic prosperity of all nations, is inspired by the realisation so painfully forced on us by the experiences of the past and of the present—that in the long run no nation can prosper by itself or at the expense of others, and that no nation can live unto itself alone. However true this may be of the United States, it is truer of ourselves.

24. The British Commonwealth also is vitally interested in the development of international trade; for many primary commodities are produced in the Dominions, in India, and in British colonies in much larger quantities than Empire markets can absorb. It is, therefore, to the interest of the United Kingdom, and of the British Commonwealth as a whole, to promote the expansion of international trade on a world-wide basis; and with this end in view to join in dissuading other countries from seeking safety, as many of them may be tempted to seek it under the difficult conditions that may follow the war, in policies of autarky or high protection.

25. In passing from the general to the particular in the United States attitude, it will be remembered that the word "discrimination" occurred in the first United States draft of Article VII of the Mutual Aid Agreement, and that a similar phrase recurs in the second and final draft; similarly, Mr. Sumner Welles, in his recent address, declared that the United States Government is determined to move towards the creation of conditions under which restrictive and unconscientious tariff preferentials and "discriminations" are things of the past. The mind of the State Department seems to revolve very largely round measures to secure that there shall be no discriminations against their export trade. This attitude is natural, for wheat, cotton, tobacco and fruit are great staple exports and the United States farmers a formidable political force.

26. As experience shows that the United States will press its particular objectives with insistence, it will be important when the time comes to keep the conversations on a wide basis covering the various aspects of the American formula as a whole, and not to let them take a line which would involve excessive



concentration on contentious questions; but in the meanwhile it is important also to analyse, as far as may be possible, what the word "discrimination" implies to American minds.

27. It implies no objection to schemes for the restriction of production and allocation of exports on the basis of agreed quotas. On the contrary, the Administration are now supporters of such schemes for primary commodities and are inclined to demand from us the acceptance of formulæ which might add seriously to our post-war difficulties, and would involve us in discrimination against the cheaper producers, including some Empire producers.

28. It implies no objection in principle to tariffs, although the absolute height of existing tariffs is one of the chief barriers to trade expansion and individual tariffs are often so constructed in practice as to be highly discriminatory as between different countries. They are theoretically free from discrimination, and the Administration of the United States, which has been the most highly protected country in the world, and in which the last word on tariffs is said not by the President, but by Congress, could not do more, whatever its convictions, than argue for reductions.

29. It does, on the contrary, imply objection on principle to preferences, and the Administration will no doubt wish to secure from us undertakings contemplating the eventual elimination of Imperial Preference, though ready to recognise that the goal can only be approached gradually.

30. The American State Department dislike quantitative import restrictions since, though their general object may be to limit the outflow of exchange, they are clearly capable of being used to discriminate between available foreign markets. They probably would not object to the total exclusion of a given commodity, but this is a rare case. The normal form of restriction is the imposition of import quotas. To this they object, and they only tolerate them if they are based on the import figures of past years, before the imposition of quotas, which tends to stereotype an old pattern of trade.

31. Centralised State purchase of staple commodities does not appear to have come under recent discussion. But it is clearly capable of being stigmatised as a simple and obvious instrument of discrimination and, in fact, the United States Government seek regularly to include in their trade agreements a provision to the effect that monopoly purchasing agencies shall be guided in making their purchases solely by "commercial" considerations and that State purchases shall be made on a non-discriminating basis: such a provision appears in our 1938 Trade Agreement with the United States. Russia could not agree to restrictions on centralised purchase. We, for different reasons, should certainly need liberty to continue it.

32. But it may be expected that the type of arrangement attracting the greatest United States hostility will be systems of exchange control affecting trading transactions, including bilateral payments agreements, whereby international trade is canalised by Government action as between particular countries. The distinction must be drawn between such bilateral payments agreements and bilateral trade agreements of the kind which we negotiated during the 1930's with the Scandinavian countries. The bilateral payments agreement compels the exporting country to spend the money which it receives from the importer on goods supplied by the importer's country. The bilateral trade agreement secures to each side certain special privileges or advantages for specified lines of trade. The benefits of these frequently are by the operation of the m.f.n. clause extended to other countries so far as they can adapt their trade to them, but where the benefits are not so extended they give a preferential advantage to exports of one of the two countries, though—unlike the payments agreement—the agreement lays no direct restriction on the free conversion and expenditure of export proceeds.

33. The Americans themselves sum up what they dislike in controlled economy by the word "discrimination." Their dislike of discrimination leads them to demand equal treatment for all purposes as between creditor and debtor nations. The Administration realise that something must be done to correct their creditor position, but they cling to this principle, which makes their task more difficult.

34. It is uncertain from what root standpoint the American attitude arises. It may spring to a considerable extent from rigid adherence to free trade doctrines, but it is probable that, at any rate in some quarters, a clear distinction is drawn between those types of regulation or trade barriers which are liable to produce international friction, and those which actually or supposedly do not. It may well be that in these quarters State trading will attract the greatest hostility, and that exchange control, payments agreements and import restrictions will be placed in the same class.

35. Arising generally from these facts, one finds in many Americans a deep-rooted suspicion of principles other than their own and a belief that any schemes which are "discriminatory" as they understand it—and this may cover almost any scheme which involves the governmental planning of international trade—are based on selfish and unworthy motives; a belief which it is most important to correct, since their honest desire to devise a system which will benefit everyone is one of the biggest assets of the post-war world.

## III.

36. The American eye is fixed upon trade questions, but in any comprehensive review the question of capital movements must first be got out of the way.

37. As explained above, the net balance of payments turns on the aggregate result of two distinct types of inflow and outflow of money :—

- (a) Inflow and outflow of capital payments.
- (b) Inflow and outflow of current payments.

These two matters require separate treatment.

Although there was serious disequilibrium in the balance of current payments of many countries before the war, mass movements of capital from country to country were the most disturbing single element leading to the monetary chaos of the nineteen-thirties. These movements arose from many causes, including the following :—

- (a) Panic flights of capital due to political or economic chaos in the country of residence or to fear of war.
- (b) International speculation in currencies, especially rife on the Continent.
- (c) The wide facilities and growing taste in many countries for the semi-speculative purchase of foreign securities and shares (particularly American shares) by means of international stock-exchange transactions.

38. There is another more fundamental reason for controlling capital movements—connected with movements of a type more natural and less vicious than the particular speculative movements just mentioned. It may be that in order to maintain full employment at home a relatively cheap money policy has to be pursued; certainly cheaper money than would be appropriate in a new country, where the opportunities for domestic investment were very much greater. Accordingly perfectly normal and proper foreign investment which seeks to take advantage of higher interest rates elsewhere may require to be controlled because the country cannot develop a sufficiently large favourable balance of trade to finance it. This reason, however, is secondary to the main reasons given above and experience will show the degree of its importance on a long term view.

39. There is no reasonable ground for expectation that the evil of irresponsible movements will automatically cure itself after the war. In particular, unless adequate measures are taken to the contrary, speculative anticipations of coming changes of currency values will offer immense possibilities of quick and easy profits to international speculators in every quarter of the globe.

40. There is unanimity of view among the officials who have studied this matter that these vast movements of capital from centre to centre ought not to be left uncontrolled. In the world as a whole they are certain, in unsettled conditions, to be a continuing source of monetary chaos. Future movements may not be on the same scale nor in the same direction. In words borrowed from Mr. Keynes, "The whereabouts of the 'better 'ole' may shift with the speed of the magic carpet: loose funds may sweep round the world disorganising all steady business." In this country, at any rate for a long time to come, not only may embarrassment arise from irresponsible inflows of money liable at any time to be withdrawn, but large outflows of money owned by foreigners and Dominion residents, and in some circumstances by British residents, may be a grave and indeed intolerable source of weakness.

41. It is suggested, therefore, that continued control of capital movements should be decided upon as the settled policy of this country and advocated as the desirable policy of all countries. Control implies, not refusal of entrance or exit, but only regulation and selection. In its general application it would be the means of distinguishing (a) between movements of floating funds and genuine new investment for developing the world's resources; (b) between movements from creditor to debtor countries helping to maintain equilibrium and irresponsible speculative movements or flights out of debtor countries or from one creditor country to another.

42. A corollary to this policy is that foreign exchange transactions and the financial transactions connected with international commodity and security business should pass through official or "authorised" channels and that the reappearance of an outside exchange market in this country should be prevented.

43. A decision in this sense would not be without its practical difficulties. Continued control of capital movements implies continuance of the general machinery of exchange control, whether or not it is used for controlling current trade. The machinery would be very difficult to introduce *ab initio* in peace time, but as we shall end the war with a very complete and elaborate exchange control regulating not only capital but current movements, the process would be one of relaxing, without abolishing, an existing system, and would therefore be much easier. Unfortunately, the relaxations could not go as far as might be expected. For instance, a very simple method of exporting capital in defiance of the control would be to obtain foreign exchange from the central authorities to pay for imports but not to make the imports. Thus, arrangements for proof of importation would still be required. Similarly, a check on the remittance of the proceeds of exports would still be needed, since an obvious way to export capital is to send goods abroad and leave the money paid for them in that foreign country. The practical problem would be so to reduce and simplify existing formalities of the exchange control (*e.g.*, by bringing them into the closest possible alignment with Customs and other similar formalities) as to render them as little troublesome as possible to trade.

44. Continuance of postal censorship after the war would be needed for a fully effective control. If its removal must for other reasons be contemplated, a very important safeguard against evasion will have gone and the path of the wilful transgressor made easier. But it is judged that an adequate control could still be maintained.

45. This will more particularly be the case if and to the extent that other countries also maintain corresponding controls, for control of capital movements at both ends of the transaction is strictly requisite to a water-tight system.

46. Control of capital movements raises a practical issue as regards the countries of the Empire. Under the existing United Kingdom war-time control capital funds are allowed to pass freely between the United Kingdom and the sterling Empire countries, each of which maintains controls corresponding to our own against the rest of the world. If this free passage is to continue, it will be necessary not only that those countries should follow our system of capital control after the war, but that they should continue to pool their liquid resources with ours *vis-à-vis* the rest of the world. It is in no way certain that they would all be prepared to do so; in particular, South Africa and India might decide otherwise. We must therefore be prepared, if necessary, to extend capital control to movements within the Empire. It is not considered, however, that this need be a source of embarrassment; already to-day Australia and New Zealand exercise control of capital movements *vis-à-vis* this country (although there is no corresponding action on our part), but no damage to the concept of the Sterling Area has been sustained.

47. The control of remittances other than those required for the current purposes of post-war trade might have to extend to arrangements for dealing specially with balances accumulated prior to the termination of the emergency period covering the war and some months thereafter.

48. It is believed that a system to control capital movements can be framed so as not to interfere seriously with the international business of London as a banking and financial centre where overseas banks maintain branches and current international business is cleared so far as it relates to current trade and commerce, overseas banking funds which are brought here in connection with such current business by approved institutions being freely withdrawable as heretofore. In particular, there is no reason why such a system should be incompatible with the continuance of entrepôt trade, which has been a fruitful source of British profit in the past, although for other reasons the scope of such trade may be more restricted in future. Much useful experience gained during the war indicates that a mixed system of freedom and control is easier to work in practice than might have been expected.

49. The United States has no exchange control (though assets of foreigners have been frozen during the war) and so far as is known little thought has so far been given by the Administration to this subject. It is known, however, that the great inflow of capital funds into the United States in the decade before the war was distasteful to the authorities there, and there appears good ground for hope that they could be interested in the subject.

50. Action by the United States would undoubtedly encourage the general control of capital movements in other countries. Our own control would also be facilitated by parallel action in the United States especially if accompanied by exchange of information. But it must remain uncertain whether they will actively co-operate. There is no present indication that their entry into the war will entail the introduction of exchange control. To press them to initiate so far-reaching a measure which must incidentally involve a certain amount of trouble to their trading community would be much too large an order unless they take the view that it would be intrinsically valuable to them as well as to the rest of the world.

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## IV.

51. Passing from capital to current movements of money, the anticipated difficulties connected with the adverse balance of payments have been indicated.

52. It may be well to repeat that it does not follow, because the prospect is very formidable, that the actual future when it reveals itself will be desperate; there are, indeed, hypotheses on which hopes could be built that the present prognosis is too pessimistic; in any event the discovery of adequate remedies at the time would probably be less difficult than the invention now of hypothetical remedies designed to fit unpredictable conditions. But early discussion is desirable for the reasons indicated in paragraph 21, including the wish of the United States, and the first question to which we have addressed ourselves is whether some general scheme can be found which will make it easier to deal with the distresses of debtor countries and to reverse those factors of pre-war international trade which tended to increase the debit balances of debtor nations and the credit balances of creditor nations.

53. We have considered a plan for a new International Clearing Union. The credit for its initiation belongs to Mr. Keynes, but it has undergone considerable modification as the result of discussion. We set it out *in extenso*, as thus modified, in Mr. Keynes's own language.

[The next paragraph is numbered 61. The gap has been left to save type corrections.]

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*Plan for an International Currency (or Clearing) Union.*

## A.

61. The practical difficulties in the way of Anglo-American economic co-operation after the war should not dissuade us from attaching the highest importance to it. We must do our utmost to find common ground, and much will depend on the method of our approach.

62. It would be a mistake merely to put forward the extent and extremity of our post-war difficulties and follow up this complaint with a plea that there is nothing to be done except to leave us a free hand to use all those expedients which we may find useful and necessary in our self-regarding interests. Any statement on these lines should be introduced only in the shape of a warning that we must not be asked to abandon possible safeguards until something better is definitely in sight, or a hint of the unsatisfactory outcome to which the failure of a constructive plan might drive us.

63. It would also be a mistake to invite, of our own motion, direct financial assistance after the war from the United States to ourselves, whether as a gift or a loan without interest or a gratuitous redistribution of gold reserves, though we may reasonably hope that Lend/Lease supplies of food and raw materials will not cease immediately after the end of hostilities. The United States will consider that we have had our whack in the shape of Lend/Lease and a generous settlement of "consideration." If the British Commonwealth stands astride the world with the vast prestige of victors, though shared with Russia and the United States herself, some natural jealousy will not be absent. We, in particular, in a distressed and ruined continent, will not bear the guise of the most suitable claimant for a dole, however real and heavy our difficulties. The assistance for which we can hope must be *indirect* and a consequence of setting the world as a whole on its feet and of laying the foundations of a sounder political economy between all nations.

64. Finally, it would be a mistake in approaching the United States to put in the forefront proposals for an increased solidarity and significance for the British Commonwealth or the sterling area in isolation from the rest of the world, which would arouse both prejudice and suspicion. Such proposals must be ancillary to, and part of, a more general international scheme.

65. On the contrary. If we are to attract the interest and enthusiasm of the Americans, we must come with an ambitious plan of an international complexion, suitable to serve the interests of others besides ourselves, which to a hopeful spirit may carry a chance of making the post-war economy of the world more reasonable and promising than it was before—something capable of wide and various application. We can feel confidence that Americans will be brought to a sympathetic understanding of our difficulties. But, however hard-up we may be for the time being, we—on the assumption which underlies all our post-war plans—shall be standing on the top of the world, one of the two or three masters of the future. It is not with *our* problems of ways and means that idealistic and internationally-minded Americans will be particularly concerned.

66. Should we not share these purposes and interests with our American friends? Why should we confine ourselves to trying to patch up something which is as like as possible to what we are doing now and may with luck and skill just serve our turn? If we sincerely wish to collaborate with them to larger ends, they will soon discover it—and they would soon discover the opposite, if that were to be true. This, therefore, is the first criterion on which our proposals must be judged.

67. But further, it is not as if we had another plan which was, from our point of view, just right. Nothing of the kind. The more we look at the alternatives, the less we like them. They are neither one thing nor the other, but a patched-up contrivance, mainly based on abnormal war experience, which might do well enough to carry us through a transitional period, but is not very likely to evolve into a satisfactory permanent system or one which will fit in with (or help) what may be happening in the rest of the world. The most attractive

version assumes a high degree of economic solidarity within the British Commonwealth. With so broad a bottom we might (perhaps) safely stand on it without support from outside. But we should run the risk of isolating ourselves from the United States and the rest of the world without real security that we had constructed a reliable economic union within the Empire.

68. It is, therefore, an ambitious and far-reaching scheme that is proposed in what follows. Certain elements in it are fundamental. Others are not, and are capable of being treated this way or that without impairing the main purpose. It would obscure the character and possibilities of the scheme if we start off with too much modification and compromise before we have heard the American point of view; and would very likely result in spoiling it in advance with unnecessary and unwanted concessions. But that must not lead anyone to suppose that the details are put forward dogmatically. The detailed plan is to afford a basis for discussion, as one variant of a central idea which is capable of being worked out in various ways. It is put forward, not as a cut-and-dried scheme to be formally adopted by the British Government, but for discussion and amendment between all those represented at the conversations as a constructive suggestion which might be found capable of contributing to the solution of the main economic problem which will face, not only us, but all the world.

### B.

69. The proposal is to establish a Currency Union, here designated an *International Clearing Union*, based on international bank-money, called (let us say) *bancor*, fixed (but not unalterably) in terms of gold and accepted as the equivalent of gold by the British Commonwealth and the United States and all members of the Union for the purpose of settling international balances. The Central Banks of all member-States (and also of non-members) would keep accounts with the International Clearing Union through which they would be entitled to settle their exchange balances with one another at their par value as defined in terms of *bancor*. Countries having a favourable balance of payments with the rest of the world as a whole would find themselves in possession of a credit account with the Clearing Union, and those having an unfavourable balance would have a debit account. Measures would be necessary (see below) to prevent the piling up of credit and debit balances without limit, and the system would have failed in the long run if it did not possess sufficient capacity for self-equilibrium to prevent this.

70. The idea underlying such a Currency Union is simple, namely, to generalise the essential principle of banking, as it is exhibited within any closed system. This principle is the necessary equality of credits and debits, of assets and liabilities. If no credits can be removed outside the clearing system but only transferred within it, the Union *itself* can never be in difficulties. It can with safety make what advances it wishes to any of its members with the assurance that the proceeds can only be transferred to the clearing account of another member. Its problem is solely to see to it that its members keep the rules and that the advances made to each of them are prudent and advisable for the Union as a whole.

71. It is proposed that the Currency Union should be founded by the United States and the United Kingdom, which would be designated founder-States and given a special position. Their representatives, and those of other members, on the Governing Board of the Clearing Bank would be appointed by the Governments of the several member-States; the daily business and technical arrangements being carried out, as at present, by their Central Banks.

### C.

72. The plan aims at the substitution of an expansionist, in place of a contractionist, pressure on world trade.

73. It would effect this by allowing to each member-State overdraft facilities of a defined amount, proportionate to the importance of its foreign trade and subject to certain regulative provisions. That is to say, each country is allowed a certain margin of resources and a certain interval of time within which



to effect a balance in its economic relations with the rest of the world. These facilities are made possible by the nature of the system itself and do not involve particular indebtedness between one member-State and another. A country is in credit or debit with the Clearing Union as a whole. This means that the overdraft facilities, whilst a relief to some, are not a real burden to others. For credit balances, just like the importation of actual gold, represent those resources which a country voluntarily chooses to leave idle. They represent a potentiality of purchasing power, which it is entitled to use at any time. Meanwhile, the fact that the creditor country is not choosing to employ this purchasing power would not necessarily mean, as it does at present, that it is withdrawn from circulation and exerting a deflationary and contractionist pressure on the whole world including the creditor country itself. No country need be in possession of a credit balance unless it deliberately prefers to sell more than it buys (or lends); no country loses its liquidity or is prevented from employing its credit balance whenever it chooses to do so; and no country suffers injury (but on the contrary) by the fact that the balance, which it does not choose to employ for the time being, is not withdrawn from circulation. In short, the analogy with a national banking system is complete. No depositor in a local bank suffers because the balances, which he leaves idle, are employed to finance the business of someone else. Just as the development of national banking systems served to offset a deflationary pressure which would have prevented otherwise the development of modern industry, so by extending the same principle into the international field we may hope to offset the contractionist pressure which might otherwise overwhelm in social disorder and disappointment the good hopes of our modern world.

74. These facilities will be of particular importance as soon as the initial shortages of supply have been overcome. Many countries, including ourselves, will find a difficulty in paying for their imports, and will need time and resources before they can establish a readjustment. The efforts of each of these debtor countries to preserve its own equilibrium, by forcing its exports and by cutting off all imports which are not strictly necessary, will aggravate the problem of all the others. On the other hand, if each feels free from undue pressure, the volume of international exchange will be increased and everyone will find it easier to re-establish equilibrium without injury to the standard of life anywhere. The creditor countries will benefit, hardly less than the debtors, by being given an interval of *time* in which to adjust their economies, during which they can safely move at their own pace without the result of exercising deflationary pressure on the rest of the world, and, by repercussion, on themselves.

75. Now this can only be accomplished by the countries whoever they may turn out to be, which are for the time being in the creditor position, showing themselves ready to remain so without exercising a pressure towards contraction, pending the establishment of a new equilibrium. The fact that this costs them nothing deserves emphasising. The accumulation of a *bancor* credit, instead of accumulating gold, does not curtail in the least their capacity or their inducement either to produce or to consume. The substitution of a credit mechanism in place of hoarding would have repeated in the international field the same miracle already performed in the domestic field of turning a stone into bread.

76. There might be one or two other ways of effecting this temporarily or in part. For example, U.S.A. might redistribute her gold. Or there might be a number of bilateral arrangements having the effect of providing international overdrafts, as for example an agreement by the Federal Reserve Board to accumulate, if necessary, a large sterling balance at the Bank of England.

77. The objection to particular arrangements of this kind is that they are likely to be influenced by extraneous, political reasons and put individual countries into a position of particular obligation towards others; and also that the distribution of the assistance between different countries may not correspond to need and to the actual requirements as they ultimately develop. Moreover, for reasons already given, we are not likely to be specially eligible applicants for bounty of this kind. If, for example, the problem were to be met by a redistribution of America's gold, it is unlikely that we should get any of it, partly because we should have so lately received assistance under Lend-Lease, partly because the British Commonwealth are the largest producers of gold, which output would be regarded, rightly or wrongly, as ours at one remove.

78. It should be much easier, and surely more satisfactory both for them and for us, to persuade the United States to enter into a general and collective responsibility, applying to all countries alike, that a country finding itself in a creditor position *against the rest of the world as a whole* should enter into an arrangement not to allow this credit balance so long as it chooses to hold it, to exercise a contractionist pressure against world economy and, by repercussion, against the economy of the creditor country itself. This would give us, and all others, the great assistance of multilateral clearing, whereby (for example) we could offset favourable balances arising out of our exports to Europe against unfavourable balances due to the United States or South America or elsewhere. How, indeed, can we hope to afford to start up trade with Europe (which will be of vast importance to us) during the relief and reconstruction period on any other terms?

79. These advantages of the proposed International Clearing Union are so great that they surely overshadow most reasons of objection on lesser grounds.

80. If, indeed, we lack the productive capacity to maintain our standard of life, then a reduction in this standard is not avoidable. If our wage and price-levels are hopelessly wrong, a change in the rate of exchange is inevitable. But if we possess the productive capacity and the difficulty is the lack of markets as a result of restrictive policies throughout the world, then the remedy lies in expanding opportunities for export by removal of restrictive pressure. There is great force in the contention that, if active employment and ample purchasing power can be sustained in the main centres of world trade, the problem of surpluses and unwanted exports will largely disappear, even though under the most prosperous conditions there may remain some disturbances of trade and unforeseen situations requiring special remedies.

81. There is no obvious means of offering a right measure of inducement to the general expansion of international trade except by a broadly based international organisation.

#### D.

82. The arrangement by which the members of the Clearing Union start with substantial overdraft facilities in hand will be mainly useful, just as the possession of any kind of reserve is useful, to allow time and method for necessary adjustments and a comfortable safeguard behind which the unforeseen and the unexpected can be faced with equanimity. Obviously, it does not by itself provide any long-term solution against a continuing disequilibrium, for in due course the more improvident and the more impecunious, left to themselves, would have run through their resources. But, if the purpose of the overdraft facilities is mainly to give time for adjustments, we have to make sure, so far as possible, that they *will* be made. We must have, therefore, some rules and some machinery to provide that equilibrium is restored.

83. Perhaps the most difficult question to determine is how much to decide by rule and how much to leave to discretion. If rule prevails, the liabilities attaching to membership of the system are definite, whilst the responsibilities of central management are reduced to a minimum. On the other hand, liabilities which would require the surrender by legislation of too much of the discretion, normally inherent in a Government, will not be readily undertaken by ourselves or by the United States. If discretion prevails, how far can the ultimate decision be left to the individual members and how far to the central management? If the individual members are too free, indiscipline may result and unwarrantable liberties be taken. But if it is to the central management that the discretions are given, too heavy a weight of responsibility may rest on it, and it may be assuming the exercise of powers which it has not the strength to implement. If rule prevails, the scheme can be made more water-tight theoretically. But if discretion prevails, it may work better in practice. All this is the typical problem of any super-national authority. An earlier draft of this proposal was criticised for leaning too much to the side of rule. In the provisions below the bias is in the other direction. For it may be better not to attempt to settle too much beforehand and to provide that the plan shall be reconsidered after an initial experimental period of (say) five years. Only by collective wisdom and discussion can the right compromise be reached between law and licence.

84. The proposal put forward below differs in one important respect from the pre-war system because it aims at putting some part of the responsibility for adjustment on the creditor country as well as on the debtor. This is an attempt to recover the advantages which were enjoyed in the nineteenth century when a favourable balance in favour of London and Paris, which were the main creditor centres, immediately produced an expansionist pressure in those markets, but which have been lost since New York succeeded to the position of main creditor, the effect of this change being aggravated by the breakdown of international borrowing credit and by the flight of loose funds from one depository to another. The object is that the creditor should not be allowed to remain entirely passive. For if he is, an intolerably heavy task may be laid on the debtor country, which is already for that very reason in the weaker position.

85. The detailed provisions proposed (the particular proportions, &c., suggested being merely tentative as a basis of discussion) are the following:—

(1) The two founder States will agree between themselves the initial values of their own currencies in terms of *bancor* and the value of *bancor* in terms of gold; and the initial values of the currencies of other members will be fixed on their joining the system in agreement with them. A member-State may not subsequently alter the value of its currency in terms of *bancor* without the permission of the Governing Board except under the conditions dealt with below; Board shall give special consideration to appeals for adjustments in the exchange-value of a national currency on the ground of unforeseen circumstances.

(2) The amount of the maximum debit balance allowed to any member-State shall be determined by reference to the amount of its foreign trade, and shall be designated its *quota*. There need be no limit to the amount of a credit balance.

The initial quotas might be fixed by reference to the sum of each country's exports and imports on the average of (say) the three pre-war years, being either equal or in a determined *lesser* proportion to this amount, a special assessment being substituted in cases where this formula would be, for any reason, inappropriate. Subsequently, after the elapse of the transitional period, the quotas might be revised annually in accordance with the actual volume of trade in the three preceding years.

(3) A charge of 1 per cent. per annum will be payable to the Reserve Fund of the Clearing Union on the average balance of a member-State, whether credit or debit, in excess of a quarter of its quota; and a further charge of 1 per cent. on the average balance, whether credit or debit, in excess of half its quota. Thus only a country which keeps as nearly as possible in a state of international balance on the average of the year will escape this contribution. These particular charges are, clearly, not essential to the scheme. But if they are found acceptable, they would be valuable inducements towards keeping a level balance, and a significant indication that the System looks on excessive credit balances with as critical an eye as on excessive debit balances, each being, indeed, the inevitable concomitant of the other. Any member-State in debit may, however, borrow from the balances of any member-State in credit on such terms as may be mutually agreed, by which means each would avoid these contributions.

(4)—(a) A member-State may not increase its debit balance by more than a *quarter* of its quota within a year without the permission of the Governing Board. If its debit balance has exceeded a quarter of its quota on the average of at least a year, it shall be entitled to reduce the value of its currency in terms of *bancor*, provided that the reduction shall not exceed 5 per cent. within a year without the permission of the Governing Board.

(b) As a condition of allowing a member-State to increase its debit balance in excess of a *half* of its quota, the Governing Board may require (i) a stated reduction in the value of the member's currency, if it deems that to be the suitable remedy, (ii) the control of outward capital transactions if not already in force, and (iii) the surrender of a suitable proportion of any separate gold reserve it may hold in reduction of its debit balance.

(c) If a member-State's debit balance has exceeded *three-quarters* of its quota on the average of at least a year [or is excessive, as measured by some formula laid down by the Governing Board, in relation to the total debit balances outstanding on the books of the Clearing Union], it may be asked by the Governing Board to take measures to improve its position and, in the event of

its failing to reduce its debit balance below the figure in question within two years, the Governing Board may declare that it is in default and no longer entitled to draw against its account except with the permission of the Governing Board. Each member-State, on joining the system, shall agree to pay to the Clearing Union any payments due from it to a country in default towards the discharge of the latter's debit balance and to accept this arrangement in the event of falling into default itself. A member-State which resigns from the Clearing Union without making approved arrangements for the discharge of any debit balance shall also be treated as in default.

(5) A member-State whose credit balance has exceeded a *half* of its quota on the average of at least a year shall discuss with the Governing Board (but shall retain the ultimate decision in its own hands) what measures would be appropriate to restore the equilibrium of its international balances, including—

- (a) measures for the expansion of domestic credit and domestic demand;
- (b) the appreciation of its local currency in terms of *bancor*, or, alternatively, an increase in money-wages;
- (c) the reduction of excessive tariffs and other discouragements against imports;
- (d) international loans for the development of backward countries.

#### E.

86. The special protective expedients which were developed between the two wars were sometimes due to political, social or industrial reasons. But frequently they were nothing more than forced and undesired dodges to protect an unbalanced position of a country's overseas payments. The new system, by providing an automatic register of the size and whereabouts of the aggregate debtor and creditor positions respectively, will give a clear indication whether it is reasonable for a particular country to adopt special expedients as a temporary measure to assist in regaining equilibrium in its balance of payments, in spite of a general rule *not* to adopt them.

87. It is not proposed to incorporate any specific arrangements for such relaxations in the constitution of the Clearing Union itself. But the existence of the Clearing Union would make it possible for member States contracting Commercial Treaties to use their respective debit and credit positions with the Clearing Union as a test. Thus, the contracting parties, whilst agreeing to clauses in a Commercial Treaty forbidding, in general, the use of certain measures or expedients in their mutual trade relations, might make this agreement subject to special relaxations if the state of their respective clearing accounts satisfied an agreed criterion. For example, a Treaty might provide that, in the event of one of the contracting States having a debit balance with the Clearing Union exceeding a specified proportion of its quota on the average of a period and the other having a credit balance of a specified amount, the former should be free to resort to import quotas or to barter trade agreements or to higher import duties of a type which was not permitted under the Treaty in normal circumstances. It might even provide that such exceptions should only be allowed subject to the approval of the governing Board of the Clearing Union, and in that case the possible grounds for exceptional action might cover a wider field and other contingencies.

88. Apart from such temporary indulgence, the members of the Clearing Union should feel sufficiently free from anxiety to contemplate the ultimate removal of the more dislocating forms of protection and discrimination and expect the prohibition of some of the worst of them from the outset. In any case, members of the Currency Union would not allow or suffer among themselves any restrictions on the disposal of receipts arising out of current trade or "invisible" income. It might also be possible to obtain recognition of the general principle that commercial treaties between members of the Union should, subject to any necessary safeguards and exceptions, exclude—

- (i) import restrictions, whether quantitative or in the form of "duty-quotas" (excluding, however, prohibitions genuinely designed to safeguard, *e.g.*, public health or morale or revenue collection);

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- (ii) barter arrangements;
- (iii) export quotas and discriminatory export taxes; and
- (iv) excessive tariffs.

89. The question of preferences and of other relaxations from most-favoured-nation treatment, which would be of a normal and continuing character, does not fall within the scope of this paper, and must be settled on principles outside the sphere of the Clearing Union.

90. The above provisions might enable us to give some satisfaction to Mr. Cordell Hull over a wide field, since we should be accepting a non-discriminatory international system as the normal and desirable régime.

#### F.

91. It is a great advantage of the proposed Currency Union that it restores unfettered multilateral clearing between its members; so that no action is necessary, except where a country is out of balance with the system as a whole.

92. Compare this with the difficulties and complications of a large number of bilateral agreements. Compare, above all, the provisions by which a country, taking improper advantage of a payments agreement (for the system is, in fact, a *generalised* payments agreement) as Germany did before the war, is dealt with not by a single country (which may not be strong enough to act effectively in isolation or cannot afford to incur the diplomatic odium of isolated action) but by the system as a whole. If the argument is used that the Currency Union may have difficulty in disciplining a misbehaving country and in avoiding consequential loss, with what much greater force can we urge this objection against a multiplicity of separate bilateral payments agreements.

93. Thus we should not only return to the advantages of an international gold currency, but we might enjoy them more widely than was ever possible in practice with the old system under which at any given time only a minority of countries were actually working with free exchanges.

94. The advantages of multilateral clearing are of particular importance to London. It is not too much to say that this is an essential condition of the continued maintenance of London as the banking centre of the Sterling Area. Under a system of bilateral agreements it would seem inevitable that the sterling area, in the form in which it has been historically developed and as it has been understood and accepted by the Dominions and India, must fall to pieces.

95. In conditions of multilateral clearing everything would go on exactly as before without our having to ask anyone to accept special or onerous conditions. We should, in this respect, be back again in the best days of the gold standard. The traditional advantages of banking in London would be retained, precisely because London has been built up on the basis of an international currency having universal validity. But if we try to make of the sterling area a compact currency union as against the rest of the world, we shall be putting a greater strain on arrangements, which have been essentially (even in time of war) *informal*, than they can be expected to bear.

96. It is possible to combine countries, some of which will be in a debtor and some in a creditor position, into a Currency Union which, substantially, covers the world. But, surely, it is impossible, unless they have a common banking and economic system also, to combine them into a Currency Union not with, but against, the world as a whole. If other members of the sterling area have a favourable balance against the world as a whole, they will lose nothing by keeping them in sterling, which will be interchangeable with bancor and hence with any other currency, until they have occasion to use them. But if the sterling area is turned into a Currency Union, the members in credit would have to make a forced and *non-liquid* loan of their favourable balances to the members in debit. Incidentally, they might find themselves involved in making between them an involuntary loan to London at the rate, perhaps, of £100,000,000 a year cumulative. They would have to impose import regulations and restraints on capital movements according as the area as a whole was in debit or credit, irrespective of their own positions. They would have to be bound by numerous

bilateral agreements negotiated primarily (at least so they would believe) in the interests of London. The sterling resources of creditor Dominions might come to be represented by nothing but blocked balances in a number of doubtfully solvent countries with whom it suited *us* to trade. Moreover, it is difficult to see how the system could work without a pooling of gold reserves.

97. It is improbable that South Africa or India would accept such arrangements even if other Dominions were more complying. We should soon find ourselves, therefore, linked up only with those constituents which were running at a debit, apart from the Crown Colonies, which, perhaps, we could insist on keeping.

98. Is it not a delusion to suppose that the *de facto*, but somewhat flimsy and unsatisfactory, arrangements, which are carrying us through the war, on the basis that we do our best to find the other members of the area a limited amount of dollars provided that they lend us a very much larger sum in sterling, can be carried over into the peace and formalised into a working system based on a series of bilateral agreements with the rest of the world, accompanied by a strict control of capital movements outside the Area?

99. The sterling area, if we mean by this the system under which the members of the British Commonwealth do their international banking through London, grew up under conditions of freedom. It lives and breathes by being a voluntary system. It is only in that same atmosphere of the City of London as Liberty Hall dealing in a currency of general acceptability that we can expect to preserve it. The notion that a multilateral plan, based on an international standard, jeopardises the position of the Sterling Area must be based on a rigid and (one would think) politically impracticable version of the Sterling Area concept and not on its historical and actual significance. A multilateral plan would, therefore, be of great assistance in maintaining the position of London in relation both to the British Commonwealth and to many other countries which like our way of doing business and would give up most reluctantly the facilities we have given them.

#### G.

100. It may be convenient at this point to note in more detail the position contemplated for centres of international banking such as London, New York or Paris, and for currency groups within the membership of the Clearing Union covering more than one country, such as the existing sterling area or groups, like the Latin Union of former days, which may come into existence covering, for example, the countries of North America or those of South America or the groups now under active discussion covering Poland and Czechoslovakia or certain of the Balkan States.

101. The governing principles should be: first, that the Clearing Union is set up, not for the transaction of daily business between individual traders or banks, but for the clearing and settlement of the ultimate outstanding balances between Central Banks (and certain other super-national Institutions), such as would have been settled under the old gold standard by the shipment or the earmarking of gold, and should not trespass unnecessarily beyond this field; and, secondly, that its purpose is to increase *freedom* in international commerce and not to multiply interferences or compulsions.

102. Thus the fabric of international banking organisation, built up by long experience to satisfy practical needs, should be left as undisturbed as possible. Except as regards a provision, explained below, concerning the balances of Central Banks themselves, there should be no obstacle in the way of the existing practices of international banking except those which necessarily arise through measures which individual Central Banks may choose to adopt for the control of movements of capital.

103. Nor should it be necessary to interfere with the discretion of Central Banks which desire to maintain a special intimacy within a particular group of countries associated by geographical or political ties. There is no reason why such Central Banks should not be allowed a double position, both as members of the Clearing Union in their own right with their proper quota, and also as making

use of another financial centre along traditional lines, as for example, Australia and India with London or certain American countries with New York. In this case their accounts with the Clearing Union would be in exactly the same position as the independent gold reserves which they now maintain, and they would have no occasion to modify in any way their present practices in the conduct of daily business.

104. There would be other cases, however, in which a dependency or a member of a federal union would merge its currency identity in that of a mother Central Bank, with a quota appropriate to the merged currency unit as a whole, and *not* enjoy a separate individual membership of the Clearing Union, as, for example, the French colonies, the Federated States of the American Union or of Australia, and possibly the British Crown Colonies.

105. At the same time there should be a general encouragement to Central Banks, which do not belong to a special geographical or political group, to keep their reserve balances with the Clearing Union and not with one another, except in the case of a specific loan from a member-State in credit with the Clearing Union to a member-State in debit. It should, therefore, be laid down that overseas balances may not be held in another country except with the approval of the Central Bank of that country; and, in order that sterling and dollars might not appear to compete with *bancor* for the purpose of Central Bank reserve balances, the Founder States might agree together that they would not accept the reserve balances of other Central Banks in excess of normal working balances except in the case of Banks definitely belonging to a Sterling Area or Dollar Area group.

#### H.

106. The position of gold would be left substantially unchanged. What, in the long run, the world may decide to do with gold is another matter. The establishment of an International Clearing Union does not require any significant or immediate change. Indeed, by providing an automatic means by which some part of the favourable balances of the creditor countries can be settled, the current gold production of the world and the remnant of gold reserves held outside the United States may yet have a useful part to play. Moreover, gold still possesses great psychological value which will not have been diminished by recent events; for the desire to possess a gold reserve against unforeseen contingencies is likely to remain. Gold also has the merit of providing, in point of form whatever the underlying realities may be, an uncontroversial standard of value for international purposes, for which it would not yet be easy to find a serviceable substitute.

107. It is conceived, therefore, that the international bank-money which we have designated *bancor* would be defined in terms of a weight of gold. Since the national currencies of the member-States would also be given a defined exchange value in terms of *bancor*, it follows that they would have a defined gold equivalent which would also be their official buying price for gold above which they must not pay. Any Central Bank would be entitled to obtain a credit in terms of *bancor* by paying actual gold to the credit of its Clearing Account, thus securing a steady and ascertained purchaser for the output of the gold-producing countries and for countries holding a large reserve of gold.

108. Central Banks would be entitled to retain their separate gold reserves and ship gold to one another against a clearance between them in the books of the Clearing Union, provided they did not pay a price above parity; they could coin gold and put it into circulation, and, generally speaking, do what they liked with it.

109. One restriction only would be, for obvious reasons, essential. No Central Bank would be entitled to demand gold from the Clearing Union against its balance of *bancor*; for *bancor* would be available only for transfer to the Clearing Account of another Central Bank. Thus between gold and *bancor* itself there would be a one-way convertibility only, such as ruled frequently before the war with national currencies which were on what was usually called a "gold-

exchange standard." This need not mean that the Clearing Union would only receive gold and never pay it out. If the Clearing Union found itself in possession of a stock of gold, the Governors of the Bank should have the discretion to distribute the surplus between all Central Banks possessing a credit balance with it, proportionately to such balances, in reduction of their amount.

110. The question has been raised whether these arrangements are compatible with the retention by individual member-States of a full gold standard with two-way convertibility, so that, for example, any foreign bank acquiring dollars through the Clearing Union could use them to obtain gold for export. It is not evident that a good purpose would be served by this. But if any member-State should prefer to maintain full convertibility for internal purposes, it could protect itself from any abuse of the system or inconvenient consequences by providing that gold could only be exported under licence.

111. The value of bancor in terms of gold should be fixed but not unalterably. The two founder States, the United States and the United Kingdom, acting in agreement, should have the power to change it. Clearly, they should exercise this power if the stocks of gold tendered to the bank were to be super-abundant for their legitimate purposes. No object would be served by attempting further to peer into the future or to prophesy the ultimate policy of the founder States in this respect.

112. Changes in the value of the national currencies of member-States stand in a different category. For the real significance of such changes is to be found not in relation to gold itself but in relation to the values of national currencies amongst themselves. The general principles by which such changes should be governed have been discussed in a previous section. It would be undesirable, if it can be avoided, to lay down more precise rules in advance, since it is difficult to distinguish by means of a rigid formula the cases, in which a change in the rate of exchange will assist the restoration of equilibrium and is the right remedy, from those cases where some other type of measure is more appropriate.

#### J.

113. It is widely held that control of capital movements, both inward and outward, should be a permanent feature of the post-war system—at least so far as we are concerned. If control is to be effective, it probably involves the *machinery* of exchange control for *all* transactions, even though a general open licence is given to all remittances in respect of current trade. But such control will be more difficult to work, especially in the absence of a postal censorship, by unilateral action than if movements of capital can be controlled *at both ends*. It would therefore be of great advantage if the United States and all other members of the Currency Union would adopt machinery similar to that which we have now gone a long way towards perfecting in this country; though this cannot be regarded as *essential* to the proposed Union.

114. This does not mean that the era of international investment should be brought to an end. On the contrary, the system contemplated should facilitate the restoration of international credit for loan purposes in such ways as those mentioned in 122 (5) below. The object, and it is a vital object, is to have a means of distinguishing—

- (a) Between movements of floating funds and genuine new investment for developing the world's resources; and
- (b) Between movements, which will help to maintain equilibrium, from surplus countries to deficiency countries and speculative movements or flights out of deficiency countries or from one surplus country to another.

115. There is no country which can, in future, safely allow the flight of funds for political reasons or to evade domestic taxation or in anticipation of the owner turning refugee. Equally, there is no country that can safely receive fugitive funds which cannot safely be used for fixed investment and might turn it into a surplus country against its will and contrary to the real facts.



116. The general principles of the control of capital movements need not be discussed here. It is evident that the existence of an International Clearing Union would make such control easier.

## K.

117. It has been suggested that so ambitious a proposal is open to criticism on the ground that it requires from the members of the Currency Union a greater surrender of their sovereign rights than they will readily concede.

118. But, in the present version of the plan, no greater surrender is required than in any commercial treaty—certainly not greater than in the binding undertakings against discrimination which the United States is inviting us to make. The obligations will be entered into voluntarily and can be terminated on certain conditions by giving notice.

119. In the second place a greater readiness to accept super-national arrangements must be required in the post-war world than hitherto. The arrangements proposed could be described as a measure of Financial Disarmament. They are very mild in comparison with the measures of Military Disarmament, which it is to be hoped the world may be asked to accept.

120. Surely it is an advantage, rather than a disadvantage, of the scheme that it invites the member States and groups to abandon that licence to promote indiscipline, disorder and bad-neighbourliness which, to the general disadvantage, they have been free to exercise hitherto.

121. There is nothing here which we need be reluctant to accept ourselves or to ask of others. Or if there be anything such, let it be amended.

## L.

122. An International Currency Union might become the instrument and the support of international policies apart from those which it is its primary purpose to promote. The following suggestions are not a necessary part of the plan. But they are illustrations of the additional purposes of high importance and value which the Union, once established, might be able to serve:—

(1) The Union might set up a clearing account in favour of the international body charged with post-war Relief and Reconstruction. If necessary, it might supplement contributions received from other sources by granting overdraft facilities in favour of this body, this overdraft being discharged over a period of years out of the Reserve Fund of the Union, or, if necessary, out of a levy on credit clearing balances. By this means it is possible to avoid asking any country to assume a burdensome commitment for relief and reconstruction, since the resources would be provided in the first instance by those countries having credit Clearing Accounts for which they have no immediate use and are voluntarily leaving idle, and in the long run by those countries which have a chronic international surplus for which they have no beneficial employment.

(2) If the United States were to wish to effect a redistribution of gold reserves, the Clearing Union would provide a suitable channel for the purpose, the gold so re-distributed being credited (*e.g.*) to the account of the Relief and Reconstruction Authority.

(3) The Union might set up an account in favour of the Super-national policing body charged with the duty of preserving the peace and maintaining international order. If any country were to infringe its properly authorised orders, the policing body might be entitled to request the Governors of the Clearing Union to hold the Clearing Account of the Central Bank of the delinquent country to its order and permit no further transactions on the account except by its authority. This would provide an excellent machinery for enforcing a financial blockade.

(4) The Union might set up an account in favour of international bodies charged with the management of a Commodity Control, and might finance stocks of commodities held by such bodies, allowing them overdraft facilities on their

accounts up to an agreed maximum. By this means the financial problem of holding pools and "ever-normal granaries" would be satisfactorily solved.

(5) The Union might be closely linked up with the Board for International Investment. It might act on behalf of this Board and collect for them the annual service of their loans by automatically debiting the Clearing Account of the country concerned. The statistics of the Clearing Accounts of the Member States would give a reliable indication as to which countries were in a position to finance the Investment Board, with the advantage of shifting the whole system of clearing credits and debits nearer to equilibrium. This important question is the subject of separate papers. (Appendices II and III.)

(6) There are various methods by which the Clearing Union could use its influence and its powers to maintain stability of prices and to control the Trade Cycle. If an International Economic Board is established, this Board and the Clearing Union might be expected to work in close collaboration to their mutual great advantage. If an International Investment or Development Corporation is also set up together with a scheme of Commodity Controls for the control of stocks of the staple raw materials, we might come to possess in these four Institutions a powerful means of combating the evils of the Trade Cycle, by exercising contractionist or expansionist influence on the system as a whole or on particular sections. This, again, is a large and important question which cannot be discussed adequately in this paper; and need not be examined at length in this place because it does not raise any important issues affecting the fundamental constitution of the proposed Union. It is mentioned here to complete the picture of the large purposes which the foundation of the Currency Union might be made to serve.

#### M.

123. Our post-war currency and exchange system should be one which is capable of wide, indeed of universal, extension as further countries become ready for it. Nevertheless it would be an advantage if the proposed Union could be brought into existence by the United States and the United Kingdom as joint founder-States, covering the United States and its possessions and the members of the British Commonwealth. The position of Russia, which might be a third founder, if she can be a party to this kind of international institution, would need special consideration. Other members would then be brought in—some from the outset, some as soon as they had established an internal organisation capable of sustaining the obligations of membership. This approach would have the great advantage that the United States and the United Kingdom (the former in consultation with the Pan-American countries and the latter with the other members of the British Commonwealth) could settle the charter and the main details of the new body without being subjected to the delays and confused counsels of an international conference. It would also mean that considerable progress could be made irrespective of the nature of the European political settlement and before the conditions of adherence of the European members could be finally determined. Moreover, membership would be thus established as a privilege only open to those who conformed to certain general principles and standards of international economic conduct. The management and the effective voting power might inhere permanently in the founder-States.

124. In view of our experience and of our geographical and political position in relation to Europe, the United States and the British Commonwealth, we could justifiably ask that the head office should be situated in London with the Board of Managers meeting alternately here and in Washington.

125. Members of the Board would be appointed by the Governments of the member-States, each of which would have a vote in proportion to its quota. But there might be a provision, at any rate for the first five years, by which the British and American members when acting in agreement could outvote the rest of the Board.

126. There is no reason why the Central Banks of non-member States should not keep Credit Clearing Accounts with the Union; and indeed it would be advisable for them to do so for the conduct of their trade with member-States. But they would have no say in the management.

127. Members should be entitled to withdraw from the Union on a year's notice, subject to their making satisfactory arrangements to discharge any debit balance. They would not, of course, be able to employ any credit balance except by making transfers from it, either before or after their withdrawal, to the Clearing Accounts of other Central Banks. Similarly it should be within the power of the Governing Board to require the withdrawal of a member subject to the same notice.

128. The principles and governing rules of the Union should be the subject of general reconsideration after five years' experience, if a majority of the Governing Board desire it.

129. It would be of great advantage if the general principles of the International Clearing Union could be agreed beforehand, with a view to bringing it into operation at an early date after the termination of hostilities. Such a proposal presents, however, something of a dilemma. On the one hand, many countries, ourselves not least, will be in particular need of reserves of overseas resources in the period immediately after the war. On the other hand, goods will be in short supply and the prevention of inflationary international conditions of the first importance. The expansionist tendency of the proposed system, which is a leading recommendation of it as soon as peace-time output is restored and the productive capacity of the world is in running order, might easily be a danger in the early days of a sellers' market and a superabundance of demand over supply.

130. A reconciliation in detail of these divergent purposes is not easily found until we know more than is known at present about the means to be adopted to finance post-war relief and reconstruction and particularly as to the intentions of the United States regarding a temporary continuance of Lease-Lend arrangements for food and raw materials after the termination of hostilities. If these intentions are on liberal and comprehensive lines, it might be better for relief and Lend-Lease arrangements to take the place of the proposed quotas during the "relief" period of (say) two years. The immediate establishment of the Clearing Union would be compatible with provisional arrangements regarding the overdraft quotas which could take alternative forms according to the character of the other "relief" arrangements.

131. If the finance of relief is actually furnished through the Clearing Union, which has been suggested above as one possibility, and if that, combined with some continuance of lend-leasing by the United States, appears likely to provide the world with as much purchasing power as is desirable in the early days, the coming into force of the overdraft quotas might be postponed until the Founder Members are agreed that the need for them is impending. In this case credit clearing balances would be limited to the amount of gold delivered to the Union, and the overdraft facilities created by the Union in favour of the Relief Council, the International Investment Board or the Commodity Controls. Alternatively overdraft quotas might be allowed on a reduced scale during the transitional period. At any rate, it might be proper to provide that countries in receipt of relief or Lend-Lease assistance should not have access at the same time to overdraft facilities, and that the latter should only become available when the former had come to an end.

132. If, on the other hand, relief and Lend-Lease facilities look like being inadequate from the outset, the overdraft quotas may be even more necessary at the outset than later on.

133. We must not be over-cautious. A rapid economic restoration may lighten the tasks of the diplomatists and the politicians in the resettlement of the world and the restoration of social order. In our case the possibility of exports sufficiently expanded to sustain our standard of life and our solvency is bound up with good and expanding markets. We cannot afford to wait too long for this and we must not allow excessive caution to condemn us to perdition. Unless the Union is a going concern, the problem of proper "timing" will be almost insoluble. It is sufficient at this stage to point out that the problem of timing must not be overlooked, but that the Union is capable of being used so as to aid rather than impede its solution.

## N.

134. In most of its objectives and in many of its methods this paper is in fundamental accord with alternative proposals which have been or could be put forward. The special merits claimed for this particular version include the following:—

*For ourselves.*

(1) Our British problem of gaining enough receipts overseas to balance our import requirements is so acute that we can scarcely hope to solve it except through a scheme which—

- (a) by a strong expansionist stimulus throughout the world provides willing markets for a largely expanded volume of our exports;
- (b) offers facilities for the multilateral clearing of international payments, since we cannot afford to have any of the credit balances, which we may acquire overseas, to be blocked and unavailable as a set-off against our debit balances elsewhere;
- (c) provides us with a margin, during the period before we can re-establish equilibrium, by an international scheme which does not require us to ask particular favours or accommodations from the United States but merely gives to us, and requires of us, the same facilities for the expansion of international trade and the maintenance of international equilibrium which all the countries will be asked to receive and to allow;
- (d) affords us the possibility of subsequent rectifications of the rate of exchange against the rest of the world without the risk of competitive depreciations or of complaints by other countries in the event of the initial value of sterling proving to be higher than the level at which we can balance our overseas trade.

(2) A multilateral system preserves, to the full extent compatible with the control of capital movements, the traditional freedom of London as a financial centre. Above all it allows the historical continuity of the sterling area in the same form and with the same absence of restraint as heretofore. For it is evident that any system of numerous bilateral agreements would put in great jeopardy not only the sterling area but the whole position of London as an international centre.

*For the United States and the World at large.*

(1) It provides a general framework by the aid of which *all* countries can hope to rehabilitate their currencies.

(2) It offers a criterion by the help of which we can satisfy American aspirations, which we ourselves share with Mr. Hull and Mr. Sumner Welles, for the greater freedom of international trade supported by firm undertakings.

(3) It is a plan which can be used to further such general world purposes as—

- (a) post-war relief and reconstruction;
- (b) international T.V.A.;
- (c) the finance of commodity agreements;
- (d) the preservation of peace;
- (e) the control of the Trade Cycle and the stabilisation of prices; and, generally,
- (f) the maintenance of active employment everywhere.

(4) It is capable of arousing enthusiasm because it makes a beginning at the future economic ordering of the world between nations and "the winning of the peace," and might help to create the conditions and the atmosphere in which much else would be made easier.

*Critical observations on the Clearing Union plan.*

135. *Advantages.*—A scheme of this kind must in the nature of things be technical and complex. A layman may be disposed to feel that it is too technical and too idealistic for a drab and self-seeking world, but behind the technicalities it seeks to offer very definite contributions to the solution of post-war difficulties.

136. First: It would relieve exporters of the necessity of satisfying themselves that the money in which they would receive payment was good.

137. Second: It would provide each member State with large over-drafts to meet contingencies; thus under proper conditions it would place international purchasing power at the disposal of countries which may emerge from the war almost destitute of exchange in the ordinary sense.

138. Third: In this way it would increase the international purchasing power of the weaker countries without reducing in any way the corresponding purchasing power of the stronger. Thus it would substitute an expansionist for a contractionist pressure on world trade.

139. Fourth: A great international clearing scheme would reverse the pre-war tendency towards special bilateral arrangements of a monetary character; it would constitute a multilateral approach to post-war problems.

140. Fifth: It would facilitate, within certain limits, the question of elimination of trade restrictions and discriminations, subject to the recognition of their use when essential to maintain a country's equilibrium.

141. Sixth: It would expressly recognise for the first time that strong countries should share with weak ones the burden of keeping balances of payments in reasonable equilibrium.

142. Seventh: The new organisation would be one round which other useful international agencies for dealing with particular economic problems might be gathered.

143. Eighth: A scheme on new, bold and constructive lines might dispose many minds (particularly in the United States) to approach contentious questions in the economic sphere with less disregard of the standpoints of other countries.

144. Ninth: The scheme, assuming an assured peace, is reasonably independent of the particular political arrangements that may be made in the peace settlement and need not cover the whole world, at least in the first instance; it would provide a mechanism for more settled countries and gradually provide for the others.

145. Nevertheless, so ambitious an experiment needs to be subjected to a critical examination, both in order to search out and expose any difficulties that may be hidden in it and to estimate the probable nature of its reception by public opinion in the world, including in particular the United States. Both the plan itself and the criticisms which follow ought to be considered in the light of probable general conditions. Accordingly, in anticipation of later sections of this Note, we add that it seems to us likely, if conditions prove as difficult as we have assumed, that the early post-war period will witness in many countries a system of control of external trade going beyond ordinary tariffs and preferences and more extensive than would in any way be desirable, while an object of the plan would be to limit this extent. How far this consideration may tip the scales in favour of the plan turns upon the question how far it is judged that the plan is a real contribution to solving the world's difficulties.

146. *Position of the United States.*—One aim of the plan is, as far as is possible, to avoid having a bill to be footed by any particular country; but, so far as there is a bill, the United States will expect to be the chief creditor country and therefore to have to foot the bill. If that country continues to maintain a great favourable balance (and *prima facie* she appears to want to), the only payment she could receive for the excess would be a credit in terms of inconvertible

bancor,\* and with the expectation that in the course of time the size of her credit balance would place her under obligation to discuss with the management of the Union measures appropriate to restore her equilibrium. It is true that the United States ought to make the major contribution to any new arrangements, that she may not be the only creditor country and that the readjustment that she ought to make in her economy could very likely be more easily made in these conditions than in any other. It is true, too, that the United States may be more disposed to co-operate in a general international scheme than in a scheme aiding particular countries which are not distressed in the ordinary sense but are crying out for international exchange. Nevertheless, it looks as if the United States will desire their *quid pro quo*, and their *quid pro quo*, in this connection as in any other, will undoubtedly be the elimination of discriminatory practices. The treatment of these practices in the plan therefore requires careful scrutiny.

147. *The question of tariffs and "discriminations."*—We gave a good deal of consideration accordingly to the question whether membership of the Clearing Union should involve the assumption by member States of definite obligations—not necessarily very precise in their character—as to the gradual elimination of many kinds of safeguarding devices subject to recognition of the right of a country to use them either after some definite degree of disequilibrium had been reached or, alternatively, subject to guidance and direction by the management of the Clearing Union. This approach was, however, felt to be precluded by the difficulty of the subject and the possibility of introducing into the Clearing Union political issues which might be the cause of great friction. Only a limited treatment of this question, indicated in section E of the plan, is on the whole felt to be possible. The central idea of this treatment is that countries might undertake in commercial treaties with one another to renounce certain forms of protection or discrimination, unless they were in substantial deficit with the Clearing Union. This suggestion, however, is exposed to the difficulty that an adverse balance of payments is only one of several reasons why a country may in future be reluctant to abandon the use of some of the practices which this suggestion would proscribe.

148. Thus the Clearing Union remains primarily a mechanism of a monetary character designed to overcome or ameliorate the disturbances of recent years and to improve the means of international exchange; and thus those questions which appear to have been specially prominent in American minds in recent times have, in the main, to be separately handled. None the less, discussion of the plan would be a means of directing American minds to a new group of economic problems.

149. *The relation of the plan to the immediate post-war situation.*—Nothing in the plan is more attractive and novel than the conception of granting overdraft facilities to countries in difficulties, and the most natural expectation would be that these facilities should come into operation immediately upon attainment of membership. This, however, would involve considerable danger. For a time after the cessation of hostilities, conditions not only in this country but in belligerent countries generally are likely to be highly inflationary. The full argument for this view would require considerable space, but the view is generally accepted by those who have studied the matter, and is illustrated by conditions at the end of the last war. The differences between the present war and the last, such as the greater and wider war effort, the increased physical destruction, the greater political confusion, are likely both to intensify and to prolong inflationary conditions when present hostilities cease.

150. Many countries will urgently require large supplies of all kinds from the outside world. Not many countries will find it easy to supply the goods required (apart from commodities of which surplus stocks are still remaining at the time) without stinting their own publics and increasing the danger of inflation at home. Though the argument could be carried too far, there will be some advantage in the prospective abnormal shortage of exchange resources in a great many countries in the immediate post-war period, or at least there are objections to a scheme which would increase the exchange resources of all countries

\* According to the draft she would have to pay interest on this bancor, but this is probably not an essential or unalterable feature of the plan.

without reducing the purchasing power of any. A scheme which would proceed by extending at once to every country large drafts on the world's resources might well set up an atmosphere likely to promote a scramble for goods, which is the last thing to be encouraged.

151. For reasons such as these the conclusion has been reached that membership should not carry with it a right to overdrafts in the first instance, and that only the rather uncertain and contingent arrangements mentioned in Section 17 of the plan could as yet usefully be formulated to cover that period. These arrangements contemplate that overdraft facilities should be alternative to post-war relief and reconstruction facilities and any continued Lend-Lease assistance, or should be allowed, during the transitional period, only on a reduced scale.

152. If one proceeds from these preliminary questions to the root problem whether the plan is intrinsically sound and advisable, a stern critic might be disposed to generalise the foregoing observations. He would say that general deflation in the world usually springs from a prior inflationary atmosphere which has gone too far, and that there is nothing in this plan which at any time or in any circumstances would damp down general inflationary tendencies when they manifested themselves and a good deal in the plan which would accentuate them. In other words, expansionist principles are admirable in many circumstances but dangerous in some. It is thought, however, that this argument could be overstrained. The plan refers (see para. 122 (6)) to the influence which the Clearing Union might exercise, in combination with other international organisations which might come to be associated with it, in combating the evils of the trade cycle. For the rest nothing has yet been invented or is likely to be invented to overcome this danger except human wisdom and human restraint. All that can be said is that, if the plan were too readily accepted as a cure-all, there are certain recurrent conditions in which its psychological influence would be bad.

153. *Fixed or varying exchanges; Gold standard analogy.*—The chief point about the old gold standard was the complete fixity of exchange rates; the currency of each gold standard country had a fixed value in gold, and therefore the ratios of value between currencies was invariable. Under the recent system of managed currencies there was no limit to the number or the extent of the alterations in the relative values of currencies that might take place. The plan seeks a middle course between these extremes. It contemplates general fixity of exchange rates and prohibits depreciation of rates of exchange except in defined circumstances; but it allows such depreciation if a member-State has a substantial deficit with the clearing account, up to a maximum of 5 per cent. in any year, with a discretion to the Governing Board to allow more; it also allows the Governing Board to insist on a stated measure of currency depreciation as a condition of permitting overdrafts beyond a certain amount, and provides that surplus countries shall discuss with the Governing Board the possibility of appreciating their currencies, as one among a number of remedies for an unduly favourable balance with the clearing account.

154. The plan is based not upon gold but upon an inconvertible equivalent called bancor. The quantity of bancor available—in contrast to the quantity of gold—is elastic and governed by the size of the balances to be cared for. Subject to these points, the second of which has some considerable significance, the plan might be described as in general a gold standard plan, with an attempted elimination of the most important difficulty of the gold standard, particularly for those countries with inadequate reserves, namely, the need for internal contraction as soon as a balance turns adverse without time or opportunity for putting into force other measures for restoring equilibrium. The last-named qualification is very important. Nevertheless, this analogy with the gold standard is an indication of the limits beyond which the plan cannot carry. No one would suggest that the reinstatement of an improved gold standard or any purely monetary arrangement is by itself adequate to set at rest the immense disequilibria with which the world will be afflicted at the end of the war.

155. *The question of depreciation of currencies.\**—The proposed regulations regarding depreciation of currencies give rise to a certain difficulty. It may not

\* Some aspects of this problem are common to almost any attempt to ensure exchange stability.

be possible for a country which has exhausted its foreign exchange and its overdraft facilities to prevent its currency from falling, and even from falling heavily, if it has no mechanism of exchange control, or if this mechanism is, as might often be the case, imperfect. Under the plan a country must first have been for a whole year in substantial deficit before it can either lower its exchange rate within the limits of 5 per cent. or apply for permission for a larger depreciation. It might happen, therefore, that it would be faced with a serious exchange crisis before this type of remedy could be applied. The possibility of undue delay in action would be increased in certain cases by the division of responsibility, for the monetary authorities of the country would have to reach agreement with the Governing Board or *vice versa*.

156. Special difficulties would arise in this connection if the plan comes into operation at the end of the war. In the unsettled conditions of that time it will be hard indeed to determine the appropriate exchange rates between different currencies. The plan therefore contemplates (para. 85 (1)) that during the first five years after the inception of the system the Governing Board shall give special consideration to appeals for adjustment in the exchange value of a national currency on grounds of unforeseen circumstances. This solution is in the nature of a compromise. Neither this country nor others is likely to feel fully safeguarded by this provision; at the same time fixity of exchange rates as a central feature of the plan becomes rather a hope deferred.

157. There is also in the background a psychological difficulty. In many countries a feeling may be expected to prevail that freedom to manipulate the value of currency is an important instrument of government, and that this freedom may even be essential to permit the pursuit of cherished economic or social policies. Although, therefore, on merits the case for supervising and restricting exchange depreciation is strong, this feature of the plan—a very essential feature—may prove contentious.

158. *Control of capital movements.*—The plan as drawn looks upon control of capital movements as a desirable but not an essential concomitant of the scheme. There seem, however, to be circumstances in which it would be essential. Nothing is more conducive to a flight of capital than the belief that a currency is over-valued and will shortly be depreciated. There is a great scope for speculation also where an appreciation of currency is expected. Under the present plan the fact that any movements would normally be limited to 5 per cent. may be sufficient to deter speculators owing to the costs involved, but in cases—presumably rare—where a larger movement was expected to be prescribed or allowed, mass movements of speculative capital might arise. As already indicated, control of capital movements will be desirable in any circumstances in the post-war world, but it would probably be impossible to make this a condition of membership of the new organisation.

159. *The quota*—The plan proposes to allocate a “quota” to each country to determine the amount of the overdraft which it may incur before becoming subject to regulation by the Governing Body or in the last resort being declared in default, or the amount it may accumulate before being liable to discuss with the Governing Body the means of abating its excess. The plan takes total import and export trade as the base, and no better substitute has suggested itself. If the average of the annual values of imports and exports is taken in the measure, the following quotas emerge in some illustrative cases:—

						<i>£ million.</i>
United Kingdom	...	...	...	...	...	900
United States	...	...	...	...	...	800
Germany	...	...	...	...	...	600
France	...	...	...	...	...	300
Canada	...	...	...	...	...	250
Japan	...	...	...	...	...	250
Malaya	...	...	...	...	...	100
U.S.S.R.	...	...	...	...	...	70

The plan of course makes provision for altering the quota each year after the transitional period by reference to an immediately preceding average.



160. Owing to the inadequacy of trade statistics—owing possibly to new groupings of countries in the peace settlement—a measure of estimation would, in any event, be necessary in fixing the quotas. The illustration given in the case of Russia suggests that the power proposed to be vested in the Governing Body to grant discretionary quotas in exceptional cases would have to be far-reaching.

161. *Regulation or discretions.*—In any plan of this kind one of the major problems is how far its working shall rest on rules and regulations determined in advance, and how much is to be left to the discretion of the controlling body. If the attempt is made to settle everything by rule beforehand, there is a danger that the rules laid down will prove unworkable or ill-adapted to the conditions that prevail. If almost everything is left to the discretion of the controlling authority, this authority is in effect invested with large powers over the life and welfare of independent countries. A heavy weight of responsibility thus rests upon it. At this stage of international evolution it may not be easy to secure general assent for the exercise of such powers and responsibilities by any super-national body.

162. This difficulty is fundamental, and it will probably be agreed that the plan as drawn steers as wise a course as possible between fixed rules and discretionary management. The questions of the latter type are, however, numerous; they include:—

- (a) Admission and expulsion of nations.
- (b) The action to be taken against a State which runs too fast or too far into deficiency.
- (c) Permission for or requirement of a depreciation of a currency.
- (d) Distribution or retention of any excess reserves of gold.

163. Few, if any, of these questions are questions of international banking; rather some of them raise matters of high international and domestic politics. This observation applies perhaps particularly to the disciplinary action to be taken against countries falling into debit. A country may fall into debit from any one of at least three causes:—

- (a) Firstly by economic misfortune, *e.g.*, exhaustion following a long war or long-run economic tendencies which happen to be peculiarly disturbing to a particular State; an agrarian State, for example, might be particularly susceptible to such misfortunes at any time; it is an assumption of the plan that many member States may fall into debit at the outset.
- (b) Secondly by financial profligacy or a deliberate aiming at a standard of life which is not economically sustainable; it might well happen that forms of government or methods of action in such States were particularly unacceptable to the public opinion of assisting creditor countries.
- (c) Thirdly (unless, indeed, such a possibility can, contrary to all past experience, be utterly ruled out in the future world) through large military preparations. The scheme offers great opportunities for a country to obtain external overdrafts for the quiet acquisition from abroad of stores of food, raw material, &c., requisite either to a State with aggressive intentions or to a State which fears aggression.

164. The actions envisaged against States whose debit has come to exceed three-quarters of the quota include the following: The State may be ordered to depreciate its currency, but not permitted to do so to the extent it would wish. It may be required to hand over any gold, and to prohibit outward capital transactions, except as permitted, and it may be refused the exchange even for essential imports. These inhibitions or others like them would, in the absence of this plan, fall upon such a country at a very much earlier stage, namely, as soon as its exchange resources and external borrowing capacity were exhausted, but they would arise as a natural consequence of economic law and not by external ukase. The United Kingdom, after exhausting all its external resources and its power of securing loans from abroad, would have to be overdrawn to the extent of three-quarters of its quota, say some £650 million before the stage of disciplinary action would be reached. It may be thought very improbable that

we should ever reach it, though, having regard to our post-war difficulties, a different view is not unreasonable. But if we did so should we welcome regulation by an external body or, indeed, be content to abide by it notwithstanding the elbow room we had enjoyed? Would other countries whose overdraft facilities (calculated by reference to their external trade figures) may be quite small, and to whom the possibility of external regulation may seem much nearer, welcome the prospect either?

165. At the outset many States would have a great incentive to enter upon membership for the purpose of obtaining (not perhaps immediately but within a measurable period) sorely needed international overdrafts not otherwise easily obtainable. Whether the Union has the seeds of permanence in the sense that after overcoming their initial difficulties States would in more settled times wish to remain members and subject to the incidents of membership, raises a more uncertain issue.

166. *Gold and Bancor.*—Under the plan bancor is to be accepted as the equivalent of gold. Moreover, bancor can always be obtained in return for gold by selling it to the Clearing Union. This provision has an important advantage from the standpoint of the British Empire as the chief gold producing area; it ensures a permanent monetary outlet for gold in all conditions, whereas at the present time the United States is the only great country which has a legal obligation to buy gold at a fixed price.

167. On the other hand, the relation between gold and bancor under the plan is curious. Though gold is to be convertible into bancor, bancor is not to be convertible into gold. It is a book entry, a conventional unit of debit or credit, or a register of sums which some countries are liable to pay to other countries, but which they are not required to pay unless the pendulum of international trade swings in their favour. The possession of a credit in bancor would not carry the solid advantages which have hitherto attached to the possession of a gold reserve. It would not, for example, serve the purpose of a war chest; it is not easy to see what would happen to the plan in the event of general war. The long use of gold as the accepted medium of international exchange has undoubtedly raised it to a position of high prestige in many countries, and particularly on the continent of Europe. It is to be expected, therefore, notwithstanding the formal provisions for the equivalence of bancor and gold that monetary authorities will prefer gold to bancor, and that any country in a position to do so will stipulate that balances due to it shall be paid in gold. Thus, *prima facie*, the better reserve will be striving to drive out the worse.

168. But that is only half the picture. Despite the probable tendency just mentioned to prefer gold to bancor, its normal use, according to the conceptions of the plan, would be as a means of obtaining bancor, and it would be shorn of its historic functions. Such a state of affairs might well stimulate the growing feeling that there is something incongruous and absurd in extracting gold from the earth with much expenditure of human toil only to bury it again in the vaults of monetary organisations; so that the threat to the position of gold to which this feeling has already given rise might in the long run be accentuated—possibly greatly accentuated. It is not clear, therefore, that the plan would prove in practice as effective a safeguard for gold-producing interests as may appear at first sight; and it is possible that South Africa and Russia, as the chief actual and potential gold-producers, may voice misgivings on this point.

169. *Nature of the Management.*—The questions raised in connection with the disciplining of a State in debit, and perhaps more especially those raised in connection with a State in default, strongly suggest that the new institution could not be represented as being of a central banking nature. It is proposed that the continuous and technical central banking functions connected with the work of international clearing should be kept in the background, and that the management of the organisation should be a political management elected by Governments, the ultimate control resting either with the United Kingdom and the United States acting together or, alternatively, in some association with the U.S.S.R. It is a subject for argument whether such a management would be accepted by the world as a whole unless it were associated with a similarly

controlled "League of Nations" possessing effective and dominating power in regard to international relations generally. While the plan can be discussed, it seems hardly possible that it could be settled internationally until agreement has been reached upon this wider question.

170. *The future of the institution.*—It is not easy to envisage the fate of the institution in the event of another general war (if such a contingency needs to be contemplated) nor is it easy to dogmatise as to its working in any profoundly difficult economic conditions. The creation of the institution would, in this sense, be an act of faith which perhaps must be conditioned by the state of the world when the war comes to an end.

171. *General.*—The plan for a Clearing Union suggests two general reflections which will also be found applicable in considerable measure to the plan for the revival of productive foreign lending, discussed in the next section, and to any other proposals that might be made in a similar sphere.

172. The first reflection is this. The economic disorders from which the world suffered in the period before the war, and many of which are in danger of being renewed, perhaps not in the same form but possibly with greater intensity after the war, were due to many deep-seated causes, both economic and political. Plans of the kind now under discussion do not profess to be complete solutions of all those disorders. They do not get rid of the fundamental need to re-establish after the war a proper measure of equilibrium in the international balance of payments. Neither do they pretend to introduce a régime in which the problem of trade barriers and discriminations will automatically be resolved by the introduction of an era of great international prosperity.

173. On the other hand, it would be an equal mistake to suppose that they are not closely related to these two great questions. The economic troubles of the past will not be removed without great forbearance and wisdom exercised in the international sphere by all the principal countries. Nor are they likely to be removed without considerable sacrifices. But it is not easy to see how they will be resolved at all without a new and greatly improved international monetary mechanism, and possibly without a material revival in the practice of productive overseas lending.

174. The schemes under discussion are designed to make a material contribution—but not a complete contribution—to the fundamental economic problems of the future. They may assist very greatly in facilitating the correction of disequilibria in the balance of payments, though they cannot certainly of themselves be relied upon to remove them. They can contribute in this way and in other ways to the relaxation of trade barriers, without of themselves removing the necessity for them. It follows, amongst other things, that in the later sections of this Note, dealing with the question of trade restrictions from the point of view both of what is intrinsically desirable and of what may in certain circumstances be forced upon us by economic adversity, the subject will have to be treated irrespective of the question whether Clearing Union plans and similar plans are in force or not, but with the qualification that the successful functioning of such plans, if they have been brought to fruition, may modify the intensity of the underlying problems.

175. The second reflection is as follows: Just as a perfect banking and trading system within a country will not save a man from the consequences of living above his income, so nothing can take the place of a sound internal financial and economic policy; for in each nation the international aspects of finance and trade are inseparably bound up with the internal aspect. Many factors which exercise an important influence on international trade cannot be subjected to international control; standard of life policies and public work policies are examples. International schemes can mask and delay the effects of an internal policy which is not soundly based, but they do no more than that; an expansionist scheme does so more easily than any other. However good an international scheme may be, it will be necessary to follow a sound policy at home and to inculcate good sense in this direction in every country. To blame a Clearing Union for failures arising in this relation would be as fallacious as to blame the League of Nations, as such, for the lack of co-operation shown by member States.

176. Provided that it does not lead to selfish policies, it is primarily for each nation or group of nations, although help and co-operation may be expected from others able to give it, to examine its own position and set its own house in order. In this sense it must still be the first objective of this country, in the interests of world order, to set itself in the immediate post-war period to achieve approximate equilibrium both between this country and the rest of the world; including the sterling area, and between the sterling area and the rest of the world. Whatever help may be derived from international organisations or otherwise, this is a responsibility which this country, in common with the other countries of the Commonwealth, must keep continually in the foreground.

177. *Conclusion.*—Final judgment upon the plan must no doubt be determined, not only by its advantages and its limitations, but also by the difficulties of the situation to the solution of which it is designed to contribute. Not all its features are equally essential, and there would appear to be ground for putting it forward, not in detail in dogmatic fashion, but at least in its general character as a basis for discussion. It would serve to bring into strong relief the probable major difficulties of the post-war period, and to indicate general principles along the lines of which a solution might be explored. There seem to be advantages in thus putting forward an ambitious scheme which would lift the discussion on to the international plane. Alternatively it might be the best course to press in the first instance the need for a new international financial system which would fulfil the functions indicated in the early paragraphs of this section of the Note, and to put forward the plan by way of illustration as an outline of one possible means of achieving this object. Its basic elements, as distinct from less essential features, are probably common to any scheme capable of yielding a fruitful result in this field.

## VI.

*The proposals of Messrs. Hansen and Gulick.*

178. While the Clearing Union plan has been under discussion here, two American Professors have been engaged upon other projects.

179. Some few months ago Professors Hansen and Gulick appeared here, despatched with the official blessing of the State Department upon an unofficial mission, and put forward at first a plan and later a draft manifesto.

180. On their return to Washington the manifesto was further elaborated, so we hear, in consultation with State Department officials. It now takes the form set out below. There is said to be a possibility of its early publication in America.

181. The document as a whole is reproduced in Appendix II. Its main points are as follows:—

The United States and Great Britain are to declare that they will each in their own country pursue internal policies designed to promote the fullest possible employment and a rising standard of living, and that they will promote world trade and the world-wide use of productive resources, and are to invite other Governments to adhere to this economic declaration. An International Economic Board with research staffs in various centres is to advise the collaborating Governments in regard to internal policy to promote the above-named ends; associated with this Board would be an International Resources Survey exploring opportunities for internal and regional development projects throughout the world. There would also be established an International Development Corporation with capital stock subscribed by the American Government, the British and Empire Governments and other Governments prepared to participate. This Corporation would sell to private investors bonds guaranteed in appropriate proportions by the participating Governments and provide for capital expenditure in the interests of the general welfare on development projects, particularly those explored by the International Resources Survey.

182. These proposals could, of course, be welded on to the Clearing Union plan. But in the first instance it is proposed to discuss them, as they were in fact put forward, as isolated propositions.

183. The first two projects—an International Economic Board to advise the collaborating Governments with respect to internal policy to promote full employment, &c., and an International Resources Survey to explore needs and opportunities for developmental projects throughout the world—make a single whole. Not only is America the land of the New Deal, but a growing body of economic opinion in many countries favours the view that the swing of the trade cycle and the ebb and flow of employment can be curbed both by budgetary policy and, in particular, by advance planning and careful timing of capital expenditure. The argument goes that this planning is useful in any State which adopts it, but useful above all when applied internationally.

184. The question is a large one. The argument has been stated in considerable detail in a memorandum by the Economic Section of the War Cabinet dated July 1941 and entitled "Internal Measures for the Prevention of General Unemployment." This country would not readily embrace a public works policy on the scale of the early years of the New Deal; that policy added to the national debt of the United States amounts which, even when reduced to correspond in scale with the population and wealth of this country, would still appear enormous in our eyes. In fact, economic conditions in the United States and in the United Kingdom (especially as regards the balance of payments) are so completely different that we may well have to follow diametrically opposite policies in order to secure equilibrium. The adaptation of credit policy to early post-war conditions in this country, under which considerable unemployment may well co-exist with a prevailing inflationary trend, will also be a serious problem with an important political aspect. Difficult questions of budgetary equilibrium are also involved. One question requiring separate study is how to overcome the great business difficulties connected with the advance preparation of useful capital projects intended to be executed at an indefinite future date determined not by the need

for them but by general economic conditions. In its internal application to this country this business question is now being studied as part of the general survey of reconstruction problems. In its application to the world at large all the difficulties of securing international unanimity in planning and all those connected with the varying power and competence of Governments in different countries are also involved.

185. Nevertheless, it is suggested that this part of the Hansen-Gulick Plan ought to be welcomed in principle. Its reception by public opinion in this country may be lukewarm or patchy, but, if there is to be Anglo-American collaboration, Boards of this kind seem to be natural appanages of it.

186. The other Hansen-Gulick proposal is that for the establishment of an International Development Corporation.

187. When the Professors were over here this part of their plan was presented in a simpler and more practicable form. As they then explained it, it was a plan for Anglo-American enterprise. The argument went that this country had unrivalled experience in the art of wise foreign lending, but after the war its citizens would have little or no money to lend; the United States, on the other hand, had in recent years bungled its foreign lending and its citizens would have, after the war, great sums available to be lent abroad, but would be unwilling so to lend under American direction. The plan, therefore, was to amalgamate London experience with New York money for the purpose of reviving fruitful foreign lending and thereby increasing the prosperity of the world.

188. The underlying idea was sound. There will certainly be great need of foreign lending after the war, particularly by America, and it may be hoped that there will be at any rate some reasonably safe borrowers. A plan of this kind perhaps holds out the best hope of getting foreign lending on to its feet again. But this project, in isolation, is unlikely to carry very far. The practical difficulties to be overcome by such a Corporation might well prove heavy, and its results limited, while the revival of foreign lending touches only one of the many problems of the post-war world.

189. The above is directed to the project in its original form: that of an Anglo-American Corporation. The draft manifesto in its latest form envisages a corporation with capital stock subscribed by the United States, the British Government, the Dominion Governments and such other Governments as are prepared to participate. This may or may not be a necessary modification: it is not an improvement. The moment that foreign European Governments are represented in the Corporation, the attempt may well begin to introduce political conditions into foreign loans, with all the international friction which such suggestions entail.

190. There is also a latent initial problem. The Bonds of the Corporation to be taken up by private investors are proposed to be guaranteed in appropriate proportions by the participating Governments. What does "appropriate proportions" mean? Surely His Majesty's Government could not contemplate guaranteeing more than the amount of Bonds issued in this country to be held by British nationals. Will the United States Government be prepared to guarantee the main part of the capital which *ex hypothesi* is to be subscribed in the United States? There is, indeed, some incongruity in a country which must borrow being associated with a strong creditor country in a large effort to resuscitate foreign lending. It may well be that the particular form of organisation which Professors Hansen and Gulick have envisaged may come to grief through difficulties of the type just mentioned.

## VII.

*Association of the Hansen-Gulick proposals with the Clearing Union plan.*

191. Mr. Harrod has drawn up a detailed plan for incorporating the proposals of Messrs. Hansen and Gulick in organisations to be associated with the International Clearing Union assuming that Union matures.

192. This plan is printed as Appendix III. Its main features are as follows:—

- (a) The International Economic Board of Messrs. Hansen and Gulick would be either merged with an Anglo-American Investment Board associated with the Clearing Union or be set up as an independent institution. It would still have the function of advising collaborating Governments on internal policy designed to promote full employment.
- (b) The Anglo-American Investment Board in its new setting would determine the amount and nature of foreign projects to be financed from its resources, and in determining this matter would seek to maintain full world employment. It would accept subscriptions to its issues only from the citizens (including corporate bodies) of credit countries.
- (c) In the case of projects affecting primitive peoples, care would be taken to avoid interfering with family, communal, and religious practices and traditions. The Board would have an independent advisory tribunal consisting of recognised authorities on this type of anthropological subject.
- (d) The Board would have regard to the most advantageous division of labour in the long run and would not finance development of industries inconsistent therewith.
- (e) It would be *prima facie* desirable to prohibit, or to prohibit except under licence, private foreign investment in the countries concerned.
- (f) The United Kingdom and the United States would subscribe capital in equal amounts making, say, £m100 together, this fund being primarily a guarantee fund to be called up only if the need arose. The main part of the money dispersed by the Board would come from subscriptions of the citizens of credit countries and from the clearing bank.
- (g) The normal interest charge made by the Board for its loans would be 2½ per cent. plus a sinking fund. The security of the loans would be greatly fortified by collection of interest and sinking funds through the machinery of the Clearing Union system. Accordingly it should be possible to raise money from investors on 25-year bonds at a rate not greatly exceeding the gilt edged rate on British or American Government securities.
- (h) The Governors would consist of an equal number of British and American members, one of each nation taking the chair in alternate years and having the casting vote. They would be appointed by the two Governments respectively.
- (j) The Board would be assisted by three Committees, an Economic Committee, a Priorities Committee, and a Progress Committee, the first of which could be amalgamated with the Economic Board above mentioned. The members of these Committees would include in the first case economists and statisticians drawn from all nations, and in the second and third cases men of experience in industry, commerce, &c., and national or colonial administration, and experts in social welfare and anthropological problems, together with economists to examine long-run implications.

193. The difficulties to be anticipated in a scheme of this kind are partly practical and partly political. To the extent that management could be looked upon as exclusively Anglo-American the political difficulties would no doubt be minimised. In the contrary event they would probably be very considerable.

194. The actual task of re-establishing a large flow of foreign lending swiftly and comprehensively, as would seem essential under such auspices in order to ensure the prestige and standing of the body, appears formidable in the probable state of the post-war world. The finance of the plan would need investigation in the light of conditions, especially in relation to the Clearing Union, which are not yet closely ascertainable.

195. When the Clearing Union comes under discussion the suggestion of gathering the Hansen-Gulick proposals into an associated organisation would then follow naturally. It would probably be most convenient that the present suggestion should first be introduced as a set of principles, rather than a complete outline, as has indeed been suggested in connexion with the Clearing Union plan itself.

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## VIII.

*Possible United States contribution to Solution of the General Problem.*

196. In addition to the part that may be played by new general plans or institutions, the United States themselves will probably have it in their power to make a considerable contribution to the solution of the general world problem, and incidentally of our own social difficulties.

197. The entry of the United States into the war may have far-reaching internal economic consequences in that country. A few months ago one would have said that the United States must emerge from the war by far the strongest and most comfortable financial Power. That will probably still be the case, if only for the reason that a country which possesses practically all the monetary gold in the world will be in an almost impregnable position. Nevertheless, it is not clear how far the powers of the Administration, the habits of mind of the public and the characteristics of industry in the United States are fitted to resist the strong inflationary tendencies of wartime, or whether the presently evidenced readiness of the United States Administration to act as fairy godmother to the post-war world will be reflected by general United States public opinion at the end of a long, and it may be exhausting, struggle.

198. Subject to this there are a number of contributions which the United States could make.

199. It is perhaps not inconceivable that the United States might be prepared to give away or to lend on very easy terms their excess gold holdings to the other countries of the world which require gold (including ourselves). But, of course, true and lasting benefit would accrue only to the extent that the recipients of the largesses used the reserves thus acquired merely as a buffer whilst they were earnestly readjusting their internal economies to the future.

200. It may be that the United States would be prepared only to grant gold loans or currency loans of limited amounts, and maybe of short duration. The extent to which this would be helpful would turn upon the circumstances of the time and the conditions attached to the loans. Loans that require to be repaid may be no more than an invitation to a country to slip a little further down the hill before collapse. More generally, any temporary assistance, whether in the form of an overdraft through a Clearing Union or a loan from the United States, is in the long run only useful in so far as it affords an opportunity to correct the underlying causes of disequilibrium in a country's balance of payments.

201. Good results might also be expected if the United States were both willing and able to embark at a very early stage on a great programme of foreign long-term lending for sound productive purposes in many countries; the Hansen-Gulick proposals, so far as they represent practical politics, are directed to this end.

202. Reduction in the United States tariff large enough to increase materially the imports of the United States from the outside world would be a valuable contribution. The question of tariff reductions is already the subject of negotiation in Washington between the United States, the United Kingdom and the Dominions. Reciprocity is, however, the basis on which these negotiations are taking place, and indeed the only basis which United States law allows. In other words, the United States Administration will only consider tariff concessions which might increase her imports in return for tariff concessions designed to increase her exports; thus, it is doubtful how the balance of payments would be affected by any bargain that may eventually be concluded. Further reductions in the American tariff will apply to our competitors as well as to ourselves so far as they can take advantage of them; a reduction large enough to provoke acute domestic criticism in the United States might still fail to increase British exports by a significant amount. Most of our exports to the United States consist of luxury goods, and so are more dependent on conditions of prosperity in the United States than on the level of the United States tariff.

203. In the immediate post-war period the United States could be of great help if she is ready to assume the main cost of financing relief and reconstruction in the war-stricken areas, and if she is willing not to bring lease-lend arrangements to an end too abruptly.

204. Over a longer period, a main way in which the United States could assist the world is by maintaining a high level of internal industrial activity and employment. The economic prosperity of the world depends in a very large degree on the prosperity of the United States; the trading area which the United States constitutes is large and important; the imports of the United States, consisting largely of commodities like rubber, which meet a semi-luxury demand, are peculiarly sensitive to the state of domestic prosperity. High industrial activity in the United States thus powerfully contributes to the improvement of the balance of payments of other countries. It cannot be assumed, however, that this object will be easily attained. The conditions likely to prevail after the war will be conditions of instability, and, if war leads to heavy inflation there, a severe subsequent depression may be more or less an inevitable sequel.

205. United States interest in stabilising commodity prices and in the creation of stock-holding schemes is another development of the utmost importance to the post-war world. There is, however, some danger that these plans will be based too closely on the analogy of the internal A.A.A. schemes. Farming interests in the United States have a political preponderance; they have also suffered from depressed conditions in recent years. Naturally, there has been strong pressure to raise the prices of things like wheat and cotton at home, while resisting the natural consequences in the shape of a loss of exports through the competition of lower-cost producers in other countries. Nevertheless, there are welcome signs of increased resistance on the part of the Administration to the extremer demands of the agricultural interests; while some of the most hopeful developments of policy are directed towards increasing the diversification of agriculture and reducing the dependence of whole areas on single staple crops for distant markets. This would be a valuable contribution which America could make towards the establishment of a balanced world economy.

## IX.

*The question of trade controls in the United Kingdom.*

206. General plans such as have been discussed in earlier sections of this Note, while designed to improve world conditions, do not profess to provide an automatic solution of the whole problem as it will affect many countries including our own, nor could any individual action taken by the United States go far to set right the general economic mechanism. It would therefore be unwise to forget the dimensions of our own special problem indicated in the first section of this Note. We shall probably be forced, if events develop as at present seems likely, to rely very largely upon our own efforts.

207. *Reserves.*—At the outset we shall have at the best only a small reserve, quite disproportionate to the probable accruing deficit, and far too small to be heavily drawn upon without great risk. We may doubtfully hope to receive for a time a limited measure of continued assistance from the United States under the guise of lease-lend. We may hope, too, so far as our essential needs are drawn from the Sterling Area, that the countries of that Area, or some of them, will be willing to continue to sell to us in return for sterling; but as many of these countries will already have enormous sterling balances, they may be very unwilling to assist us by substantially increasing them.

208. *Export markets: business efficiency.*—The first thing to be done is to make every possible preparation both for the reopening of old and the opening of new export markets and for the improvement of business efficiency. The whole of this subject is now under separate study.

209. *Exchange depreciation.*—We shall in any case need latitude at the end of the war to fix the value of the £ in terms of dollars and other currencies at a rate *prima facie* appropriate to economic conditions as they then appear, having regard to the varying degrees of inflation and wage movements in different countries. Nor in the absence of an International Clearing Union or some analogous plan would it be reasonable to expect us to forgo in advance the right to make subsequent alterations in the exchange value of the £ from time to time, if the extremely fluid and varying economic conditions likely to supervene in the early post-war period seem to require it.

210. Nevertheless, the efficacy of exchange depreciation as a means of restoring equilibrium must not be over-estimated in the case of a country situated as we are. There are particular reasons for aiming at the exchange stability of sterling and for regarding the method of exchange depreciation as a remedy to be used only in the most exceptional circumstances after the initial post-war figure has been fixed. These reasons may be set forth as follows:—

- (i) The position of London as a centre of international finance and a place where overseas balances are held depends on general confidence being felt in the prospective exchange stability of sterling.
- (ii) The position of London as the centre of the Sterling Area is not easily compatible with the use of exchange depreciation to meet our local difficulties. If the other members of the Sterling Area move at the same time, they will be submitting their local circumstances to changes primarily appropriate to ours. If, on the other hand, they do not move when we move, the attractiveness of London as their financial home is seriously impaired.
- (iii) An exchange depreciation by Great Britain is particularly liable to set up competitive exchange depreciations elsewhere.
- (iv) An important part of our invisible earnings is fixed in terms of sterling. To this extent a depreciation of sterling is a dead loss.
- (v) Even if its competitors do not follow suit, a country can only hope to gain by exchange depreciation if the elasticity of its demands for imports, and the elasticity of the world's demands for its exports, are high. Since 90 per cent. of our imports consists of indispensable food and materials, the first condition is certainly not satisfied in our case. With regard to exports, unless a depreciation of our exchange by 10 per cent. increases their volume by more than 10 per cent., we have simply made the world a present of the additional exports. The

effect of exchange depreciation in raising the cost of our imports would, indeed, be modified in so far as we could rely on our principal suppliers, in the Sterling Area and elsewhere, following suit as they did in 1931. But so far as these countries are also now our competitors in the arts of manufacture, the effect of their following suit would be to limit the scope for the expansion of our exports, since these would have become no cheaper to them relatively to their own manufactured products.

- (vi) Now that our money wages are linked to the cost of living over a wide field, so that in effect real wages are fixed, the efficacy of currency depreciation for reducing competitive costs is gravely impaired. A significant depreciation of sterling would be liable to start an upward wages cycle and leave us no better, or even worse, off than before.

211. The standard of life which a country can command depends primarily on its natural advantages, on the intensity and skill with which its people work, and on the business efficiency with which their work is organised. Generally speaking, if the prevailing level of wages and other incomes is out of relation to these underlying factors, it can in the long run only be brought back into harmony with them by painful readjustments of an internal nature.

212. *Protective Mechanisms.*—Possessing small reserves and being unable to place reliance on exchange depreciation as a weapon of defence, we may, if the future turns out to be as difficult as at present is judged likely, be thrown back, at any rate for a while, upon measures which may be broadly described as protective or regulative mechanisms.

For some years after the war, if heavy difficulties are experienced, we may be forced from motives of self-preservation—more especially if no Clearing Union is in action—to use these devices to a much larger extent than we should otherwise deem desirable. It is for this reason that in other passages of this Note we have described the prospects before us under this head as discouraging.

213. The remainder of the section is mainly devoted to discussing to what extent some of these mechanisms should be regarded as intrinsically desirable. To some extent the arguments are prejudged or at least affected by the signature of the Mutual Aid Agreement, but it has been thought well to set out the argument as a whole without particular regard to this decision. In paragraphs 250 to 255 an attempt is made to define the issues of policy, and in paragraph 256 the best line of approach to the question with the United States, in the light of the additional factors introduced by the Mutual Aid Agreement. The position resulting from the signature may, perhaps, be put as follows. It seems to commit us to a policy of negotiating with other countries which allow us reciprocal concessions, and particularly with the United States, with a strong bias to the avoidance of discriminatory practices to the full extent that the economic structure of the post-war world permits us to do so; but it does not commit us in advance to abjure in every case every specific act not in line with this general tendency. We in any case assume that the principle of non-discrimination should, primarily, be applied *vis-à-vis* those countries which themselves apply or conscientiously work towards this principle and do not vitiate it by applying, *e.g.*, excessive tariffs or general quota systems or the like, but that *vis-à-vis* other countries which do adopt such methods our hands should not be tied. It is therefore useful to set out the broad considerations which must influence us in deciding in detail what is possible and safe.

214. To avert possible misunderstanding, a word of explanation may be desirable with regard to the nomenclature employed. We have used the terms “unqualified multilateralism,” and “bilateralism” as summary descriptions of opposite types of international economic systems. These are far from satisfactory terms, and there is in particular a danger that their use may cause some confusion between bilateral arrangements of a *monetary* character and bilateral arrangements of a *commercial* character, which though they are often associated in practice are none the less very different things. A completely multilateral international monetary system would, for example, be compatible with many forms of commercial policy to which the term “bilateral” is often applied. The term “bilateral,” in relation to commercial agreements, is, in fact, frequently used in respect rather to the mode of negotiation (*i.e.*, between two

countries as opposed to multilateral negotiation between several countries) than to the content of the resulting agreements, but "bilateral" as here used does not refer to the mode of negotiations, but to the content which may connote a departure from the most-favoured-nation principle. On the whole no terms other than "multilateral" and "bilateral" would appear more satisfactory for the purpose of summary description, but the paragraphs that follow should be read with this general observation in mind.

215. *The general argument for unqualified multilateralism.*—It is probably unnecessary to set out this case in any detail at this point. It has, in fact, been substantially dealt with in the argument in section IV in favour of a Clearing Union, and is indirectly referred to again in paragraphs 241 to 249. Its broad outline is well known. Generally speaking, it was under a general system of that type that the industrial supremacy of this country in the last century arose. Support of such a system was the traditional policy of Great Britain until recent times. Article VII of the Mutual Aid Agreement points to the elimination of preferential or discriminatory trade barriers and restrictions as an ideal, though its attainment may be gradual. The opinion of the United States appears to regard an untrammelled multilateral system as intrinsically the most desirable thing, and that view will command respect, even though it may be held that in the probable conditions of the future world there will be inevitable qualifications attaching to it.

216. *Particular instances of trade restrictions likely to be requisite.*—Whatever general attitude may be adopted upon this question, unqualified multilateralism could not in practice be attained at once when the war is over. The Board of Trade have indicated the following types of restrictions which occur to them as necessary for a period, at any rate, whether a Clearing Union plan is in force or not. They would appear to be necessary at any rate so long as this country has an appreciable deficit on its balance of payments (upon the assumption, of course, that the Clearing Union if in being, or its dependent organisations, could not devise effective means of overcoming the troubles without resort to unilateral action on our part).

217. In the first place the multilateral principle of the most-favoured-nation clause is not one which we should be expected necessarily to observe towards all countries in all circumstances. It would be necessary to recognise the right of a country to terminate its most-favoured-nation agreements with a State which applied excessive tariffs or other restrictions to its trade, and to adopt counter measures with a view to negotiations for a reduction of the obstacles.\*

218. Again, it would not be desirable that we should be under rigid obligations which would prevent us in all circumstances from applying special import restrictions, either in the United Kingdom or in the non-self-governing Colonies, in order to cushion the impact of low-cost competition from, e.g., Oriental countries in process of industrialisation. It is assumed that the Atlantic Charter should not be read as inconsistent with such restrictions. Another use of import restrictions which may be recognised as legitimate is in order to implement international commodity agreements. It will be a question for later decision whether such post-war assistance as is extended to our stock-raising and fishing industries should take the form of a resumption of import quotas or of some other method, such as duties or subsidies or some combination of the two.

219. While import quotas have the demerit of making a present to the producers (domestic and foreign) of any increment of value they cause and thus raise the cost of living which it will be important to keep down after the war, yet they are well-suited to the negotiation of agreements with the foreign

\* Legislation adopted in this country in the pre-war period provided—in Section 12 of the Import Duties Act, 1932, and Section 2 of the Debts Clearing Offices and Import Restrictions Act, 1934—for the possible application by administrative Order confirmed by Parliament, of discriminatory duties or restrictions against countries which themselves discriminate against United Kingdom trade. It did not, however, go to the length of authorising such action in cases where the other country's tariffs or restrictions were regarded by us merely as excessive without being discriminatory: for that purpose, special legislation would have been necessary. The powers under Section 12 of the Import Duties Act were actually used against France in 1934, when she adopted a basis for quotas which we regarded as discriminatory. Negotiations followed which led to the Anglo-French Trade Agreement of June, 1934.

suppliers beneficial to our export trade, since it is possible to guarantee them the precise amount of trade they can get, and often an upward movement of prices will diminish or even eliminate loss to them. On the other hand, systems of duties or of subsidies would be less predictable in their effects and harder to make the subject of commercial bargaining with a number of countries. The main objection to import quotas, so far as commercial policy is concerned, is that they freeze the competitive position and make no provision for development.

220. It will probably be necessary for us to continue to apply "Clearing" and similar methods in our relations with some countries which themselves persist in exchange restrictions. We could not be expected to tolerate the continuance of such a situation as obtained, until clearings were instituted, in, *e.g.*, Spain, Italy, Roumania and Turkey, which utilised sterling obtained from their exports to us to purchase other foreign currencies, while allowing their obligations towards us to fall into arrears. Again, some special type of arrangement may be needed to conduct trade satisfactorily with Soviet Russia or other countries adopting a similar system of trading.

221. In addition to these specific questions which have been brought forward by the Board of Trade, the question may arise whether the Government may not find it necessary to make use of export subsidies. In the recent past they were used not by this country but by many others, including the United States.

222. The centralised State purchase of staple commodities will for severely practical reasons need to be continued for a time; it may be decided on grounds of policy to continue it indefinitely. The system lends itself naturally to discriminatory use, and it is far from clear that we could afford in the practical application of the system to eliminate from our minds all considerations of the effect on exchange of purchase from alternative sources. Even if we did we should not be immune from suspicion of different motives.

223. Bilateral payments arrangements between two countries—which the United States State Department especially condemn—may also be a necessary weapon in our armoury. Past experience of them has shown how easily they may be used for purely selfish ends. It is not necessarily the case, however, that they must be so used, nor that they must operate for restriction of international trade.

224. In this brief catalogue no specific reference has been made to tariffs and preferences upon which in general Ministers will no doubt be sufficiently briefed. The Board of Trade have noted in regard to the question of Imperial Preference that its actual results in the years following 1932 undoubtedly were to lessen to some extent the damage caused to our interests by the depressed international conditions of that period and to restrain the Empire countries from pursuing courses which would have produced maladaptation of their economies to ours.

225. *The general case against unqualified multilateralism.*—Behind the detailed questions as to the advantages and disadvantages of particular expedients, there lie broader issues which have been alluded to above (paragraph 213). The principle of non-discrimination as it is understood by the American implies that State control and regulation of trade must tend to result in discrimination and that a country can be and should be indifferent as to the sources from which its imports are drawn, and as to the markets to which its exports are sent. It requires each country to allow its traders to purchase their supplies from wherever they can be most cheaply obtained at the rates of exchange that are established; it forbids the country to make any attempt to control the resultant flow of its external trade as between different channels. It can be argued that this attitude of indifference, however suitable it may have been to the spacious Victorian days, and however intrinsically desirable it may be because of the avoidance of friction which international regulation is apt to produce, is incompatible for a variety of reasons with the conditions of the future world as it is likely to be.

226. Some degree of regulation is necessary for reasons connected with the disequilibria to be expected in the balance of payments. Because the traders of a country A may find it cheaper at the current exchange rates to import from country B than from country C, it does not follow that it is to the

interests of country A that they should do so. Country B may be from A's standpoint a "hard currency" country, while C may be a "soft currency" country. Accordingly, the effects of importing a particular commodity on a large scale from B may be to make it more difficult to purchase supplies of other commodities which can only be obtained from B, and perhaps to entail a threat to the monetary stability of A; whereas large supplies might have been obtained quite easily from country C in return for exports which C would have been glad to purchase. It is no sufficient answer to say that the relative "hardness" or "softness" of the currencies of B and C should be reflected in their respective exchange rates. This would only be true theoretically if we could assume that equilibrium in the balance of payments could be secured simply by a suitable adjustment of exchange rates.

227. The relative cheapness of different sources of supply at the prevailing exchange rates to the private traders of a particular country may be a very imperfect measure of the ease with which the country concerned can pay for supplies obtained from these different sources. Under these conditions it seems right, as a matter of economic principle, that the Government of the country concerned should retain the power to regulate its imports with regard to the factors which the calculus of the exchange rates leaves out of account. This may not only be desirable from the standpoint of a particular country in a weak position; it may be desirable from the standpoint of the expansion of world trade as a whole. To revert to the illustration given, countries A and C may both be in a weak position as regards the balance of payments, and may be important potential markets for one another's products. Under a system based on the unqualified acceptance of the principle of non-discrimination, the traders of both countries may find it cheapest at the current exchange rates to buy from a financially strong country, B, with the result that each country finds its exports curtailed and loses so much gold or foreign exchange that it is forced to take steps, by restricting credit or otherwise, to reduce its imports. The result in such a case may well be that the volume of international trade is less than it would have been if A and C had been free to make a bilateral agreement with one another.

228. In other words, when the equilibrium of the balance of international payments is seriously disturbed, the condition of a multilateral system based on non-discrimination may lead to a frustration of mutually advantageous trade between two countries in a weak financial position, without doing any good to any other country. The experience of the inter-war period, though in the nature of the case it cannot be conclusive, lends some support to this view. The development of bilateral arrangements came at a time when international trade under a multilateral régime had suffered a disastrous curtailment. The introduction of bilateral and other discriminatory expedients by many countries was, in fact, followed by, though it was not necessarily the cause of, a considerable recovery.

229. Apart, however, from the special difficulties arising from a disturbance of the equilibrium of the balance of payments, there are several other reasons which suggest that a country cannot be entirely indifferent as to the channels of its external trade. Some of these reasons are economic in character. An abnormal flood of imports from a particular source may entail severe dislocation, and regulation may be desirable in the interests of stability. Goods may be offered from some source at temporarily cut prices, due perhaps to a sudden exchange depreciation or a vagary of trading policy in the exporting country concerned, and it might prove most short-sighted to allow more reliable suppliers to be displaced from a country's markets by such competition. Again, an established trade may be threatened by the incursion not of a cheaper competitor, but of a competitor relying on Government subsidies or supported by the offer of lavish Government credits; it would be dangerous to deprive ourselves of the right to counter such attacks.

230. It would seem rash to assume that these dangers can in future be treated as being of such secondary importance as to make it reasonable to renounce safeguards against them for the sake of larger interests. Their practical importance has increased in recent years and is likely to increase steadily in future as a consequence of two of the outstanding trends of the modern world. The first of these is the widespread movement towards more socialised economies,

under which external trade becomes less and less a matter of the private transactions of individual traders, and more and more a matter of State policy. In Russia external trade is a Government monopoly; and the supplies of particular commodities which the Russian Government may seek to sell at any particular time and the prices at which she may be willing to sell them are liable to be governed by various considerations, such as the urgency of the need for foreign exchange, which may have little or no relation to ordinary commercial consideration. After the war the economies of various countries may approximate in degrees which it is impossible at present to foresee to the Russian system. Again, external trade was largely subject before the war to decisions of Government policy in totalitarian countries and in Japan. Exports might be pushed at particular times as a means of securing more foreign exchange in order to accumulate more war materials. It is impossible to be sure at present how far such possibilities may remain when the war is over. The danger, however, that markets might be seriously disturbed by sudden changes in the supplies offered by particular countries may be a very real one. This danger cannot be adequately provided against by ordinary import duties which cannot be varied quickly; and experience has shown that special anti-dumping duties, which involve many difficulties of definition and which are fundamentally inapplicable to conditions of State trading, are no satisfactory remedy.

231. The second tendency of which account must be taken is the increasing importance of stability and security in the modern economic world. This is shown by the fact that unemployment was a major preoccupation in so many countries during the inter-war period. If, accordingly, particular trading arrangements involve extreme instability and expose trade to violent fluctuations and severe dislocation, this must be regarded to-day as a major defect of such arrangements. It may well prove, therefore, that the method of quantitative regulation, which, despite its many difficulties and possibilities of abuse, offers a far more effective means than tariffs of ensuring steadiness and regularity in the flow of trade, has a legitimate and constructive part to play in the economic arrangements of the future. But the essence of selective import quotas is a repudiation of that attitude of indifference as to the source from which imports are drawn, which, as has been seen, underlies the non-discrimination principle.

232. It may be added that the tendency towards more highly controlled internal economies may affect the problem of external economic arrangements in another way. After the war we, and other industrial countries, may desire to pursue internal economic and financial policies of a new type, designed to promote steadier trade and greater stability of employment. The efficacy of such policies might be seriously impaired if it were impossible to exercise any control over external trade, so that our sole method of correcting disequilibrium in our balance of payments would be to change our internal policy.

233. In addition to these purely economic considerations important issues in the international political domain are also involved. If it should prove that on grounds of security account must be taken of the best sources of supply in the event of a further war, it would seem essential to avoid becoming unduly dependent on markets and sources of supply which are especially liable to be cut off in that event. To prevent such undue dependence, measures irreconcilable with a strict application of the principle of non-discrimination may well be required.

234. Again, the economic relations between different countries may be an important factor in their political relations. It may well be that we should be reluctant after the war to see the Balkan countries remain subject to an economic domination by Germany which would probably carry with it an effective political domination. It may be that in order to avert this danger it will be essential to attempt to develop alternative outlets for Balkan trade, both with ourselves and with other countries such as Egypt in the Mediterranean area. For this purpose special arrangements involving some degree of discrimination might be found helpful. Such arrangements might also fit in, as has already been indicated, with the logic of the balance of payments position.

235. Closely connected with the foregoing is the large and difficult issue of the preferential economic relations which it is reasonable to establish between countries joined together in some form of political association. The question of Imperial Preference is, from our own standpoint, of especial importance in this



connection. But the issue has a more general aspect. It may well be that some of the smaller States of Europe will wish to join together after the war in some form of political association, cemented by economic ties. Agreements have, for example, been recently concluded between Greece and Yugoslavia, and between Poland and Czechoslovakia, "with a view to" the establishment of Customs Unions; and it seems possible that an intermediate stage of preferential arrangements may be regarded as the most practicable approach towards this goal. Arrangements of this kind would, of course, need to be considered carefully upon their individual merits; but it is conceivable that they may prove indispensable to any attempt to build up political and economic units in Eastern Europe capable of resisting domination by stronger Powers.

236. It is necessary to consider the bearing upon such developments of the most-favoured-nation clause, which can be regarded as a practical expression of the principle of non-discrimination. Customs Unions have been frequently, though not invariably, recognised as exceptions to most-favoured-nation obligations. It has, moreover, been customary for the commercial treaties of many countries, including our own, to permit various exceptions from the clause in favour of looser preferential arrangements within the Scandinavian, Iberian, Central American and certain other groups of countries connected together by close historical and geographical ties. In the inter-war period there were proposals for similar exceptions in favour of other regional groups, notably the countries of the Danubian basin. Little came of these proposals in practice, the Danubian project being wrecked by political opposition coming mainly from Germany. But so far as the United Kingdom is concerned, though we have always taken the line that we must consider concrete schemes upon their merits before we can agree to waive our most-favoured-nation rights (a necessary precaution if we are to be in a position to discourage undesirable developments, such as one which would place Eastern Europe within the German orbit, or ones which would be likely substantially to prejudice our export trade), it is a mistake to suppose that we have ever adopted an attitude of general opposition to special regional arrangements. Some confusion upon this matter may have been caused by the fact that we did not feel able to waive our most-favoured-nation rights in favour of schemes of a different character, namely, those which aimed at the establishment of what were called "low tariff clubs," and which would have been open to participation by any countries complying with the tariff stipulations, without regard to special "historical and geographical ties."

237. The United States have recently made a trade agreement with Argentina, under which she assents to special tariff arrangements between Argentina and Brazil "with a view to an eventual Customs Union." There is no reason to suppose that she would be inclined to oppose the extension of this principle to other areas, where a good case for its application could be made out. There is thus nothing in the actual trend of American commercial policy which presents any obstacle to such developments of the type indicated as may be found desirable. None the less, the question remains as to whether there is not some contradiction between the aim proclaimed in Article VII of the Mutual Aid Agreement of eliminating "all forms of discriminatory treatment in international commerce" and the likelihood that it may be desirable in practice to permit further derogations from the most-favoured-nation principle of the nature indicated.

238. The answer can, of course, be made that, if the additional exceptions to the most-favoured-nation principle are limited to arrangements declared to be "with a view to an eventual Customs Union," they will not be inconsistent with the ultimate elimination of discriminatory treatment. This answer, however, assumes that a Customs Union involves no discrimination, not only in form but in substance, and raises the question as to whether a sharp distinction between Customs Unions and preferential tariffs systems can be justified on any basis of principle as distinct from considerations of expediency and practical convenience. It can be argued that Customs Unions have the advantage over preferential arrangements in that they result in extended areas of actual free trade and in a simplification of administrative formalities to which trade is subject. Much depends on the relative height of the tariff system of the Customs Union on the one hand and the general level of the tariffs of the countries party to the

preferential arrangement on the other. Each case needs to be considered on its merits, *e.g.*, with regard to its political desirability and its possible injury to our export trade. But it is important to observe that, although we have tended in the past to support this distinction on such practical grounds, its application may work out adversely to us in future. There seems some danger that we may be required in obedience to the principle of non-discrimination to relinquish gradually the preferential system that has been built up in the British Commonwealth, at a time when similar preferential systems, from the benefits of which we are excluded, are being developed in other parts of the world under cover of declarations in favour of eventual Customs Unions.

239. To sum up, a strong case can be made out for the view that a multi-lateral trade system based on the principle of non-discrimination and a complete absence of regulation of trade are in important respects not well adapted to the conditions that are likely to prevail in future. These conditions comprise:—

- (1) A new international financial background, in which it cannot be assumed that the exchange rates of different currencies are a reliable measure either of the relative costs of production or of the ease of obtaining those currencies.
- (2) A new economic and social background, in which Government trading and Government control of trading are important elements, and in which the avoidance of violent disturbances of trade channels is an essential objective.
- (3) A new international political background in which the political solidarity of groups of countries is increasingly bound up with close economic intercourse between them.

240. In view of these circumstances it can be argued that an attempt to return to unqualified multilateralism might seriously hamper both our efforts and those of other countries to reconstruct their economic systems upon a sound basis.

241. *The dangers of bilateralism.*—On the other hand, any drift of policy away from multilateralism in the direction of bilateralism and discrimination would entail serious disadvantages and dangers which it is necessary to consider. It can be argued, with particular reference to (3) of paragraph 239, that (a) preferential trade arrangements may accentuate political divisions and tend to the growth of rival "blocs," and (b) that such arrangements between other countries will in more or less degree tend to injure our own export trade.

242. Except where it can be shown that bilateral arrangements would serve to enlarge the volume of international trade, departure from a multilateral system involves real economic loss. For example, before the war Denmark imported feeding-stuffs from primary producing countries and sold butter to us; we completed the transaction by exporting manufactured products to the primary producing countries. If our trade both with Denmark and with her primary producing countries were strictly balanced we should lose the advantage of such triangular or multilateral trade, with consequential adverse effects upon our standards of living. We could, no doubt, afford some loss of this nature, if it were all that were necessary to enable us to solve our balance of payments difficulties and to provide such shelter as is possible from the repercussions of trade depressions in other countries. But the economic loss and the readjustments involved to a trading system such as our own must not be under-estimated.

243. The foregoing objection is indeed subject to some qualification. Payments agreements are not always strictly bilateral: they are capable of being developed in such a way as to facilitate triangular settlement. To some slight extent this is already done. For example, we purchase from Bolivia for sterling which can only be used within the Sterling Area. Bolivia purchases little from the Sterling Area, but much from Brazil. We therefore permit her to use this sterling to purchase from Brazil, who needs sterling for her purchases in the Sterling Area. If we were to rely on bilateral payments agreements after the war it would almost certainly be necessary to develop the system along these lines. The effect would be that such countries as would trade with us on these terms would form a kind of club of countries whose exports to us as a whole would be limited by the amount of their imports from us as a whole, without having

to balance in the case of each individual country. This would unquestionably be an improvement on pure bilateral trade, though its application would be limited, since it would not enable us to set off our credits with countries which were debtor as a whole against our debits with countries which were creditor as a whole. Furthermore, it would have the disadvantage that the system would probably, though not inevitably, have to be elaborated piecemeal, and, by appearing to range the countries whom we brought into our system against the United States, it might hardly be more acceptable to the latter than bilateral agreements. Nevertheless, it would be a considerable improvement in principle and practice on pure bilateralism.

244. At the present moment, of course, a degree of triangular trading is possible under our payments agreements in the other direction, since they cover payments not merely with the United Kingdom but with the whole Sterling Area. Argentina, for example, can sell to us, and with the proceeds buy from the Dominions. The principle is exactly the same, and would be no less necessary to the efficient working of our system of regulated trade after the war than during it. The difficulty to be experienced in keeping the Sterling Area together within such a system is examined below; but it might be slightly easier to keep it together if the system were generalised in the manner suggested in the preceding paragraph than if we had to bring them into a series of separate bilateral agreements.

245. Nevertheless, if the majority of other countries followed our example in adopting bilateral trading systems, the economic advantage which we might hope to gain from using our purchases in each separate market as a bargaining weapon to expand our exports to each of those markets would be much diminished. For example, so long as the United States commercial policy remained relatively free and unregulated, we might hope to expand our exports through payments agreements in South American markets. But the adoption by us of a system of rigid bilateral bargaining might lead the United States to adopt a similar system; and the pressure of American economic, financial and political counter-measures might rob us of most of our bargaining advantages in these markets. In a similar manner, the adoption of bilateral arrangements by the United States and by other countries would greatly reduce our powers of bargaining in many other markets.

246. A more fundamental point is this: The adoption of a system of freer multilateral trading removes a number of causes of international friction. Many countries amidst after-war difficulties—perhaps especially Germany, France, Italy and Japan—will be under special temptation to adopt this type of technique. The importance of British trade in the total of world trade is such that, if we adopt a regulated bilateral system, the majority of other countries will probably do the same. Moreover, the United States itself would probably develop preferential trading arrangements and discriminatory measures in order to reinforce her bargaining position in particular markets. In this case each trading agreement with each separate State would become a matter of diplomatic negotiation of a kind which might not only exacerbate relations between the two States primarily concerned in the negotiation, but also between those States and other States; for its successful conclusion would necessarily involve preferential and discriminatory advantages for the two participants at the expense of others. In other words, it is difficult to see how a harmonious international system could emerge from a general adoption of bilateral methods; and it is important, therefore, to consider the influence which our example might exert in this respect. There is the further consideration that, in so far as a bilateral system entailed a greater degree of regulation and control, opportunities, which are the life-blood of enterprise and trade, might be restricted.

247. It may be agreed also, though opinions upon this difficult matter may differ, that the effects on Imperial relations of the adoption by the United Kingdom of a highly regulated system might be particularly dangerous. There is much triangular trade between the United Kingdom, the United States and the British Colonies—as, for example, the purchase of tin and rubber from British Malaya by the United States—which is financed by the sale of American goods to the United Kingdom. For this reason a bilateral agreement with the

United States would have to cover American trade with the Colonies as well as with the United Kingdom. It might, however, have disadvantageous effects upon British Malaya if the process of bargaining led the United States to attempt to obtain its tin and rubber from alternative sources of supply. Similar considerations apply to the trade of the Dominions. But, since the Dominions will presumably wish to maintain a large measure of fiscal autonomy, it would be difficult to obtain a bilateral agreement between the United States on the one hand and the whole British Commonwealth on the other. Moreover, if such measures were to lead to the foundation of separate American and British trading blocs, it is probable that the Dominion of Canada would wish to join the American rather than the British bloc; and the Union of South Africa might also in certain circumstances prefer to join an American bloc in order to preserve her large gold-producing interests. The wide adoption of a bilateral system might, therefore, introduce many disruptive economic forces into imperial relations.

248. However this may be, it would certainly seem to be the case that a highly regulated system would greatly complicate the maintenance of the concept of the Sterling Area, which seems to many of us to be important among the influences binding the Commonwealth, or the main part of it, together. At present the Empire countries (whether Dominions, India or Colonies), with the exception of Canada, not only bank in London, but, broadly speaking, contribute to us or draw from us their accruing surplus or deficit of exchange. If at any time our position is such as to entail the imposition of import restrictions, their effect would be materially frustrated if other Empire countries were importing freely with little regard to the effect on exchange. Equally, if our interests required regulation of the currents of trade with a given foreign country, the effects of any bilateral arrangements we might make might be greatly impaired by the currents of trade between that country and other countries of the Empire. A high degree of harmony between the policy of this country and the policy of all Empire countries in this regard would be needed—might, indeed, be essential as an alternative to the disruption of the Sterling Area link. But while no doubt such harmony might be secured permanently in relation to the Colonies, and temporarily in relation to the Dominions and India, it would seem optimistic to hope for more. The problem of the effect of Dominion policies and conditions upon our central reserve is inherent in any system while the Sterling Area exists; but under a highly regulated system it is brought into the open as a matter of constant discussion or negotiation.

249. Finally, there is the consideration, to which almost overriding importance must be attached, that it is essential to avoid a head-on collision of policy with the United States. It is perhaps hardly too much to say that the maintenance of Anglo-American co-operation may be regarded as a vital condition of the future peace and security of the British Commonwealth. It is evident that this co-operation is more likely to be secured if we follow an economic policy which is acceptable to the United States than if we follow one which arouses their strong disapprobation.

250. *Issues of policy.*—Having regard to the above considerations, which cover a large ground and which appear at least to point to conflicting conclusions, it is evident that the determination of our policy is a matter of great difficulty and delicacy. Fortunately there is no need to anticipate that the forthcoming discussions need plunge immediately into these difficult questions. The first branch of Article VII of the Mutual Aid Agreement relates to agreed action by the United States of America and the United Kingdom, open to participation of all other countries of like mind, directed to the expansion, by appropriate international and domestic measures, of production, employment, and exchange and consumption of goods, which are the material foundation of the liberty and welfare of all peoples. The reference to the elimination of all forms of discriminatory treatment in international commerce follows only upon this wide objective which is intended as a statement of common purpose and a demonstration of unity given to the world. The earlier discussions will no doubt centre around these primary objectives, at the attainment of which various suggestions discussed in the earlier part of this note are aimed, and alike those troubles which spring from our own balance of payments and those which spring from the

altering conditions of government in the various countries of the world, need take no more than their proper place in the general working out of the problem as it progresses.

251. At the same time the issues of policy on the question of discrimination, which is a far-reaching one, cannot be disregarded. We have assumed that the Atlantic Charter and the signature of the Mutual Aid Agreement imply an intention on the part of Ministers not to stand on the proposition that the whole multilateral and non-discrimination approach is inapplicable to modern conditions or that a highly regulated system of external trade involving preferences and discriminations is inevitable and perhaps desirable. We must start from the recognition that in principle the restoration of multilateral trade and a general basis of non-discrimination should be the ideal aimed at, as opposed to the elaboration of a network of highly regulated systems of trade and payments. But non-discrimination is only one of the aims in Article VII, and in deciding how rapidly it is possible to make progress towards this aim we may have to consider how far at any given time it conflicts with other aims, such as maintaining a maximum degree of international trade and internal prosperity. It is important to recognise, moreover, that two issues are involved which are in some respects distinct even though in practice there is a close association between them, namely, the issue of multilateralism *versus* bilateralism, and the issue of the maximum degree of freedom or *laissez-faire versus* regulation and control. Thus the choice might appear to be between two broad types of policy as follows:—

- (1) We might decide to associate ourselves with the aim not only of eliminating discrimination, subject to such qualifications as may be determined in favour of Imperial Preference, but also of removing regulation and control in international trade, in so far as they can be held to involve discrimination, and to undertake to advance towards this goal by renouncing those bilateral arrangements, quota restrictions, &c., which might be characterised as selfish or unfair, and such other types of State regulation of trade as might be regarded as potentially discriminatory, as soon as our balance of payments was restored to reasonable equilibrium.
- (2) We might adopt the position that some degree of control and direction of trade may be desirable in the post-war world for so many and such varied reasons, and that the expedients which may be most appropriate for this purpose depend so much on detailed circumstances that we cannot give definite undertakings to renounce particular expedients, but that, recognising the great dangers to international comity which discriminatory practices entail, we should be careful to limit the use of such practices to circumstances in which they are decisively justified by the purposes to be served, and to keep in mind always the legitimate interest of other countries and the general principles of the Atlantic Charter. Our general thesis might be that, subject as above, systems of regulation may not be a bad thing in themselves provided that they are used wherever possible by common agreement in the common interest.

252. The first of these alternatives has the great advantage that it would represent a far closer approach to the American standpoint than the other. The existence or otherwise of an effective Clearing Union would be an element in the situation to be taken into account, but in any event, apart from the view that may be taken upon questions of general principle, we should have to be satisfied that there was a reasonable prospect of realising this aim in practice.

253. In attempting to secure Anglo-American accord upon the basis of the second course, which is no doubt one which would commend itself to many minds, some degree of difficulty must be anticipated. Any such course must involve to a considerable degree the method of trial and error, and it is not easy to treat a policy of this character as the subject of definite undertakings of the type which the United States seem to desire. We have considered whether some formula could be devised and suggested whereby we could define with some precision in discussion with the United States the circumstances in which this country could

undertake to abjure all measures (apart from Imperial Preference) of a discriminatory character. If a Clearing Union plan is in force, its clearing statistics would afford some criterion of the need of any country to safeguard its balance of payments: there might, moreover, be associated with it some international arrangement dealing with this matter. Subject to this we do not feel able to suggest any useful formula of this kind.

254. It has been conjectured in paragraph 34 above that in some American quarters at any rate hostility to trade barriers may centre upon those which are actually or supposedly liable to lead to international friction, and in particular upon State trading, exchange control, payments agreements and import restrictions. So far as this proves to be the case, the sub-division of issues in paragraph 251 may not be complete, and the ultimate discussions may become much more particularised as against individual types of trade barrier or regulation than has previously been envisaged. This, however, can only be discovered as the conversations proceed.

255. Assuming that some such course as is indicated in (2) of paragraph 251 is adopted, it would seem that the assurances as regards commercial policy that we could afford to give to the United States without impairing unduly our power to restore our economy after the war to equilibrium can only be of a general character. We could, for instance, assure her that it is the object of our policy to promote the expansion of international trade on a world-wide basis, and that in any measures to which we may feel compelled to have recourse we shall be careful to keep this object in mind. We could assure her further that we are anxious, so far as our foreign exchange difficulties allow, to avoid any restrictive action likely to be detrimental to the interests of the United States, that the governing object, indeed, of any restrictions we may place on imports from the United States will be not to import less, but to safeguard our future power to import from her. But the chances of our being able to satisfy the United States by assurances of this general character must clearly depend on the extent to which we are able to persuade them not only of the gravity of the post-war difficulties that are likely to arise from the disequilibria in the balance of payments (both of this country and of the United States) that the war must be expected to leave behind, and of the serious obstacles placed in our path, *e.g.*, from high and often prohibitive tariffs, but also of the validity of the other arguments that have been indicated against an entirely unregulated international system in the modern world, and as to the possible constructive value of new methods.

256. It is accordingly suggested that in our initial conversations with the Americans, after first explaining broadly the dimensions of our special problem and discussing the intrinsic difficulties involved in the elimination of safeguarding devices, we should, if any substantial clash of views seems likely to arise, defer the issue of what formal commitments we could afford to enter into in our commercial agreements, until after we had explored with them the question of the constructive economic arrangements and new international institutions or practices which Anglo-American influence could be used to encourage in the post-war world. We have committed ourselves in the Mutual Aid Agreement to go as far in the direction of the first course as other agreed arrangements make safe and possible for us. It would, therefore, be unfortunate to embark on a controversy concerning the interpretation of what the second course would mean in practice until after we had investigated the possibility for us of something more on the lines which the Americans are likely to favour.

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## X.

*Monetary arrangements (more especially in the absence of a Clearing Union System).*

257. Even within the wider framework of a comprehensive scheme on the lines of the Clearing Union direct arrangements would be necessary between the various monetary authorities for day-to-day foreign exchange business in the absence of an outside market, and, unless and until some such scheme is in operation, these arrangements would represent the essential mechanism for the settlement of international payments. For a variety of reasons there must in any case be arrangements for close and constant contact. In the absence of a Clearing Union or during any interval while it was being set up, the arrangements would need to be far-reaching, and it is convenient in what follows to look at the matter primarily on that hypothesis.

258. So far as concerns any discussions with the United States on this subject, it may be well to bear in mind the pre-war arrangement known as the Tripartite Agreement. At the time in 1936 when the French franc was about to plunge down roughly to 180 fr. to the £, this Tripartite Agreement was entered into between this country, the United States and France. The main object was to provide a façade of international arrangements to cover a step which would otherwise have been disastrous to French credit. The United Kingdom and United States Governments expressed themselves as sympathising with the French action and having no intention to follow it by competitive depreciation. At the same time informal practical arrangements were agreed between the exchange organisations of the three countries for keeping the situation in hand. In actual fact, the Tripartite Agreement was never much more than a façade: it was never put to any severe test in regard to the maintenance of currency levels. But Mr. Morgenthau was always extremely proud of it—he looked upon it as his own special child—and the subject is likely to recur in Anglo-American conversations.

259. Out of the Tripartite Agreement there arose incidentally far more intimate contacts between the monetary authorities of the three countries (and of other countries which subsequently adhered to it) than had previously existed, and the preservation and extension of this arrangement must be aimed at.

260. If there is no Clearing Union, provided that after the war the principal countries can maintain exchange solvency and at least a reasonable degree of exchange stability by measures such as those already described or otherwise, it may prove convenient to develop the Tripartite Agreement principle into a series of understandings between the exchange organisations (governmental or otherwise) of principal countries, backed by the Governments of those countries, designed primarily to secure the greatest measure possible of exchange stability and to provide means of informal or even formal consultation before a currency devaluation takes place. The possibility of such arrangements presupposes effective measures to prevent disorder arising from uncontrolled speculative movements of capital on a large scale.

261. These arrangements (in the absence of a Clearing Union) could, in the first instance, only be for short experimental periods. They might take the following form:—

- (a) Agreement on a fixed rate of exchange between any two countries concerned, not to be varied during the period of the agreement.
- (b) The exchange organisation of each country to agree to hold the currency of the other to any amount requisite for the period of the agreement.
- (c) Balances thus held to carry an exchange guarantee and to be repayable in gold at the guaranteed level on termination of the agreement, subject to such provisions as might be agreed for the funding of balances over a period or for relending by creditor countries during the period of reconstruction or in later stages for the purpose of offsetting a temporary disequilibrium.

262. Such a system might appear excessively bilateral. The conception on the contrary would be that these understandings, of necessity commencing

bilaterally, and in many cases by adaptation of existing arrangements, should gradually be developed into a multilateral monetary network upon such lines as experience showed to be feasible.

263. The suggestion is at present tentative and would have to be further considered in the light of events as they develop. There are certain difficulties to be faced, at least in the initial period until the system had assumed a multilateral character, as follows:—

- (i) Credits with debit countries cannot automatically be offset against debits with credit countries, although there may be scope for special arrangements.
- (ii) It is not yet clear how such a plan can be made compatible with the arrangements of the Sterling Area. If, for example, the agreement with the United States is made with the United Kingdom and not with the Sterling Area as a whole, so that other members of the Sterling Area are free to transfer their accruing London balances to New York if they wish to do so, the United States would be undertaking, in effect, to finance indirectly the United Kingdom's unfavourable balance with the rest of the Sterling Area. If, on the other hand, the agreement is between the United States and the Sterling Area as a whole, the other members of the Sterling Area pooling their dollar income with ours, this might involve the other members of the Area in making an involuntary loan to the United Kingdom equal to the amount of their favourable balance.
- (iii) If the balances piling up against us under (c) in all countries with which we have such agreements, when added together, represent a total larger than the gold we can spare, serious difficulty arises. In other words, the arrangement is not a short cut to a solution of the general difficulties we can foresee; rather it would be a convenient mechanism, operating, it may be, over short intervals, provided that a solution of those difficulties is first found in the general economic and monetary field.

264. The first practical question to be faced would be how the network of war-time payments agreements can be adapted to post-war needs. It would no doubt be the aim to make sterling freely transferable (except for capital payments) over a wide area by such stages as experience might show to be possible and prudent. It has been felt that detailed consideration of the technical arrangements for transition from a war system to a post-war system could best be undertaken after Ministerial decisions on points of principle have been given.



## APPENDIX I.

## THE UNITED KINGDOM'S POST-WAR BALANCE OF PAYMENTS.

*Introductory.*

The following notes analyse the possible developments in our balance of payments after the war. The first section deals with the immediate post-war transition (for a period of, say, two years after the war, which is assumed to finish at the end of 1943), when the difficulties may be primarily those of shipping; and the second refers to the period after the completion of the first transition to peace conditions.

(1) *The probable Balance during the First Two Years after the War.*(a) *Imports.*

1. There are so many uncertainties involved in any attempt to estimate the balance of payments during the immediate post-war period that the results can necessarily be little more than a guess.

2. In this immediate post-war period, the limit on imports is likely to be set not only by financial considerations, but also by shortage of shipbuilding, and possibly by shortages of supplies (*e.g.*, of timber cut and available at the ports or of oil-seeds gathered and ready to be shipped). Our probable difficulties of shipping will depend not only on shipping losses but also on the increased import needs of countries, such as Russia, which are ordinarily in the main self-sufficient.

3. One may approach the problem, therefore, either by asking what value of imports we may be able to ship, or by asking what value we can afford to purchase.

4. The values that we may be able to ship may be estimated very tentatively as follows (a normal post-war year has been added for comparison):—

				<i>£ millions.</i>		
				<i>1944.</i>	<i>1945.</i>	<i>1946.</i>
Imports	...	...	...	1,050	1,250	1,290

The figures of the earlier years may well be appreciably reduced if shipping losses exceed expectations or if the need to relieve Europe proves to be even more onerous than is here assumed; the calculations on which these estimates are based may require to be somewhat modified in the light of the possible effects of the Russo-German fighting, of the outbreak of war in the Far East and of the new United States shipbuilding programme.

5. The difficulties of shipping may not reduce very far below normal the value of our imports, chiefly because the high value imports do not represent any very considerable tonnage, and are in many cases (as for example textile materials) of such character as to give them relative priority. But, having regard to the probable post-war level of demand, the limitation on supplies will almost certainly involve a continuation of rationing for some considerable period if stocks are not to be reduced.

6. The value that we can afford to import must be approached by asking what a minimum quantity (based, say, on 1941 consumption) would cost and how far our prospective exports would suffice to buy it, at prices of imports and exports assumed to be 50 per cent. above those of 1938.

7. Our imports in 1938 and 1941 may be very roughly divided as follows :--

	<i>£ millions at assumed post-war prices.</i>	
	1938.	1941.
Food and Tobacco ... ..	626	444
Raw Materials ... ..	473	352
Military Stores ... ..	...	136
Petroleum Products ... ..	67	71
Finished Goods* ... ..	110	57
Remainder† ... ..	11	12
	1,287	1,072

8. If we regard the minimum imports as represented by the 1941 imports of food and tobacco, raw materials, petroleum products and the remainder (parcel post and animals not for food), the total is £879 millions. This figure includes, however, about £53 millions for stockbuilding (about £27 millions of food, £11½ millions of raw materials, and £14½ millions of petroleum); but this is partially offset by a decline in stocks of tobacco and imported wines and in retailers' stocks of food and other goods, the import content of which is estimated at about £14½ millions. The value of stocks of imported food and raw materials destroyed by enemy action during 1941 was some £20 millions, so that actual consumption was about £58 millions less than the gross imports, or about £821 millions.

9. But there are difficulties in regarding any such figure as a practicable minimum. The 1941 imports provided raw materials for a working population considerably smaller than will be seeking employment in the post-war period: if all workers now occupied were to remain in industry and continued to use the same low volume of imported raw materials per head, there would be no available imported materials to provide for the re-employment of the present armed forces.

10. It would require on the 1938 standard about £36 of imported raw materials a year to provide for each additional insured worker. On the 1941 standard (which almost certainly reflects the higher application of labour to raw materials in the munitions industries as well as a higher use of home-produced materials) it requires about £25 to provide for each additional worker. Assuming a figure of £32 a head, a further provision of at least £50 millions in the first, and £80 millions in the second year, for additional raw materials would seem necessary, and even so, it is not certain that, with the change in the pattern of output, materials would suffice to provide full employment.

11. Again, about £110 millions of the 1938 imports shown above represented the import content of exports. The imports required for the manufacture of the prospective volumes of exports in the first two years are about £100 and £130 millions. This would leave to the home market, on the basis of £821 millions, less than 70 per cent. of the materials used to serve it before the war, and, even on the basis of an additional £50 millions, only about 75 per cent.

12. This may be confirmed by another route. The real civilian expenditure per head in 1941 was approximately 83 per cent. of that of 1938. If we import 83 per cent. of the food imports of 1938 (less the 1938 addition to stocks) and similar percentages of the raw materials available for the use of the home market and of petroleum, as well as the normal remainder in 1938, that will in total amount to £856 millions. To this must be added 100 millions for raw materials for export. On the other hand, we may deduct about £120 millions of added home production of agriculture and raw materials. This gives a total of £836 millions.

13. This calculation would necessarily imply, with 1938 standards of consumption of raw materials per head, an employment of only 83 per cent. of the numbers of 1938, involving an unemployment of rather over 3 millions. Further technical investigation would be necessary to show what addition would be

\* The 1941 imports are mainly due to imports of machine tools.

† Parcel Post and Animals not for Food.

required to permit a high level of employment. It would probably be of the order of £60-£70 millions.

14. In the light of these figures, an estimate of £900 millions would seem to represent the lowest practicable limit of imports, and it must remain very doubtful whether it is consistent with a high level of employment in post-war conditions.

(b) *Stocks.*

15. If we continue to hold stocks on approximately the present scale, it might be possible to reduce imports in the early months after the war, or to dispose of them to countries with urgent demands. No reasonably precise figure can be put on the saving that might thus be effected. In any case there will almost certainly be types of raw material necessary for civilian consumption and reconstruction of which stocks will require to be substantially re-built. The extent to which stocks can be thus used will, in addition, depend upon how far consumption in this country is restricted. If severe rationing could be maintained, it is possible that some £50 millions of stocks might be made available. In the original calculation of the post-war shipping possibilities, it was assumed that such stocks were used in this country to permit an early return to a comparatively high level of consumption.

(c) *Invisible Exports.*

16. If freight rates are assumed to have risen since 1938 about 50 per cent. more than prices generally (*i.e.*, to rather more than twice the level of freights in 1938), the earnings of *United Kingdom shipping in 1944* may be put at about £110 millions and those of 1945 at about £120 millions. In effect, this assumes that freight rates will remain at approximately their present level, and that the tonnage of our merchant fleet will be about 60 per cent. of pre-war at the end of 1943, while world tonnage is about 90 per cent. of pre-war at the end of 1943. After the last war (see below) they rose very steeply and provided an important contribution to the post-war transition. It must be recognised that however desirable effective control of freights may be in other respects, it will undoubtedly increase the difficulties of the balance of payments.

17. *The return to British foreign investments* was about £200 millions in 1938. It has been estimated to be about £175 millions in a normal post-war year,\* where account is taken of price increases and of the results of a high level of activity. The earnings even of 1920 were only about one-third of those of 1913 in terms of 1913 prices. We must expect a considerably diminished income from railways, estates, mines and similar investments (which in future will form a much larger proportion of our remaining assets) in those areas which may have been affected by fighting. It would not be well to count on receipts greater than £80-£100 millions at the assumed post-war prices for the first two years.

18. *The net earnings of commissions, &c.*, are subject to an even greater uncertainty. In 1920, their estimated value (at 1913 prices) was about half that of 1913. Apart from the general considerations affecting such earnings in the post-war period, there is likely, during the first two years, to be a substantially reduced proportion of all trade being handled through ordinary commercial channels and contributing thus to our earnings from entrepôt. A guess of £10 millions for 1944 and £15 millions for 1945 may not be wide of the mark.

19. Government expenditure abroad will almost certainly remain large during the first year after the war. At this distance of time, it is quite impossible to estimate it, or to judge how far it may be offset by receipts. A token debit figure of £50 millions is inserted.

(d) *Exports.*

20. The probable volume of exports is likely to depend more upon the possibilities of expanding manufacture and of diverting products to the export markets than on the level of demand in markets which will have been starved both of consumption goods and of opportunities to replace depreciated equipment.

\* See paragraphs 81-88 below.

21. If one based an estimate on the experience of the rate of expansion of exports in the years 1919 and 1920, it would be difficult to justify figures much higher than £500 millions for 1944 and £650 millions for 1945 as compared with the present rate of about £350 millions.\*

22. It is, however, proper to assume that, by maintenance of raw material and other controls, in order to secure adequate supplies and manufacturing capacity without encroachment by the demands of the home market, and by an export drive, these figures can be somewhat increased. There must, however, be a certain interval while production is being diverted to peace-time goods, and also between completion of production and receipt of payment. On reasonable hypotheses as to the period of production and the time required for transport and payment to be received, it would still appear unlikely that receipts in the first year can much exceed £650 millions, but it may be legitimate to assume exports of £850 millions in the second year, both at a level of value 50 per cent. above those of 1938.

(e) *Conclusions.*

23. The results of these very rough estimates may be stated thus:—

(i) *Assuming such Imports as can be Shipped.*

		<i>£ millions.</i>					
		<i>Credit.</i>		<i>Debit.</i>			
		<i>1944</i>	<i>1945</i>	<i>1944</i>	<i>1945</i>		
Exports	...	650	850	Imports	...	1050	1250
Shipping	...	110	120	Government			
Interest	...	80	100	Expenditure	...	50	50
Commissions	...	10	15				
<i>Deficit</i>	...	250	215				
		<hr/> 1100	<hr/> 1300			<hr/> 1100	<hr/> 1300

(ii) *Assuming Bed-rock Minimum Imports.*

		<i>£ millions.</i>					
		<i>Credit.</i>		<i>Debit.</i>			
		<i>1944</i>	<i>1945</i>	<i>1944</i>	<i>1945</i>		
Exports	...	650	850	Imports	...	900	900
Shipping	...	110	120	Government			
Interest	...	80	100	Expenditure	...	50	50
Commissions	...	10	15	<i>Surplus</i>	...	—	135
<i>Deficit</i>	...	100	—				
		<hr/> 950	<hr/> 1085			<hr/> 950	<hr/> 1085

24. No account has been taken thus far of capital movements on the one hand or of the possible effects of lease-lend on the other, and it appears that on the basis of the present assumptions, the total imports for which we could pay without incurring additional debt and without lease-lend assistance might be about £1,835 millions in all, or £918 millions a year. This might suffice to keep the population fed and to provide raw materials at about the present rate of use per head, but it is not clear whether it could suffice to provide the volume of raw materials required to meet the minimum peace-time requirements with full employment, having regard to the changed pattern of production and consumption.

\* This, of course, includes a considerable volume of exports of munitions.

*Comparison with 1919-20.*

25. In the corresponding period after the last war the gap was bridged by enormous increases of prices of export goods and by very high shipping earnings.

26. In 1919 there was a total of £1,461 millions of retained imports and £799 millions of domestic exports, and thus a visible advance balance of £662 millions. For 1920 the retained imports were £1,710 millions, the domestic exports were £1,334 millions, and the visible advance balance was £376 millions.

27. The invisibles of 1919 have not been officially calculated. It might, perhaps, be justifiable to guess shipping earnings at £450 millions (freights were about seven times the 1913 level), interest at £160 millions, and commissions at £40 millions, or about £650 millions in total, leaving a small adverse balance as compared with a favourable balance of over £200 millions in 1913.

28. For 1920 there are official estimates. Shipping earnings were estimated at £340 millions, income from overseas investments at £200 millions and commissions at £57 millions. Thus there was a credit balance of approximately £222 millions.

29. This 1920 credit balance was obtained largely by very high export prices. The average value of export goods was about 358 per cent. of that of 1913, as compared with a rise of import values to 295 per cent. of 1913, including freights, and probably about 281 per cent. of 1913, excluding freights. Shipping freights, in addition, had increased even more than export prices, and were about 425 per cent. of 1913.

30. While the high level of export prices undeniably helped us through a difficult time, it can scarcely be disputed that its long-run effects were very damaging to us. The high prices of textiles, of coal and of secondary products generally led to the widespread expansion of capacity by our competitors and by countries which had previously been our market, and made the latter determined, if possible, to avoid similar exploitation for the future. Even if similar opportunities arose in the early post-war period, it is very doubtful whether our long-run interests would be served by seeking to exploit them to the full.

*(2) The Balance of Payments in a Normal Post-War Year.**(i) Invisible Exports.**(a) Interest from Foreign Investments.*

31. In a memorandum prepared in the Bank of England it has been estimated that the net reduction in the United Kingdom interest on foreign investments between 1938 and the end of the second year of war was as follows:—

	<i>£ millions.</i>
	<i>Annual Rate.</i>
Long-term investments, net loss of interest received ...	29
Short-term investments, net increase in interest to be paid on funding ... ..	9
	—
	38

32. There is, however, reason to think that this under-estimates the long-term loss of income that has already been suffered. Firstly, we are left with a level of gold and liquid balances insufficient to conduct a peace-time volume of international trade and financial business if London is to retain its position as a centre of international finance; the replenishment of our liquid resources will cost us the loss of a further £100-£200 millions of income earning assets, or (say) £4-£8 millions of annual income. Secondly, we shall need to convert to a higher rate of interest, either by refunding or by repatriation of foreign investments, a large part of the short-term liabilities which we now owe. A rise of 2 per cent.

in the rate on £500 millions of this, to cover both interest and sinking fund, would cost us an additional £10 millions a year. Thus the total loss of income to the end of the second year of war should probably be put at about £55 millions.

33. This loss of income will, however, be increased as the war continues. Net foreign disinvestment, defined so as to include the loss of gold, of foreign exchange and of foreign securities, the repatriation of securities by foreigners, the purchase of United Kingdom securities by foreigners, the R.F.C. loan, and the net increase in short-term liabilities, has been estimated as follows:—

1941—						£ millions.
1st quarter	...	...	...	...	...	215
2nd quarter	...	...	...	...	...	166
3rd quarter	...	...	...	...	...	120

The effect of lease-lend is clearly marked in the above figures, but it has probably not yet been fully felt. On the other hand, expenditure in India and other theatres of war is rising. If total foreign disinvestment continues at a rate of £125 millions a quarter, and if we do not secure relief by some fundamental readjustment of inter-imperial financial arrangements on the same lines as that recently agreed with Canada (of which account has been taken below), we should suffer further foreign disinvestment of some £400 millions by the end of 1942, and of some £900 millions by the end of 1943. It is difficult to tell what form this net loss of assets will finally take; but if we allow an average rate, both for interest and sinking fund of 4 per cent., we shall lose a further £16 millions by the end of 1942 and £36 millions by the end of 1943.

34. Account must also be taken of the probable loss of assets during the first two years after the war. The probable deficit for that period has been estimated in the first part of this paper, and it is there suggested that there will be a net loss of assets which might be as much as £450 millions, or even more if there were a price rise during the post-war years. This figure might, however, be considerably reduced if it were absolutely necessary to limit imports in accordance with our capacity to pay for them, even at the possible expense of considerable unemployment. The loss of subsequent income (again taking 4 per cent.) would be about £18 millions, if the loss of assets over these two years amounted to £450 millions.

35. These three sources of loss, those suffered already, those likely to be suffered before the end of the war, and those likely to be suffered during the first two years of peace before exports can be built up to a level adequate to maintain a post-war equilibrium, amount in total to £90 millions, if the war ends at the end of 1942, and if £450 millions of post-war losses are assumed; they amount to nearly £110 millions, on the same assumption, if the war continues to the end of 1943. These losses might be reduced by an extension of inter-imperial financial arrangements, or by a severe restriction on imports in the early post-war period.

36. Against these prospective losses must be set certain increases. It will be assumed below that the price of imports will, during the relevant post-war period, be 50 per cent. higher than the 1938 level. It will also be assumed that full employment exists both here and in our export markets. These will both have the effect of raising the earnings of our foreign investments in mines, estates, railways, trading corporations, banks and financial houses and similar bodies. We may, in very round figures, allow a gain of £55 millions as compared with 1938 from higher prices, and of £20 millions from a higher level of activity, making £75 millions in all.

37. Thus, in total we may lose some £15 to £35 millions of income from foreign investments, reducing our receipts from about £200 millions in 1938 to about £185 millions, or £165 millions in a normal post-war year, according as the war is assumed to end in 1942 or 1943. For the present calculation, the figure may be put at £175 ± 15 millions.

38. It will, however, almost certainly be necessary to provide for repayment of some part of this short-term debt, apart from the sinking fund payments for which provision was made above. We should, probably, allow £25 millions

annually for this purpose. The repayments of earlier British investments amounted on average to £66 millions a year over the five years before the war, and even after war-time sales of these, there is likely to be some residue of repayment. But it is clear that, in the absence of continued foreign investment in this country, an adverse balance of capital movements may be added to an adverse balance on income account, and further increase our difficulties.

(b) *Shipping Earnings.*

39. An estimate has been made of the effect of the war upon our shipping earnings. The result of that estimate is to suggest that, in terms of 1938 costs, on the average of the years 1944-47, our net shipping earnings may be some £15 to £25 millions below the 1938 level (if we assume no gain of Axis or of lease-lend tonnage). Allowing for the general increase of prices above the 1938 level, the earnings of shipping may (on the same assumptions) be estimated at £114-£130 millions. On rather more favourable assumptions as to gains of enemy tonnage they might be £132-£152 millions. For purposes of the present calculation the figure may be put at £125 ± 15 millions.

(c) *Commissions, Government Payments and Miscellaneous Receipts.*

40. The Board of Trade has estimated that our receipts from Commissions and Insurance amounted to about £35 millions in 1938, while in respect of such miscellaneous items as tourist expenditure, film royalties, sales of shipping, remittances of missionary societies and so on, our income and expenditure were approximately equal. The excess of Government expenditure abroad over Government receipts from abroad was put at about £13 millions. Thus the net receipts from the whole of this group were estimated to be about £22 millions.

41. Of the 1938 earnings from commissions and insurance, about £21 millions came from insurance, £9 millions from commodity brokerage, and £5 millions from financial transactions. All profits from life assurance earned in the United States are hypothecated for the next fifteen years to the amortisation of the R.F.C. Loan; earnings in Europe are likely for a period to be substantially diminished. With increased Government purchase, the scope of commodity brokerage is much curtailed. There has again been a marked increase of royalties on foreign films, not all of which may be offset in the early post-war period by increased receipts from British films. The main hope for improvement must lie in an expansion of our income from tourist traffic relatively to our own expenditure upon it. In 1938 we were debtors on account of tourists to the extent of some £5 millions. If residents in the United States were able to return to their 1929 expenditure, or if our own travel were restricted, we might on balance be substantial creditors. On the other hand, it must be expected that there will remain a residue of increased Government expenditure abroad for some years, some, but not all, of which may be met by increased receipts. Taking all the relevant considerations into account, it would not be safe to expect our net earnings from this group of sources to exceed some £30 millions in terms of post-war prices during the early post-war period; they will depend very considerably on our policy with regard to tourist expenditure abroad. For purposes of our calculation, we may put the figure at £30 ± 10 millions.

(d) *Summary of Invisible Exports.*

42. From the preceding paragraphs we may estimate the change in the income from "invisible exports" as a result of the war:—

	£ millions.	
	1938.	<i>Post-war</i> <i>Year.</i>
Interest on Foreign Investment ...	200	175 ± 15
Shipping Earnings ... ..	100	125 ± 15
Commissions, &c. ... ..	22	30 ± 10
	<hr/>	<hr/>
	322	330 ± 40

(ii) *Imports.*(a) *Imports in 1938.*

43. In 1938 the retained imports of the United Kingdom under the main Board of Trade classifications were as follows:—

*United Kingdom retained imports, 1938.*

	<i>£ millions.</i>
Class I.—Food, Drink and Tobacco ... ..	417·8
Class II.—Raw Materials and articles mainly unmanufactured ... ..	217·6
Class III.—Articles wholly or mainly manufactured ... ..	215·5
Total (including animals not for food and parcel post)... ..	858·0

44. These categories do not fully indicate the extent of imports of industrial raw materials. Many of the latter are included in Class III in the forms in which they usually enter into international trade. This Class includes, for example, all imports of ferrous and non-ferrous metals in ingot form, all chemicals, oils, newsprint and paper boards. In all, Classes II and III together contain about £315 millions of raw materials and semi-manufactured products, about £73 millions of finished products and about £45 millions of petroleum products.

45. There was, in 1938, some excess of retained imports over actual consumption as the result of Government and private stocking; no exact figures are available, but the total may be estimated at about £25 millions. Thus, the consumption of 1938 was probably of the order of £833 millions.

(b) *Probable Post-War Imports.*

46. In estimating our post-war requirements, account must be taken of the probable changes in the insured population, in the percentage of unemployment, in productivity and consumption of raw materials per head, and in the changes in actual consumption likely to follow from the need to use increased resources to produce manufactured exports. It has been assumed here, and throughout the subsequent calculations, that we are planning for a high level of employment, which has been taken to imply an unemployment of 5 per cent. Account must, at the same time, be taken of increased productivity both in British agriculture and in the production of raw materials at home.

47. The result of taking all these factors into account is to suggest that (leaving aside for further discussion below the possibilities of curtailing these imports) our requirements in conditions of freedom of international trade similar to those which existed in 1938 are likely to be of the order of £1,290 millions at a price level assumed to be 50 per cent. higher than that of 1938. This figure, which is equivalent to about £860 millions at 1938 prices, is about equal to the actual imports of that year, but in excess of the probable consumption of that year. The added requirements for a slightly larger population and a larger volume of assumed employment are met partly from this excess, partly from an expected increase in the production of food and materials at home resulting in a saving of £30 millions of food imports and £10 millions of raw materials at post-war prices. For purposes of the present calculation, imports may thus be put at £1,290 ± 40 millions.

(iii) *The Gap to be filled by Exports.*

48. It follows from the estimate of our invisible exports in paragraph 42, and from that of imports in paragraph 47, that, if there is to be a balance on income account, our post-war exports must amount to about £1,000 millions, or alternatively there must be an equivalent reduction of our imports:—

	<i>£ millions.</i>
Estimated Post-War Imports ... ..	1,290 ± 40
Estimated Post-War Invisible Exports ... ..	330 ± 40
Gap to be filled by Exports or Reduction of Imports ... ..	960 ± 80



(iv) *The Prospects of Post-War Exports.*(a) *Exports in 1938.*

49. The total value of exports of produce and manufactures of the United Kingdom in 1938 was £471 million. Its division into broad classes was as follows:—

	<i>£ million.</i>
I.—Food, Drink and Tobacco ... ..	35·9
II.—Raw Materials and Articles Mainly Unmanufactured ... ..	56·9
III.—Articles Wholly or Mainly Manufactured...	365·2
Total (including IV and V) ... ..	<u>470·8</u>

(b) *The Effects of Increased Trade Activity.*

50. It is an underlying assumption of the whole of the present calculation that trade activity, not only in the United Kingdom, but also in our export markets, is at a high level. It will also be argued below that the terms of trade should be assumed to be somewhat more favourable to the agricultural and raw material producing countries, which are our chief export markets. Proper allowance must be made for the consequences of these two factors upon our exports. For the moment it is appropriate to inquire what increase of exports we might expect within the limits of the general system of trade relations which existed during the immediate pre-war years.

51. In the world as a whole, 1938 was not a year of particularly good trade. According to the League of Nations indices of world production, primary production in 1937 was about 2 per cent. over that of 1938; intermediary production was about 8 per cent. higher; manufacturing production was about 7 per cent. higher. British exports were about 11 per cent. greater in aggregate value and about 13 per cent. greater in volume. It is possibly legitimate to assume in our main export markets a level of activity in the post-war period 10 per cent. higher than that of 1938, and a 15 per cent. increase of British exports. This would give an increase of about £71 millions at 1938 prices, and an excess of about 2 per cent. over the volume of exports of 1937.

(c) *The Terms of Trade.*

52. It was assumed in paragraph 47 that the prices of our imports would have risen, on average, by 50 per cent. between 1938 and the post-war period. It remains to consider what rise in the average prices of United Kingdom exports should appropriately be assumed.

53. On the one hand, there has been a long-term movement adverse to our agricultural imports and favourable to our industrial exports. On the other hand, the combined effects of a higher level of activity, of the need greatly to increase our exports, of the increasing monopolisation of agricultural products, and, finally, of the increased capacity to produce the engineering products on which we have largely relied hitherto, conspire to make terms in the future possibly less favourable to us.

54. If we take all these factors into account it is probably wisest to assume that the terms of trade will have moved against us at least to the extent of 7 per cent., so that the post-war average price of our exports may be assumed to be 40 per cent. above that of 1938.

55. This hypothesis has been made the basis of the subsequent calculations, but it must be recognised that it is considerably open to dispute. There are some who would hold that the continuing force of agricultural improvement is likely to offset the other factors mentioned, so that export prices may also be taken to be 50 per cent. above 1938. There are others who would hold that the increasing tendency towards monopolisation (as in the case of wheat), the effects of full employment and the reductions of our relative prices necessary to secure our post-war volume of exports, can scarcely fail to bring us near to the relative prices of 1924, which would involve a level of export prices (given import prices 50 per cent. above 1938), only about 26 per cent. above that of 1938.

56. If there is to be a relative cheapening of industrial exports in terms of agriculture and raw material imports, it is proper to take account of the effects of this on the volume of our exports. It is legitimate at least to assume that these will be increased in the ratio in which the relative incomes of primary producers have been increased; that is in the ratio  $\frac{150}{140}$ . This would, in terms of 1938 prices, given an increase of £39 millions. If the relative incomes of primary producers are assumed to be increased in the ratio  $\frac{150}{138}$ , the corresponding increase would be £103 millions at 1938 prices.

(v) *Summary.*

57. Thus, assuming a high level of trade activity, but the 1938 general system of trade relations, we may estimate the volume of our exports as follows:—

	<i>£ millions.</i>
1938 exports ... ..	471
Add for increased activity ... ..	71
for change in terms of trade ... ..	39
	—
Total at 1938 prices ... ..	581
Add 40 per cent. ... ..	232
	—
Total at post-war prices* ... ..	813

Thus in round figures we may put post-war exports at £810 ± 25 millions.

(vi) *Size of the remaining Deficit.*

58. The gap which it remains to bridge, either by an increase of exports above the level which we might reasonably have hoped to achieve in the pre-war environment, or by a reduction of imports, can now be estimated as follows:—†

	<i>£ millions.</i>
Gap to be filled by exports or by contraction of imports (paragraph 48) ... ..	960 ± 80
Less estimated exports ... ..	810 ± 25
	—
Remaining gap ... ..	150 ± 105

(vii) *Possible Methods of Bridging this Gap.*

59. There are, broadly, three methods open to us to bridge this remaining gap. We may attempt to diminish imports; we may attempt by various devices to turn the terms of trade in our favour; we may attempt by a change in the whole environment of international trade to increase our exports while maintaining our imports.

60. Attempts to turn the terms of trade in our favour, even if they were not repugnant on political and general grounds, are not likely to be permanently successful or to go more than a very short distance towards bridging the gap. They may be dismissed from practical consideration. It remains to consider the other two alternatives.

\* If no change in the terms of trade is assumed, this figure becomes £542 millions plus 50 per cent., which is, as before, £813 millions: similarly, if the terms of trade move more adversely, as assumed at the end of paragraph 24, the total of exports is £542 millions plus £103 millions, increased by 26 per cent., which is again £813 millions. This is, of course, the effect of the assumption that we sell more to the producers of our imports in proportion as they may benefit by improvement of their terms of trade. The principal effects of the change in the terms of trade remain to be considered below.

† The outstanding features of the general course of our balance of payments after the last war seem to be that, after adjustment for movements in the general level of prices, our imports in 1924 were somewhat higher and our exports somewhat lower than in 1913, that we had lost an appreciable sum from invisible exports, and that the balance of our payments was adjusted by a considerable decline in the large positive funds which in 1913 had been available for new overseas investment. It is possible that after this war the "gap" to be filled may not be much greater than after the last war when measured in "real" terms; but the essential difference is that we cannot again fill it, as we did last time, by restricting new overseas investment, since this line of reserve did not exist in 1938.

*(a) Reduction of Imports.*

61. The 1938 imports included about £90 millions of goods at a comparatively high stage of manufacture, of which about £73 millions were finished goods (other than petroleum products) ready for use. We could, if necessary, either dispense with these or produce them at home with relative ease, importing in some cases the necessary materials. If, indeed, an adverse balance leads to a decline in our exchange rate, many of these will be more profitably made in this country. But it is not to be hoped that we can wholly exclude such imports, and when allowance is made for imports of raw materials it is doubtful if more than some £60 millions, at post-war prices, can be saved in this field.

62. The development of agricultural production during the war has increased the net output of agriculture by about one-third, equal to about £100 millions at the assumed post-war prices. Credit has already been taken in the estimate of imports for some £30 millions of this (at post-war prices), which was provisionally regarded as a possible measure of the long-term increase in efficiency in the conditions of 1938. If agricultural policy is directed to the maintenance of a level of activity intermediate between this normal development from 1938 and that of war-time, a further reduction of £30-40 millions of imports might be the consequence.

63. There have been similar developments in our home resources with regard to certain raw materials. Account of these has been taken in the estimate of imports; further substitution of home-produced materials is not likely to yield great savings.

64. It is not easy to estimate what total saving of imports could be made without seriously affecting standards of consumption. A guess may be hazarded that the figure does not, at the most, exceed some £90-100 millions at the assumed level of post-war prices.

65. A greater reduction than this could, indeed, be achieved by forcing down our standards of consumption, and if all other methods of adjustment fail, we shall, in the extremity, suffer such a fall in the exchange value of sterling and in the levels of employment and expenditure in this country as to force our consumption of imports within the strait-jacket of our financial capacity to pay for them. But, even if such a reduction could be achieved without a total collapse of sterling, it is an eventuality which we wish, if at all possible, to avoid.

*(b) Expansion of Exports.*

66. There remains the possibility of expanding our exports. This solution, if it is feasible, is obviously to be preferred to any alternative. At present the volume of our exports is only some 50 per cent. of the 1938 level. What prospects are there for us not only to recover our pre-war level of exports, but also to expand them sufficiently to fill the whole of the gap of about £150 millions indicated in paragraph 58, or at the least that of £50 millions which remains after the maximum contraction of imports suggested in paragraph 64?

67. The necessary volume of our imports under these two alternative hypotheses is shown in round figures below:—

(£ millions at post-war prices.)

<i>Credit.</i>				<i>Debit.</i>	
	<i>A.</i>	<i>B.</i>			
Invisible Exports ...	330	330	Imports ...	...	1,290
Required Value of Exports to Balance ...	960	860			1,190
	<hr/>	<hr/>			<hr/>
	1,290	1,190			1,290
					1,190

Hypothesis A is that the whole gap is filled by an increase of exports.  
Hypothesis B is that £100 millions of the gap is filled by reduction of imports.

68. If home produced exports of the United Kingdom are revalued for the years 1913-1938 in terms of the assumed post-war prices it will be seen that Hypothesis A involves the achievement of a volume of exports only 7 per cent.

below that of 1913; while Hypothesis B involves a return to a volume just about equivalent to that of 1928. The former represents an increase of 46 per cent., the latter an increase of 31 per cent. over the volume of 1938.

69. The calculations of the last three paragraphs have assumed export prices 40 per cent. above those of 1938. It remains to consider the consequences of the two alternative assumptions regarding the future course of the terms of trade that were discussed in paragraph 55.

70. If it could be assumed that there were no adverse movements of the terms of trade, and that export prices, like import prices, would be 50 per cent. above those of 1938, the total of £960 millions required under Hypothesis A would be obtained with a volume of exports equal to that of 1929 (136 per cent. of 1938) and the £860 millions of Hypothesis B with a volume of exports only about 8 per cent. greater than those of 1937 (122 per cent. of 1938).

71. If, on the other hand, it is assumed that the terms of trade will be so adverse that export prices are no more than 26 per cent. above those of 1938, the required exports under Hypothesis A can be obtained only by a volume of exports 62 per cent. above that of 1938 and 4 per cent. above that of 1913; the smaller total under Hypothesis B would require a volume of exports 45 per cent. above that of 1938, or about 7 per cent. below that of 1913.

### (3) *General Conclusions.*

72. The broad conclusions of this study of the post-war balance of payments may be summarised as follows:—

It has been assumed that—

- (i) the war will end in the later months of 1943;
- (ii) after the end of the war there is a sufficient continuance of rationing and other controls to make it possible to rebuild working stocks with a volume of imports below that of a normal pre-war year;
- (iii) there is a high level of employment (about 5 per cent. of unemployment) in this country;
- (iv) there is comparable prosperity in our export markets;
- (v) there is no fundamental and retrospective readjustment of all inter-imperial financial arrangements;
- (vi) we do not succeed in acquiring any very considerable tonnage of Axis or lease-lend shipping;
- (vii) the terms on which our exports exchange for our imports are about 7 per cent. less favourable to us than before the war.

On these assumptions, the following conclusions have been reached:—

- (a) There is likely to be an adverse balance of the order of £150 millions under conditions of full employment, when the fullest account has been taken of all normal increases of exports within the present framework of international trade relations.
- (b) The upper limit of the contraction of imports which could be effected without serious damage to our standards of consumption may be put very tentatively at about £100 millions.
- (c) We shall, therefore, require to increase our exports by at least £50 millions, and we should, if possible, increase them by an amount nearer to £150 millions, above the level that they may normally be expected to reach, if we are to maintain pre-war standards of consumption.
- (d) The higher of these figures would probably involve an increase of our 1938 exports by about 46 per cent. (a return to a volume of exports about 7 per cent. below those of 1913); the lower figure would involve an increase of about 31 per cent. (a return to the volume of 1929).
- (e) If the terms of trade move more adversely to us than has been assumed, so that they approximate to those of 1924, the higher figure would require an increase of 62 per cent., and the lower figure would require an increase of 45 per cent. over the volume of exports of 1938.

The following appendices to this note are available if required. The numbers of the paragraphs to which they refer are given in brackets :—

- Appendix B.—A memorandum prepared in the Bank of England on the loss of interest and dividends on foreign investment between the outbreak of war and the end of Year II (paragraph 31).
- Appendix C.—United Kingdom investment overseas, 1929–38 (share capital only), and indices of world production, 1929–38 (paragraph 36).
- Appendix D.—Prospective United Kingdom shipping earnings during the early years after the war (paragraphs 16–39).
- Appendix E.—Estimate of post-war imports (paragraph 47).
- Appendix F.—Exports of produce and manufactures of the United Kingdom, 1913 and 1938 (paragraph 49).
- Appendix G.—The net barter terms of trade, 1913–41 (paragraphs 52–56.)
- Appendix H.—Sources of the estimated adverse balance of payments in the normal post-war year (paragraph 58).
- Appendix I.—The United Kingdom balance of payments, 1913, 1920, 1922 and 1924 (paragraph 58).
- Appendix J.—Exports of United Kingdom produce and manufactures, 1913–38, revalued in terms of 1938 prices and in terms of assumed post-war prices (paragraph 68).
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## APPENDIX II.

(Draft by Messrs. Hansen and Gulick.)

*Tentative Draft of Joint Economic Declaration by the Governments of the United States and Great Britain.*

To effectuate further the Atlantic Charter the Governments of the United States and Great Britain agree :—

A.—To pursue each within its own country appropriate internal economic policies designed to promote the fullest possible employment, increasing production and a rising standard of living, and to secure economic stability.

B.—To promote by international collaboration and appropriate commercial policies world trade and the effective world-wide use of productive resources.

C.—To invite other Governments to adhere to this economic declaration and to join by appropriate action in carrying it into effect.

To this end the two Governments jointly propose :—

A.—To establish an International Economic Board to advise the collaborating Governments with respect to internal policy designed to promote full employment, economic stability and world trade; this Board to have research staffs in Washington, in London and in Ottawa, and ultimately in other centres, with provision for interchange of personnel.

B.—To undertake an International Resources Survey with the active collaboration of all countries for the purpose of exploring the needs and opportunities for internal and regional developmental projects throughout the world.

C.—To establish an International Development Corporation in which the capital stock will be subscribed by the American Government, the British Government, the Dominion Governments and such other Governments as are prepared to participate both with respect to capital subscription and representation on the board of directors; this Development Corporation to sell bonds guaranteed in appropriate proportions by the participating Governments to private investors, and to make capital expenditure through the purchase of shares in local developmental Corporations or Government Authorities in the interest of the general welfare on developmental projects, particularly those explored by the International Resources Survey.

NOTE.—It is assumed that appropriate action will also be taken to deal with the immediate post-war relief problems. This is related to, but not necessarily an integral part of, the long-range proposals outlined above. Clearly it will be necessary to ensure immediately after the war the distribution of foodstuffs to the countries suffering from the war, to restock their agriculture with breeding animals and seeds and to make available raw materials, machinery and machine tools, in order that the resources of these countries may at the earliest possible moment be restored to economic strength and productive power.

## APPENDIX III.

*Anglo-American Investment Board.**(Note by Mr. R. F. Harrod.)**Preface.*

It is hoped that after the war the United Kingdom and the United States will enter a new era of close economic co-operation. What precisely does this mean? We cannot build on the possibility of achieving anything in the nature of a full customs union. A mere trade agreement, combined with a currency agreement, would bring us little nearer together than we were before the war.

It appears to me that the best hope is in the formation of new types of organisation such as an Anglo-American Clearing Bank, for which a plan has already been outlined, an Anglo-American Investment Board and an Anglo-American Buffer Stock Control.

Such bodies might be regarded as the nucleus of an Anglo-American condominium. They would not interfere either with the sovereign rights of the two countries or with those of other countries whose needs they met. The commitments required of the various States would be of the same nature as they normally make when signing Trade Agreements.

The organisations would derive their power from the fact that they would be providing a service that has not been provided in the world before, and which no single State, however powerful, could provide by itself.

It seems to follow that they should not be corporations registered under American or under English law, still less under Swiss law, but should be entirely autonomous and regulated only by the instrument of agreement between the two countries.

Whether Russia should be associated in the condominium or only come in as a member on the same basis as other countries would no doubt be decided after Anglo-American discussions. In either case, the Investment Board ought to appeal to Russia since it would give her an opportunity of acquiring foreign money for reconstruction without *either* having to enter into negotiations with foreign capitalists *or* becoming indebted to any particular foreign Government.

I have not dealt with the position of the Dominions. I assume that they would eventually become partners in any Anglo-American scheme.

*Purpose.*

The case for an Anglo-American Investment Board depends upon the assumption that, after the post-war boom, the world will once more begin to suffer from under-employment of its man-power and chronic depression. These maladies can only be cured if sufficient scope is found for the employment of man-power on capital development.

This problem will not appear immediately after the war, as there will be much work to be done on reconstruction and restocking. The richer countries will be expected to give some financial assistance. There would be great advantage in having this comparatively routine work handled by the same institution that will ultimately be expected to deal with the larger and more difficult problem. The English and American members of the institution would gain experience and mutual confidence.

There is, indeed, much to be said for having this institution, together with the Clearing Bank, in being on Armistice Day. Our common dangers and common purpose provide the right atmosphere for securing an agreement of mutual accommodation on the basic principles. It is possible that if the matter is left until after victory, each country may feel it can afford the luxury of being obstinate about its own prejudices, and narrower interests, differences of opinion may harden, and the great opportunity for establishing Anglo-American collaboration and joint leadership may be lost.

The main purpose of the Board is to secure a balanced world economy; to secure, that is, that unemployment shall not co-exist with want, nor great

potential savings with development projects neglected for lack of money and enterprise, and its secondary purpose is to provide a radical cure for the lack of balance between credit and debit countries, for which the Clearing Bank would only provide a temporary, though none the less highly valuable, palliative.

One way in which a balance could be achieved would be if each country secured that enough capital work was undertaken at home to give full employment and absorb all the savings of its people when thus fully employed. If each country could do this, not only would unemployment be terminated, but credits and debits on current account in the international clearing could not arise.

Messrs. Hansen and Gulick have proposed to establish an "International Economic Board" to advise collaborating Governments with respect to internal policy designed to promote full employment. This is of the first importance. If the Anglo-American Investment Board were adopted, the "International Economic Board" could be merged in it; or it could be set up as an independent institution.

By itself this does not create confidence that the unemployment problem will be solved; the "Economic Board" is and must only be advisory, if national sovereignties are to be respected, and with the best will each country might yet find it impossible for political or other reasons to implement the policy fully. Furthermore, some foreign investment may be desirable in itself to promote sound projects in countries lacking sufficient capital.

It would be the duty of the Board to determine the amount and nature of the projects to be financed from its resources.

In determining the aggregate value of projects to be financed it would seek to maintain full world employment. The employment given by a development project is by no means confined to the beneficiary country. Tools and raw materials are required, and the labour employed spends its income on consumption goods. All this constitutes a new net demand for goods; much of it is directed to countries outside the project country; thus, new employment is created outside which in turn gives rise to a further new demand, and so on, until a new equilibrium is reached in which the whole world is geared to a higher level of activity.

The Board would only accept subscriptions to its issues from the citizens (including corporate bodies) of credit countries. This flow of funds would tend to liquidate their credit. But it must not be supposed that credit countries would gain no benefit except the interest on their loans to the Board. Their exports, and thereby indirectly their whole internal level of employment, would be stimulated. And at the same time their imports would rise in consequence of the stimulus to internal purchasing power. In the new situation their credit position would, save in very exceptional cases, be reduced, for the loans plus the additional imports (both debits) would exceed the additional exports. It is important to emphasise that the credit countries would not only have found a means of earning interest on their credit balance but also have had their internal employment stimulated. The project countries, and almost certainly also those not subscribing to the loans, would have their debit position reduced.

In regard to the nature of the projects the Board would have the following points in mind:—

1. The British and Americans would wish to have scrupulous regard to aspects of welfare other than economic. In the case of primitive peoples care would be taken to avoid interfering with family, communal and religious practices and traditions. It would be no part of the plan to tear village communities up by the roots, to proletarianise vast masses of natives or create new and dangerous social problems among them. There must be no suspicion of exploitation. To safeguard the position the Board could set up an independent advisory tribunal of eminent men, regardless of nationality, who are recognised authorities on this type of anthropological subject, and publish its reports.

2. The Board would take a long view. For many years there has been a strong tendency towards national autarky. This has been due to some extent no doubt to motives of security, but also to the growing obstructions and uncertainties in international trade and to periodic depressions. The better success the Board had in maintaining the volume and balance of world trade, the less motive would countries have for seeking to obtain self-sufficiency.



Thus the Board would have regard to the most advantageous division of labour in the long run and not finance the development of industries inconsistent with that. For instance markets must be left for the export of manufactured goods from countries which cannot provide their own food and raw materials.

3. We do not yet know whether England and America will jointly or severally undertake the policing of world disarmament. This, if taken seriously, must have regard not only to finished weapons but also to the types of industry readily capable of conversion for armament purposes and to the production of key materials in regions which cannot be fully relied on to pursue a peace-loving policy. Before approving any project the Board would consult the policing authority.

These three considerations regarding the desirable direction of foreign investment are so serious as to give a *prima facie* case for prohibiting or licensing private foreign investment in the condominium countries.

It has been suggested that we should ask America to control capital movements in order to facilitate our own control of capital movements which we may wish to maintain after the war in order to safeguard our balance of payments. A request based on the desirability of preventing the exploitation of natives, maintaining the international division of labour and preserving peace might have greater weight.

A project regulating foreign investment based on these motives might also appeal to Russia.

If America would not agree to controlling private investment the Board might go far to achieving the same effect (1), by providing money for its approved projects at rates far below those which would attract the private investor and (2), by keeping things sufficiently humming on approved lines to deprive would-be borrowers of their appetite for less desirable projects. Having decided upon the best lines of development the Board would stultify itself fatally if it stinted those lines.

#### *Finance.*

The United Kingdom and the United States would subscribe capital in equal amounts, making, say, £100 million together. This would be primarily a guarantee fund only to be called up if the need arose.

The main part, however, of the money required for the projects would come from two sources, (i) subscriptions of the citizens (including corporate bodies) of credit countries to bonds issued by the Board, and (ii) the Clearing Bank. (In the event of there being no credit countries, *i.e.*, only small maladjustments in the international balance of payments, citizens of all countries would be allowed to subscribe).

The value of new projects financed from time to time should be governed by economic circumstances in the manner described below; it is important that it should not be determined by the varying facility of raising new funds from time to time. The Board should, however, aim at securing over a period a defined proportion of the funds from public issue.

Loans for the projects would be made by the Board to the governments of the project countries, and the governments would be responsible for the direction of the projects (save as provided for by the Progress Committee, see below) and for the payment of interest and sinking fund on loans. In the case of Colonies and Mandated Territories the Metropolitan Government or Mandatory powers would be responsible. Where a single project entailed work in more than one country the responsibility would be divided in pre-arranged proportions.

In order to promote projects which would not otherwise be feasible it is important that the rate of interest charged should be low; by the same token it must not be so low as to offer too strong a temptation to Governments to foist public works on to the Board which they would normally undertake themselves.

The following figures are very tentative and must only be taken as illustrative:—

I suggest that the normal interest charge made by the Board for its loans should be  $2\frac{1}{2}$  per cent. There would also be a Sinking Fund to redeem the loans over a term of years, the length of which would vary with the nature of the project.

What assurance can the Board have that these charges will be paid? Loans would only be made to State Members of the Clearing Bank. This Bank would debit the amount due each year for interest and sinking fund to the account of the Central Bank of the borrowing country. Thus this country could only endeavour to escape payment by withdrawing from the Clearing system, which would probably entail the collapse of its currency in the Foreign Exchange markets. There would, therefore, be a strong incentive to her to fulfil her obligations and the temporary indulgence to debits allowed by the Clearing Bank arrangement would facilitate that fulfilment. Furthermore, the Clearing Bank scheme will provide means for final liquidation of debits by members, even if they withdraw from the Bank. Thus the Board should have reasonable confidence that, save in very exceptional cases, the obligations to her would be discharged.

Since the Clearing Bank would automatically and immediately receive back her contribution to the finance of the Board's loans in the form of additional interest-free deposits,\* it would be sufficient for her to charge the Board an interest of 1 per cent., or less.

Consequently, the Board could afford to raise money from the public at a rate above  $2\frac{1}{2}$  per cent., and at the same time set aside a fraction of its earnings to reserve.

What guarantee would the Board be able to give to subscribers? The British Government might well be unwilling to participate in a joint and several guarantee by the British and American Governments:—

- (1) In virtue of the machinery of the Clearing Bank all interest and redemption money due to the Board should be recoverable save in very exceptional cases.
- (2) To meet these there would be the reserves accumulated by the Board together with the £100 million guarantee fund.

In these circumstances it should be possible to make the Clearing Bank the sole guarantor of the Investment Board's bonds.

Thus the investor would be absolutely safe so long as this foundation stone of Anglo-American collaboration lasted.

On this security it should be possible to raise money from investors on 25-year bonds at a rate not greatly exceeding the gilt-edged rate for British or American Government securities.

#### CONSTITUTION AND FUNCTIONS.

##### 1. *The United Kingdom and United States Governments.*

The Board would have a Charter defining its functions and powers to run for a specified term of years. This could only be amended by agreement between the Governments of the United Kingdom and the United States.

Decisions of the statutory committees (see below) in the exercise of their proper powers could only be over-ridden by agreement between the two Governments.

##### 2. *The Governors.*

The Governors would consist of an equal number of British and Americans, one of each nation taking the chair in alternate years and having the casting vote. They would be appointed by the Governments of the United Kingdom and the United States.

The Governors would have responsibility and control over:—

- (i) The internal affairs and management of the Board.
- (ii) Its relations with the Anglo-American Clearing Bank.
- (iii) All matters relating to the public issue of bonds, including the amount, the timing, the rate of interest, the technical questions of issue, &c., though they would give careful consideration to any representations made by the statutory Economic Committee.

\* This follows inevitably from the position of the Clearing Bank as the Central Bank of Central Banks.

- (iv) The rate of interest charged for loans and the terms of redemption, subject to the two rules, which would be included in the charter (a) that the rate charged would be appreciably below that at which funds were raised from the public and (b) that a sinking fund should be attached.
- (v) All questions connected with the default of borrowers.
- (vi) Execution of the decisions taken by the statutory committees in accordance with the terms of the charter, save as provided for in the duties of the Progress Committee.

### 3. *The Statutory Committees.*

Three such Committees are proposed, namely, the Economic Committee, the Priorities Committee and the Progress Committee.

#### (i) *Economic Committee.*

In the event of the International Economic Board proposed by Messrs. Hansen and Gulick having been set up, the functions of the Economic Committee could be delegated to that body.

It would be the duty of this Committee to determine the amount of capital outlay required from time to time to maintain a condition of full activity in the world.

It would be assisted by an expert staff of economists and statisticians (drawn from all nations), who would assemble all statistics relating to world production, trade and finance. It would examine such economic barometers as the trend of general prices, the relations between prices and costs, the relation between the prices of raw products and manufactured goods and the state of employment.

It would receive reports from the appropriate bodies in each country on its internal conditions and on the policy being pursued to maintain steady progress.

It would give advice to the Governments of all countries on the need for measures from time to time to prevent incipient depression or to check unhealthy expansion.

In the light of its information and of the prospective action of individual Governments, it would give instructions as to the amount of outlay to be financed by the Board. At its discretion it could also give instructions regarding the zones in which the outlay would be most advantageous.

There would be an annex to the Charter specifying the average size of the aggregate of new loans to be allowed per annum. This might initially be of the same order of magnitude as the annual foreign investment by the United Kingdom in the years before 1914. The Committee would not be bound to confine itself to the specified sum in any one year, provided that it aimed at not exceeding this average over a period of ten years. It would be understood that the United Kingdom and United States Governments would seriously consider revising this figure on a representation from the Economic Committee.

The Committee would consist of an equal number of British and Americans. They would be appointed by the Governments of the United Kingdom and the United States and consist of economists and men of experience in business and administration. In the case of this, though not necessarily in that of other committees, it is desirable that economists should play a prominent part, since this committee is primarily concerned with the fundamental questions of the general balance between supply and demand, saving and investment, &c.

#### (ii) *Priorities Committee.*

In the event of the International Resources Survey proposed by Messrs. Hansen and Gulick having been set up, certain duties of the Priorities Committee could be delegated to that body.

This committee would be concerned with the choice of particular projects.

Projects might be put forward: (i) by the governments of any state member of the Clearing Bank for capital outlay in their own countries, (ii) by the governments of the condominium countries, (iii) by the expert staff of the Priorities Committee, and (iv) by the Clearing Bank. The Clearing Bank would be entitled to ask for an enquiry into the condition of excess debit countries;

where the debit condition was due to exigent circumstances and not to irresponsible finance, the Priorities Committee would consider projects likely to redress the external balance of the debit countries.

The Priorities Committee would examine each project to assure itself that the project was practical and advantageous. In the case of a debit country it would be obliged to assure itself that the project was likely, either directly or by raising general efficiency in the country, to increase the value of its exports by an amount at least equal to the interest and the sinking fund on the project.

All projects would also be scrutinised in the light of the considerations referred to on pages above. At this stage the concurrence of both the British and American representatives would be required. (The Representatives would be apprised of the views of their Governments on the broad lines of investment policy.)

If there were in existence any Anglo-American (or international) body responsible for policing or for the international control of armaments, all schemes would be passed to that body for vetting.

The Priorities Committee would then draw up a priority list having regard to the intrinsic merits of each scheme, to any representations by the Economic Committee and to the importance of securing a reasonably even-handed distribution of favours among the different countries needing assistance.

The order of priority having been determined, the date of inception of each scheme would depend on the total value of outlay to be made in accordance with the directions of the Economic Committee from time to time.

The Priority Committee would consist mainly of men of experience in industry, commerce, public utilities, or in national, local, or colonial administration. There should also be experts in social welfare and anthropological problems, and economists to examine long-run implications.

It would be assisted by a staff of experts capable of examining the technical aspects of all schemes submitted, who could be drawn from all nationalities.

### (iii) *Progress Committee.*

This Committee would have, in respect of each scheme, two duties: one optional and the other mandatory.

(a) In many cases the Government of the project country might be well qualified for assuming full responsibility for the execution of a scheme, as, for example, the British Government in the case of a project in a British colony. In such cases the Government would be allowed to take full responsibility. In other cases a Government—for example, that of Thailand—might lack not only the money but also disposal over the necessary technical and administrative skill. Such a Government might prefer the Investment Board to take full responsibility for the whole execution of the scheme. There might be intermediate cases where a limited degree of technical assistance was required. The amount of technical and administrative assistance to be rendered should be stated in the scheme as passed by the Priorities Committee and agreed by the Government of the country concerned at that stage.

It would be the duty of the Progress Committee to assume the responsibilities required. It would draw its personnel as the demand arose from any country where suitably qualified experts could be found. In the long run it might build up a permanent civil service of such experts, who could be sent round from project to project.

(b) In every case it would be responsible for assuring itself that the money lent was actually expended upon the scheme. This might involve delicate problems; its powers of supervision would be limited by the sovereign rights of the States affected.

It would not be possible to *enforce* the execution of a scheme. In the event of bad reports representations could be made to the Government concerned. If no satisfaction were obtained, the matter would be reported to the governors, who would order the outlay to be stopped and would secure that the part of the loan already advanced was repaid over a reasonable term of years through the machinery of the Clearing Bank. To prevent the suspicion of arbitrary interference by the United Kingdom and the United States it is important that the Governors should take such action only on the recommendation of the Progress

Committee. The professional qualifications required for membership of this Committee would be similar to those required for the Priorities Committee.

[Alternatively these three committees could be international in character. The question of how far it is wise to go in diluting the Anglo-American condominium by the international principle is perhaps one which can only be settled after discussion with America. If Russia were to become a third party to the condominium, her view would no doubt also have to be consulted.

All powers would be invited to become Associates of the Board, subject only to the condition that they were members of the Clearing Bank. Associated States would be represented on the statutory committees by rotation in proportion to their size, measured by some such economic yardstick as the value of their foreign trade.]

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