

NOTES BY ~~B. F.~~ HARROD  
ON MEMORANDUM ENTITLED  
POST-WAR MONETARY AND FINANCIAL POLICY.

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17th November, 1941.

I should like to say by way of preface:

1. that the following notes only express my private and personal opinions, and
2. that, being primarily designed to clarify and underline a major issue, on which there is apparently not yet complete accord, and being written in some haste, they make no attempt to do justice to the many points in the Memorandum which should command general assent.

The burden of the Memorandum appears to be that, while our long-run aims and interests largely coincide with those expressed by Mr. Sumner Welles, our post-war difficulties will be so severe that we cannot honestly pledge ourselves to refrain from certain lines of policy that the Americans regard as inconsistent with Anglo-American collaboration.

Our proper course, therefore, it is argued, is 1. to explain our difficulties to the Americans in the strongest terms, 2. to refuse to commit ourselves to renouncing practices which they deem objectionable and 3. to explore other avenues of collaboration in the hope thereby of facilitating the pursuit by the United States of a unilateral liberal policy (see last paragraph of Memorandum).

With regard to 1, it is evidently right that we should paint our difficulties to the Americans in the strongest light. It does not follow that we should allow ourselves to be the victims of our own forensic skill. I cannot agree with the ink-black pessimism of the Memorandum about our long-run balance. I should guess that, when the various items have been fairly computed, our post-war balance will not be found to have deteriorated by more than £100 million at most. This is not very formidable. It is a smaller sum than the gain or loss of external receipts which depends on whether or not we succeed, in collaboration with America, in sustaining world buying power after the war.

With regard to 2 and 3, the following points may be made:-

- i. Bi-lateral practices are not likely to help us in the long run. They are a device designed for cashing in on immediate advantages during a finite period, but setting up forces ultimately adverse to their user. If this is true, then, quite apart from U.S. pressure, we should not contemplate their use as a long-run measure for putting our house in order.
- ii. This argument is greatly reinforced when we consider that if we insist on maintaining bi-lateral agreements, America, in exasperation is likely to follow suit. On this ground alone we have more to lose than gain by any such attempt.
- iii. If by obtaining American collaboration, we secure (a) her abstinence from aggressive competitive bi-lateral tactics which might soon undermine our position in export markets and (b) the maintenance of world buying power, vital for our export position, which we should hardly be able to achieve save with American collaboration, in sum we have much to gain by that collaboration.
- iv. It does not seem feasible to hope for any real measure

of collaboration from America if we refuse to meet her on what she regards as the crucial issue. If, then, we believe that the gain from U.S. collaboration is large and what we could gain from bi-lateral practices is problematical, slender and in the long run negative, it would be great un-wisdom to refuse to abandon them.

v. There is the additional danger that such a refusal might diminish Lease/Lend ardour and so have a bad effect on the war effort.

vi. It seems to follow that the correct course in the negotiations is to say (a) our long run aims are identical with the American (b) we shall have the greatest difficulty in playing our part by adopting a liberal trade policy owing to our balance of payments and (c) we can only undertake to do this if America on her side makes certain undertakings, which will relieve us of our difficulties.

vii. Even if we are so despairingly sceptical as to hold that it will be impossible after discussion to formulate undertakings with the necessary precision, or that America will not accept them, it would still be most unwise to express unwillingness to renounce bi-lateralism until the negotiations have proceeded to the bitter end. If we said that we should in no case renounce it, the Americans would regard the negotiations as doomed and make no real effort to find an acceptable formula.

viii. The sceptic might go even further and hold that there are no undertakings in virtue of which we could safely renounce bi-lateralism. This view appears to me entirely untenable. If it were held, it would follow that we should either (a) postpone all negotiations until after the war - since a breakdown would be injurious - or (b) if we have to negotiate, keep silence as to our unwillingness to renounce bi-lateralism until the end, so as to spin the negotiations out for as long as possible.

ix. It remains to formulate the points on which we should require undertakings from America. There are many possible forms of undertaking which would be equally satisfactory, and in putting anything forward we should presumably make it plain that we were quite open to consider alternatives advanced by them.

x. The preceding points are arguments of expediency; there is also one of principle. It must be admitted that we may have to retain objectionable practices for some time after the war. It must also be admitted that if our hopes for a new world based on Anglo-American collaboration break down completely and if we are unable to stem a rising tide of confusion, we may have to adopt them in self protection. To contemplate that we may retain them in any case appears to conflict with the spirit of the Atlantic Charter, which touches not only America but all peoples, and with the implicit pledges of our statesmen. What our new world order is to be has not been made plain; but it is generally understood that, whatever it is, it is not to be a system of the Schachtian kind run from London instead of Berlin. Yet how otherwise can one describe a widely ramifying system of payments agreements and bi-lateral arrangements? It follows that we are already bound in honour to renounce such a system, although we need not interpret our obligation as precluding us from extracting certain concessions from America as the price of doing so.

xi. It may be difficult to form a final judgment on these points until we have some fairly concrete idea of what American collaboration is to amount to. It is important to establish that this is not a mere matter of words.

I therefore venture to add certain proposals. These are only put forward by way of example; other much better projects

may be forthcoming.

Before doing so, I would draw attention to three subsidiary points in the Memorandum:-

1. It is urged that our adverse balance may be aggravated by the need to give domestic reconstruction priority over exports. This is surely a doubtful point; it certainly should not be mentioned to the Americans, since it would seem to them extraordinarily selfish and myopic. I do not think that our people would dream of pressing for very speedy reconstruction, if it were put to them that it might seriously jeopardise the much longed for American collaboration. Moreover such speedy reconstruction is not in our own interest; it is most important that it should be spaced out over a fairly long period to give us time to concert plans for preventing subsequent depression.

2. It is stated in paragraph 20 that the depression of 1929 was largely attributable to disequilibria in the balance of payments. I venture to suggest that to the best of my belief this statement would not be generally accepted by professional economists.

3. It is stated in paragraphs 8 and 9 that we must find means of adjusting wages to the conditions of world markets and not expect relief by exchange depreciation.

If we consider the position at the end of the war it would seem to be easier to re-value the pound, if our prices are out of equilibrium, than to attempt a general reduction of wages. Surely the present sterling-dollar rate settled in haste under the exigencies of war is not regarded by ourselves or the Americans as inviolable.

But if we are looking further ahead, it is to be hoped that the machinery devised for Anglo-American collaboration (e.g. on the general lines of Mr. Keynes' plan) will be adequate to preserve equilibrium without any resort to money wage reduction. This should be common ground between ourselves and the Americans, so that there need be no difficulty in reaching agreement.

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In proceeding to constructive proposals is it right to assume that members of the American Administration and its advisers are now prepared to think on rather bold lines? We have intimations to that effect. It would in any case be wise to put such proposals forward, since we should thereby broaden the discussions and remove them for a considerable period from petty points of probable conflict.

The two ideas that I have chosen are purely tentative and intended only for illustration:-

#### I.

I have for long thought that in international clearing, the onus of adjusting a balance should be shifted from the debit to the credit country. (A credit country may be defined as one whose balance is favourable when all current transactions together with the foreign investment voluntarily initiated by its citizens or government are taken into account). When the world on balance was still short of capital it was right that countries tending to overspend should be under pressure. But in the modern world the central problem is likely to continue to be over-saving, unemployment, and "poverty in the midst of plenty". In this case the onus of rectifying a balance should surely be on the country with excess savings (= the credit country).

This could be secured by a very simple device. An international clearing bank could be established at which the central bank of each country would have an account, expressed in terms of its own currency. Rates of exchange would be promulgated with the usual small margin between buying and selling points. (These rates might or might not be subject to periodic revision in accordance with Mr. Keynes' ideas).

Foreign exchange markets would function normally, but when buying or selling points were reached instead of gold flowing the central bank of the credit country would acquire a balance at the clearing bank equal to the excess of payments due into the country over those due out, while the clearing bank would acquire a balance in the central bank of the debit country of equal amount.

Balances at the clearing bank could always be used to buy foreign currencies at the promulgated rates, but not otherwise.

The only important point to which agreement is required by the participating countries is that the central bank of each should be willing to receive a cheque on the clearing bank as a proper discharge of debt and that it should not seek to dispose of its claims on the clearing bank save in the purchase of foreign currencies from that bank.

In financial terms this means that instead of acquiring gold the credit country acquires claims on the clearing bank. Each country could decide for itself whether it wished to allow these claims to count as reserve for its own central bank; it would probably be wiser to choose some other criterion for the issue of its own internal currency and credit. There seems no reason to believe that America would object to such an arrangement; gold is becoming unpopular there; she is under no strong temptation to add to her hoards.

(If, on the other hand, America desires to keep gold in the monetary system and prevent its depreciation, without having to add to her hoards, this could easily be done within the framework of the plan by the clearing bank promulgating a buying price for gold. Furthermore any country which wished could adopt the gold standard, provided that it fixed its price of gold consistently with the rate at which its currency exchanged against the dollar as initially agreed (or as and if varied from time to time in accordance with an agreed plan). But no country would be required to be on the gold standard and the clearing bank would not be required to sell gold. Such a scheme would kill two birds; it would maintain the value of gold while depriving its international flow of any harmful effects).

In economic terms the plan means that if a country acquired a credit balance through its international dealings, it could only liquidate it by (a) lending more abroad or (b) encouraging imports whether by tariff reduction or the stimulation of internal purchasing power through public works, etc.

If America would agree to such a plan, most other countries would no doubt follow suit. (Russia might be recalcitrant but we could concert measures with the Americans to handle the Russian exchange problem consistently with the general idea and in conformity with Russian requirements).

Such a plan would automatically solve the balance of payments problem. (It is not inconsistent with the Keynes plan for shifting foreign exchange rates from time to time).

It has the following great advantages:-

1. The American Administration ought to be able to secure

acceptance for it easily, since it would not affect the individual citizen directly at all. It would leave him perfectly free to do what he liked with his own. It would allow the maintenance of the gold standard. The question how the Federal Reserve system treated its balance at the clearing bank in relation to its reserve laws and credit policy is an esoteric matter in which the individual American is not likely, after so many recent changes, to be deeply interested.

2. It gives scope for a perfectly hard and fast agreement in unequivocal terms, defining what each country has to do under those terms. (In this it contrasts strongly with any undertaking for tariff reduction).

3. It would provide a strong inducement to the Americans to do the things we want them to, reduce tariffs, lend abroad, maintain purchasing power at home, without compelling them to do all or any of these things should they prove to be too difficult politically. At the worst they would accumulate a credit balance, instead of, as previously, accumulating gold. But in doing this they would be inflicting no injury on their neighbours.

The debit countries need not be put under pressure. The debits would be automatically liquidated if and when the credit countries took the necessary measures. In the meanwhile, arrangements could be made, if this were thought desirable, for the clearing bank to make medium-term loans at nominal rates to assist the debit governments in public works etc. (It might, however, be necessary to have a provision that if a country became the victim of gross inflation, whether through lack of financial control or rapidly rising wages, she should be declared disorderly and temporarily removed from the ambit of the agreement).

This clear cut method for affording relief to countries which foresee exchange difficulties in the immediate post-war period, could, if agreed to, be published as a first instalment of the Anglo-American world order, and might serve to encourage the V element on the continent of Europe.

## II.

I believe that the right solution of the commodity question is that buffer stocks should be held not by the producing countries but by an international institution closely affiliated to and financed by the international bank. This would remove control from the interested parties and from the arena of conflict.

Our own main need in connection with these commodities is to secure a moderation in their fluctuations of price and so reduce the amplitude of the trade cycle. This is also one of the main needs of America and it should therefore be possible to secure agreement.

The international institution could promulgate buying and selling prices with a substantial margin between them, at which it would be prepared to buy and sell unlimited quantities. The margin would allow the ordinary machinery of the commodity trade to continue to function. The prices should only be reviewed at long, say, quinquennial intervals, or, if more frequently, subject to the condition that they should not be moved by more than, say, 2% in a year.

If Mr. Hansen's scheme for an Anglo-American investment board were adopted, the commodity institution should work in close collaboration with it. They would have the same objective - to flatten out the trade cycle. Investment plans are apt to be unreliable as cures for the cycle (i) because they cannot be turned

on and off sufficiently quickly and (ii) because it is difficult to find good uses for sufficiently large sum of money. (The Colonial Office should, however, be preparing plans for using really large resources for beneficial purposes in our colonies). The purchase and release of buffer stocks suffer from neither of these defects. The trend is automatically reversed within the trade cycle period and big money is involved.

This scheme would seem to have one cardinal advantage for the Americans in that it would relieve them of the burden of financing surplus stocks. If the purchases of the international institution are to have their full effect in checking depression they should be financed by credit creation.

There remains the crucial question of price. The right solution would be to fix a price that would, according to the best information, balance supply and demand in the long run. If the price were fixed too low, it would have to be raised in order to enable the institution to fulfil its obligations. If it were fixed too high, it could be stepped down at 2% per annum without causing great inconvenience.

If this solution could be agreed, we could dispense with the whole system of quotas and restrictions, only too likely to cause recurrent international friction. This would be an immense gain. The quota-restriction plan seems inconsistent with other parts of the American doctrine of the free flow of trade and ultimately with any idea of reaching a more rational world economic system.

But of course the Americans might object to such a price in the case of commodities in which they are interested. It might be too low.

The advantage of putting forward a general scheme of this kind for commodities is that the Americans can be forced to answer the question in general terms. We should ask them if they wish to stereotype existing prices (or prices of the 1920's!) in the case of all commodities? Do they wish to stereotype the existing distribution of production in the case of all commodities? Do they wish in every case to abandon the idea that the market should go to the lowest cost producers?

They might accept the general principle of an economic price which might well be called a "just" price but plead hardship in special cases, when producers cannot readily turn to another trade. The most economical way of dealing with such cases is to insist on the just price, but to provide compensation for cases of hardship during the transitional period.

It is possible, however, that the Americans would not accept the principle. We could put it to them that they should be prepared to accept it as a contribution to an agreement by which they would (a) be relieved of the burden of carrying surplus stocks (b) be able to give their producers a guaranteed, albeit low price (c) be brought in sight of a solution of the trade cycle problem which they so much desire and (d) be laying the foundation of a rational world system.

If they remained obdurate on the prices of certain commodities we should have to revert to the quota system in those cases. But this could be worked and much better worked as part of the larger scheme for the international holding of buffer stocks and price stabilization.

If the Americans accepted the idea of a just price, this scheme could also be published to encourage the V cause.

These projects are both ambitious, but it seems to me that the world situation and opportunity calls for something a little beyond the ordinary. I do not suggest them in any exclusive spirit but only as examples. We have also Mr. Keynes' scheme and Mr. Hansen's proposals.

We have reason to believe that the Americans are prepared to think on large constructive lines. If we put such schemes forward, we might well find ourselves happily converging to a point of agreement with the Americans about the post-war world. At the worst we should keep them talking for a very long time and postpone piece-meal discussions likely to cause friction to a date at which such friction can no longer have an injurious effect on the war effort.