Treasury Chambers,
Whitehall, S.W.

30th April, 1942.

Dear Harrod,

These will explain themselves.

May I hope for reactions in the next fourteen days or so?

Yours sincerely,

R. F. Harrod, Esq.,
Offices of the War Cabinet,
Great George Street,
London, S.W.1.

OFFICIAL COMMITTEE ON EXTERNAL ECONOMIC PROBLEMS.

The shorter note on External Monetary and Economic Policy mentioned in paragraph 18 that a plan was under consideration for an international organisation for steadying the prices of primary products and the holding of buffer stocks, and that when it was ready it was proposed to ask Ministers whether this subject should be introduced into the preliminary discussions with the American representatives.

The attached draft has been prepared in the Treasury after informal consultations with other Departments.

It is intended to send a document to the Official Committee on External Economic Problems, but I am first sending the attached draft for consideration and criticism to the following Departments, etc:

Board of Trade
Ministry of Agriculture
Ministry of Food
Dominions, Colonial and India Offices
Economic Section
Sir Frederick Leith-Ross
Sir William Palmer
Mr. Harrod
Mr. Ronald

R. V. N. HOPKINS
Treasury Chambers.
30th April, 1942.

Fifth Draft.

THE INTERNATIONAL CONTROL OF RAW MATERIALS

I.

The internationalisation of Vice-President Wallace's "Ever-normal Granary," in preference to Restriction, is the basis of these proposals.

1. This problem has two aspects - Restriction and Stabilisation. Producers are too easily interested in the former, perhaps because it carries with it the suggestion of higher prices. Restriction may be, sometimes, a necessary accompaniment of Stabilisation. But chronic, as distinct from temporary, restriction can scarcely be in the general interest and must be the symptom of a malady, which should be cured rather than endured, either local in the shape of misdirected production, or general as a result of deflationary pressure and depressed demand. The proposals of this paper, whilst not rejecting the expedient of restriction where it seems unavoidable, are, therefore, primarily directed to Stabilisation, both particular and general. They amount to an internationalisation of the "Ever-normal Granary" proposals of Vice-President Wallace, which seem to go to the root of the matter and are likely to promote the general interest more completely than can be claimed for any projects which are primarily directed to restriction.

2. The extent of the evil to be remedied can scarcely be exaggerated, though it is not always appreciated. A study of the violence of individual price fluctuations and the inability of an unregulated competitive system to avoid them is given in an appendix. It is there shown that for the four commodities - rubber, cotton, wheat and lead - which are fairly representative of raw materials marketed in competitive conditions,, the average annual price range over the decade before 1938 was 67 per cent. An orderly programme of output, either of the raw materials themselves or of their manufactured products, is not possible in such

conditions.

3. The whole world is now conscious of the grave consequences of this defect in the international competitive system. Apart from the adverse effect on trade stability of the truly frightful price fluctuations which we have learnt to accept as normal, they also impose obstacles to the holding of an adequate quantity of stocks, the eventual effects of which are not less injurious. For although the difficulty of rapidly altering the scale of output, especially of agricultural crops, leads to what appear to be large stocks at the bottom of the market, nevertheless when the turn of the tide comes, stocks turn out to be insufficient for the reason that it is just as difficult rapidly to increase the scale of delivered output as it had been to diminish it. Prices rush up, uneconomic and excessive output is stimulated and the seeds are sown of a subsequent collapse.

4. For many years the orthodoxy of laissez-faire has stood in the way of effective action to fill this outstanding gap in the organisation of production. Nevertheless there are to-day many signs that the world is ripe for a change. Assuredly nothing can be more inefficient than the present system by which the price is always too high or too low. Is not centralised international action capable of effecting a vast improvement of system, at any rate in the case of the great staple raw materials, most of which can be readily stored without serious deterioration?

5. The details of any scheme must be governed by the special problems and requirements of the individual commodities. The extent to which each commodity is homogeneous and the facility with which it can be replaced by other commodities are factors which affect its treatment. The natural conditions of production of different commodities differ so widely, e.g. between annual crops, tree crops and mining undertakings, that no plan can claim to be applicable to all commodities. Moreover, the reaction of producers to price variations differs very greatly and the

existence of a buffer stock scheme will itself create new conditions. For these reasons, as stated at the outset, schemes for the regulation of production - whether national or international - may be required if a buffer stock scheme is to work effectively. Any buffer stock plan must therefore be capable of adjustment to meet different requirements. Nevertheless certain general principles of operation can, it is suggested, be usefully prescribed and agreed.

6. The essence of the plan should be that prices are subject to gradual changes but are fixed within a reasonable range over short periods; those producers who find the ruling price attractive being allowed a gradual expansion at the expense of those who find it unattractive. Thus we should aim at combining a short-period stabilisation of prices with a long-period price policy which balances supply and demand and allows a steady rate of expansion to the cheaper-cost producers.

II

The Outline of a Plan.

7. The broad outline of such a scheme is as follows. Let us call our typical commodity commod.

(i) An international body would be set up called the Commod Control on which the governments of the leading producing and consuming countries would be represented. The management would be independent and expert, and the interests of consumers equally represented with those of producers. Its object would be to stabilise the price of that part of world output which enters into international trade, and to maintain stocks adequate to cover fluctuations of supply and demand in the world market. It would not be directly concerned with the domestic price and production policy of commodities produced and consumed within the same country.

(ii) An initial basic price fixed c.i.f. at the principal centres of consumption (in terms of bancor if the International Clearing Union is in operation) for commod would be fixed by the Commod Control at a reasonable level on the basis of current conditions, to be modified from time to time thereafter in the manner prescribed below by a process of trial and error based on the observed tendency of stocks to increase or to decrease. This does not mean a single price but a complex of prices according to varieties of quality, of dates in relation to the crop year in the case of agricultural commodities, and to position relatively to the cost of transport to the ultimate consumer. It should not be technically difficult to fix the complex of prices in proper relation to the basic price, provided a proper discretion is allowed to independent experts, for these margins are already established by trade practice in the management of futures markets.

(iii) Subject to special arrangements in the initial period suggested in (xv) below, the Commod Control would be prepared at all times to buy commod, holding and storing it either in the consuming or (subject to the safeguardsin (vi) below) in the

/producing

producing centres as may be most convenient and advisable, at a price (say) 10 per cent below the fixed basic price; and it would sell commod at all times at a price (say) 10 per cent above the fixed basic price. It might be that this price range could be safely narrowed after experience of the working of the plan. It should not be the same for every commodity, and exceptional purchases or sales might sometimes be required by over-riding conditions. A study of the percentage deviations of crop yields from trend level in pre-war years, suggests that, even in the case of agricultural crops, a price range of 20 per cent will normally be sufficient to allow a fair measure of stabilisation of producers' incomes for the world as a whole. It will not be sufficient to effect this purpose within each separate country. But to do so lies essentially outside the scope of an international scheme, since it cannot be brought about consistently with a uniform international price. There is, however, nothing to prevent individual Governments from operating within the international scheme, if they wish to do so, with a view to a further stabilisation of the incomes of their own producers.

(iv) Within these reasonably wide limits free and competitive markets would handle the trade as they would in the absence of control. The safeguards against excessive price fluctuations provided by the Control should allow merchants to hold stocks and to operate with confidence within the determined range and thus relieve the Control of a multiplicity of detailed operations in day to day business. The operations of merchants within this range might effect, in practice, a still narrower range of normal short-term fluctuations except where an abnormal surplus or deficiency of current supply was clearly in prospect. But the Control would have to be prepared, if necessary, to carry a large part of normal, as well as abnormal, stocks. A consuming centre might be allowed to attract stocks by offering to bear part of the cost of storage, provided it was not allowed, except by general agreement of all consumers, to bring within its jurisdiction an amount of

/total

total stocks out of proportion to its importance as a consumer. Generally speaking, the location of stocks should be as widely distributed amongst consuming and producing centres as climatic conditions for safe storage permit.(1)

(v) Apart from its contractual buying and selling obligations the Commod Control would itself deal in the market or arrange with merchants so as to keep its stocks in motion where they might otherwise deteriorate, replacing old stock by new stock, without, however, modifying its total stock except as the result of its contractual sales and purchases. It would be free to hold part of its stocks in the shape of futures, appropriately related in price to spot transactions, and to ease market difficulties by changing the position of its stocks.

(vi) Some provision would be necessary to prevent the Control from being saddled with responsibility for holding purely domestic stocks. Thus deliveries at producing centres should be accepted only at the Control's discretion; sales should not be made, unless the Control chooses, except on c.i.f. terms appropriate to some consuming centre; and the Control should not be under an obligation to accept sales from a producing country in any year exceeding its average annual export by more than (say) 25 per cent. These restrictions might be modified in the light of experience. But it would be prudent to limit the possible burden on the Control in the first instance.

(vii) At annual or, in the event of sudden changes in the situation, at shorter intervals the Commod Control would re-consider its stock position. If its stock was increasing beyond a stipulated figure, or at more than a stipulated rate, thus indicating that the price was unduly attractive to producers, or unduly discouraging to consumers, the basic price would be reduced.

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(1) In the case of "key" commodities the Commodity Controls might be required to take the instructions of the Super-national Policing Authority for the preservation of World Peace (if such a body is set up) as to the places of storage and the quantities to be held.

/Similarly

Similarly it would be raised if stocks were falling below a convenient level or at too fast a rate. A wider latitude would, of course, be necessary for commodities of which the yield was subject to the fluctuations of the seasons than in other cases. The Control would aim at making price changes small and gradual, and downward revisions should not normally exceed 5 per cent within a year. But it should be free to alter its basic price at any time, and, in exceptional circumstance, by more than 5 per cent.

(viii) If, for unforeseen reasons, contraction of output became necessary at a faster rate than that to which the producers could reasonably be expected to adjust themselves, or if in fact production does not contract in response to the reduction of price, producers would be allotted export quotas proportionate to their average sales for export over the previous three years; and, if necessary, an international regulation scheme would have to be negotiated. But such schemes should contain provisions ensuring

(1) that any reduction in the permitted scale of production was accompanied by an appropriate reduction in price;

(2) that the quotas assigned to countries subsidising their domestic production were gradually reduced in favour of countries which did not give such subsidies.

(ix) The Control would publish at frequent intervals full statistics of output, consumption and stocks and all other information valuable to producers and consumers.

(x) Subject to (viii) above, individual governments would be free to subsidise their own producers and to make any other arrangements for their benefit. But they would be expected to maintain a stable and consistent policy without frequent or violent changes and to act, so far as possible, with the full knowledge of the Control and in consultation with it.

(xi) The profits arising out of the difference between the Control's buying and selling prices might be sufficient to pay for the costs of storage and management. If, however, they were inadequate for this purpose, a suitable levy should be imposed on all

/exports

exports to meet the expense. This might not be necessary unless the Control were so successful that it was seldom called upon either to buy or sell at its contractual prices. Any net profits earned by the Control could be employed in the general interests of the industry, or to narrow the range of buying and selling prices, or to provide part of the fund for financing the stocks.

(xii) The finance of the storage and holding, for which large sums might be required if the system was extended to a number of commodities, would be provided through the International Clearing Union, with which the Controls would keep their accounts; or possibly, failing this, by an arrangement between Central Banks. It might be provided either by overdraft facilities; or, if the amount required altogether was greater than could be conveniently provided in this way, some part might be found from permanent or semi-permanent loans issued to the publics of the creditor countries, secured on the stock of the Control and guaranteed by the Clearing Union. For the purpose of such loans the requirements of a number of Commodity Controls might be amalgamated.

(xiii) Since the difficulty of accurately adjusting supply and demand may make it very convenient that the potential productive capacity should be in excess of normal requirements, it may be advisable to offer some inducement to maintain such extra capacity in existence. It would, therefore, be the duty of an efficient Commodity Control to find ways of conserving and suitably rewarding a prudent margin of excess potential capacity, charging the costs of this to the industry as a whole.

(xiv) A General Council for Commodity Controls (1) should be established, to which each particular scheme would be referred for examination before it was brought into operation, in order to ensure that its provisions were in conformity with the general

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(1) If the Economic Committee, suggested in another connection, is set up, it would be natural for the General Council for Commodity Controls to be closely associated with it.

/principles

principles formulated above. It would also be the function of the General Council to review the condition of each of the Commodity Controls, and to issue annual reports upon their operation, and to make recommendations as to the policy which they should follow. Such recommendations would have as their object the protection of the general interest and especially the maintenance of a stable level of prices and the control of the trade cycle. The General Council should further be empowered to authorise, and possibly to require, modifications in the basic prices and the stipulated figure of stocks in particular control schemes. This would permit an adjustment of the prices of a particular commodity to a change in the general level of raw material prices or of other prices.

(xv) Special provisions would be required during the initial period when most materials are likely to be in short supply, which the Controls must not aggravate by endeavouring to build up working stocks. Moreover, it would be undesirable that they should fix basic prices under the influence of temporary conditions which might be considerably too high in normal circumstances. On the other hand, the transitional period after the war, when supplies of raw materials will inevitably remain under official control for the time being, will offer a specially good opportunity for getting the Controls organised. The conclusion is that during this initial period the Controls should do no more than underpin the market and give confidence to producers by fixing a reasonable basic price on the basis of which they would buy, whilst postponing their liability to sell on this basis until sufficient stocks had accumulated in the ordinary course of events. In any case, however, in which surplus export stocks already existed in the hands of governments, a Control should be prepared to take them over at an agreed price, thus solving the problem of how to prevent the liquidation of such stocks from interfering with normal current output.

/ III.

III.

Commodity Controls as a Contributory Measure to the prevention of the Trade Cycle.

8. Superimposed on the meaningless short-period price swings affecting particular commodities and particular groups of producers there is the fundamental malady of the Trade Cycle. Fortunately the same technique of Buffer Stocks, which has to be called into being to deal with the former, is also capable of making a large contribution to the cure of the Trade Cycle itself.

9. At present a falling off in effective demand in the industrial consuming centres causes a price collapse which means a corresponding break in the level of incomes and of effective demand in the raw material producing centres, with a further adverse reaction, by repercussion, on effective demand in the industrial centres; and so, in the familiar way, the slump proceeds from bad to worse. And when the recovery comes, the rebound to excessive demand through the stimulus of inflated prices promotes, in the same evil manner, the excesses of the boom.

10. But if the Commodity Controls are in a position to take up at stable prices the slack caused by the initial falling off in consuming demand and thus to preserve some measure of stability of incomes in the producing centres, the vicious cycle may be inhibited at the start; and, again, by releasing stocks when consumption recovers, the Commodity Controls can prevent the inflation of raw material prices which carries the seeds of an incipient boom.

11. The very fact that in the aggregate large sums of money may be involved in such storage schemes, though it aggravates the technical and financial problems, is of positive assistance when we come to the handling of the Trade Cycle. For we have at our disposal a weapon capable of producing large effects by rapid action, and of operating in the negative as well as in the positive

direction, so that it can function as a stabilising factor both ways. By taking up or by releasing stocks, the complex of Commodity Controls can operate in both directions on a scale and with an immediacy which is quite impossible for projects of public works. Organised public works, at home and abroad, may be the right cure for a chronic tendency to a deficiency of effective demand. But they are not capable of sufficiently rapid organisation (and above all they cannot be reversed or undone at a later date), to be the most serviceable instrument for the prevention of the Trade Cycle. Buffer Stock Controls to deal with the epidemic of intermittent effective demand are therefore the perfect complement of Development Organisations (or International T.V.A.) to offset a deficiency of effective demand which seems to be endemic.

IV.

Some Difficulties Reviewed.

12. The personnel and the powers of the Controls, and especially the initial negotiations laying down the general principles and regulations governing a particular Control, present obvious difficulties. What is the proper balance of authority between consumers and producers? How closely must each individual scheme conform to a general model? Is the practical management to be mainly commercial or official? How are dead-locks, arising from a conflict of interest, to be ultimately resolved?

These questions are not easily answered. But it is fair to point out that most of them apply equally to any schemes for introducing order into international trade. We may throw our hands in at the start on the ground that it is too difficult to improve this awkward world. But if we reject such defeatism - at any rate to begin with and before we are compelled to acknowledge defeat - then the questions to be asked at so early a stage of our work need only be whether this particular machinery for introducing international order is exposed to more difficulty on the above heads than alternative proposals directed to the same general purpose.

Now in certain respects the above proposals offer much less practical difficulty than schemes which depend on organised restriction. They avoid the difficult and invidious task of fixing quotas which are fair and of providing means of subsequent adjustment which are acceptable. They require no policing. A minority of producers who prefer to stay outside the scheme present no special problem. They lose their rights to participate in the management of the scheme; they will not be helped in their local storage problems; and it is not obvious what they gain.

13. None the less, it is possible, though in "expansionist" international conditions by no means certain, that for some commodities schemes for regulating production would also be required. Under conditions of a large excess of productive capacity

/over

over that required to meet the effective demand, prices might be lowered continuously until they were insufficient to provide a reasonable standard of life for the majority of the producers concerned. In a sense the essential principle of the present proposal is that the long-term economic price is the price that should be aimed at. But this must not be interpreted in such a way that a minority of producers with low standards of life might depress prices to a level inadequate to all. It should be regarded as the price which would yield to producers a standard of living which is in reasonable relation to the general standards of the countries in which the majority of them live. It is in the interest of all producers alike that the price of a commodity should not be depressed below this level, and consumers are not entitled to expect that it should. The desire to maintain more adequate standards of living for primary producers has been the mainspring of the movement towards commodity regulation schemes in recent years, and they may still remain necessary for this purpose. None the less they should be regarded in such a case as a last resort, since we are faced with a persisting or quasi-permanent situation. The problem is, in fact, one aspect of the general problem how to deal with low-standard producers if there is to be complete freedom of trade and non-discrimination; and is a further reason for the conclusion that some "protective measures

/must

must be held in reserve as a proper defence of standards of life for other producers (this has an application to manufactured as well as primary products).

Whatever success may attend on efforts to raise nutritional and other standards to a decent level in all producing countries, there must necessarily remain, at least for a long time ahead, a wide difference between this "decent" level and the level attainable in the wealthier countries. It is necessary, therefore, that buffer stock schemes should be framed on lines which leave each country free to give subsidies to their own producers, in order to maintain their standard of living at whatever level they consider suitable. None the less it must be recognised that a real difficulty arises if such subsidies are given on a substantial scale by the wealthier countries. For the effect of the subsidies is likely to be to maintain a larger volume of production in the countries giving them, and thus to check any tendency which might otherwise exist towards a redistribution of world production in favour of countries with more restricted economic opportunities. The resultant situation would thus be exposed in a considerable degree to one of the main objections to commodity restriction schemes, namely their tendency to stereotype the distribution of world output on the basis of past performance. In view of the probability that a considerable readjustment of the shares of different countries in world production may be an essential condition of restoring equilibrium to the international balance of payments, this must be regarded as a serious objection. It would seem to be important, therefore, to try to secure a general understanding that subsidies given by particular governments to their own producers of commodities which are the subject of buffer stock schemes should be confined within moderate limits. It might furthermore be desirable/to provide as suggested above, expressly that where buffer stock schemes are combined with commodity regulation schemes the quotas of countries giving subsidies should be reduced by a small percentage each year.

It should be added that the successful operation of buffer

/stock

stock schemes on the lines here proposed must depend in the long run on the genuine acceptance of the principle that the long-term economic price (in the above sense) should be the aim of international policy. Serious dangers would arise if a plan were to be adopted which bore a general resemblance to the foregoing, but which did not contain provisions ensuring a progressive reduction of price if stocks continued to accumulate beyond a certain level. Upon this basis it might well happen that the attempt would be made to establish a world price at a level which could doubtless be defended as not excessive from the standpoint of the standard of living which it afforded to primary producers, but which might none the less result in the eventual discredit and breakdown of the plan through the excessive accumulation of stocks.

14. How comprehensive must the Controls be at the outset? Can progress be piece-meal?

There is no obvious objection, and indeed much advantage, in piece-meal handling by which we start off with those commodities which are most important or most in trouble if left unregulated or present least practical difficulties at the outset. Evidently some of the advantages claimed above would only materialise when the Controls had become somewhat comprehensive in their field of operation. But this does not mean that the system has to be born fully matured in a day if it is to come into effective operation.

15. Increasingly before the war governments were finding themselves forced to support their producers against the effect of other countries' restrictions on their markets, and the network of governmental controls established in this way and responsive to no economic stimulus was in some cases one of the main reasons for the accumulation of surpluses. The effectiveness of any buffer stock scheme must partly depend on the possibility of eliminating pre-war restrictions and securing general cooperation on the part of all governments in policies directed to the expansion of consumption.

/16.

16. Can the Controls function satisfactorily without degenerating more often than not into restriction schemes? Only experience can show. Restriction schemes, when they <u>are</u> unavoidable to supplement the Buffer Stock arrangements, should be regarded as a means of temporary relief - not a normal or a persisting expedient. For they tend to crystallise the price and the distribution of output between different countries as they exist at the date of the scheme's inception, or - worse still - as they existed over a period of years prior to its inception. In this way the signal advantages of free international competition, namely its adaptibility to changing conditions, both of demand and supply, and the proper advantage it gives to the cheapest producers, are needlessly thrown away. "Stabilisation" must not rest on the absurd assumption that conditions of demand and of supply are fixed, or that the chief purpose is to protect the increasingly uneconomic producer from the natural effects of world competition. Our object should be to combine the long-period advantages of free competition with the short-period advantages of ensuring that the necessary changes in the scale and distribution of output should take place <u>steadily</u> and <u>slowly</u> in response to the steady and slow evolution of the underlying trends.

17. How are we to define what we mean by a commodity for this purpose, having regard to the variety of types and grades and to the possibilities of substitution between one article and another? Who is to decide the extent of diversity, as for example the range of price between highest and lowest, the size of maximum and minimum stocks, and the criteria for altering the basic price, to be allowed to one Commodity Control compared with others?

The first set of questions are practical and technical and cannot be either solved or dismissed in a general discussion.

These again, it may be pointed out, are difficulties common to <u>all</u> international schemes for introducing better order into the supply of raw materials. But both sets of questions point to the practical importance of the proposed General Council for Commodity Controls, which would have to undertake the initial task of organising particular Controls and approving their rules and regulations and of securing even-handed justice in all directions, as well as keeping a watchful eye on their subsequent operations. If the objection is made that the General Council will have large powers, the answer must be made that international economic controls, if they are to be effective, must have large powers. To object to such powers may be not much more than a polite way of objecting to the Controls themselves.

18. How much money will these schemes require? Will the amount be in reasonable relation to the means of supplying it?

It is difficult to frame an estimate before deciding how wide a range of the staple raw materials of international trade the schemes will endeavour to cover, or without entering in detail in each particular case into the number of months' stock it would be advisable to hold, or in advance of experience of the proportion of total stocks which the Controls would, in practice, be required to carry. One can only say that, potentially at least, the total amounts required, when all the possible controls are fully fledged, are large. An attempt has, however, been made to compile figures (highly approximate) so as to indicate the order of the magnitude involved, for eight principal commodities - wheat, maize, sugar, coffee, cotton, wool, rubber and tin - which are given in Appendix II. These figures show that the total value of a year's international trade in these commodities, taking the average volume over the years 1935/38, was about £700 millions at the prices of 1939 and £950 millions at the prices of 1942. A year's stocks on this basis in the hands of the Control would be much too high; three months' would probably be too low - at any rate the Controls must be prepared to hold more than this; and some figure intermediate between these extremes might be appropriate. It must be pointed out that by no means the whole of the necessary finance is <u>additional</u> to what would be required otherwise. Normal stocks must be held and must sometimes accumulate to abnormal amounts, even in the absence of Controls, and the finance for carrying such stocks has to be found from somewhere.

For example, it is estimated that the stocks of the above eight commodities (very unequally distributed between them) including the domestic surpluses, likely to be held at the end of 1942, outside Russia and the enemy and enemy-occupied countries, are likely to be worth about £900 millions at present prices, the finance for which is being found already.

The existence of a Clearing Union, which could take the main responsibility for the provision of the finance, would so greatly facilitate a system of Commodity Controls which is essentially based on their having the financial capacity to carry an "ever-normal granary," that some might hold this project to be, in effect, conditional on the adoption of the former. This might, nevertheless, be an overstatement, if we remember that the scope of the proposed Commodity Controls could, if necessary, be limited to those cases where the Governments and Central Banks of the countries chiefly concerned felt strong enough to arrange the necessary finance by agreement amongst themselves. The introduction of the Clearing Union into the picture means that the burden is pooled and is carried, in effect, by those Banks, namely those with credit balances, which happen at the moment to be in a position to carry it without effort; whereas at present the burden falls on the Central Bank of the producing country precisely at the moment when it is least able to support it, because the falling off of demand for its product is simultaneously unbalancing its international position.

Closely associated with this advantage is another one of scarcely less importance, namely that the raw material stocks of a producing country are rendered by this means always liquid. A producing country is always paid for its output at or above a reasonable minimum price, whether or not the whole of this output passes immediately into consumption, and paid for it <u>in liquid cash</u> which it can employ on maintaining its normal volume of imports and its normal standard of life, thus retaining its own stability and being no longer the occasion, by repercussion, of instability in others. There can be no question that the scheme proposed would be of the very greatest value to raw material countries, especially to those which are financially weak, with overseas debt and lacking in reserves or are highly specialised in their produce.

It might well be, if the scheme came eventually to cover a wide range of commodities, that there would be created an excess liquidity for the world as a whole, if the finance were to be provided entirely by Clearing Union credit. In this case an appropriate part should be funded by a long-term international loan issued under the auspices of the Clearing Union and secured on the stocks of all the Controls, sufficient to cover an appropriate proportion of the stable, as distinct from the fluctuating, proportion of the pooled financial requirements of the Commodity Controls as a whole.

19. In conclusion, it is worth mentioning that this scheme is a means, and perhaps the only means, of implementing the often-repeated undertaking of free and equal access for all countries alike to the sources of supply of raw materials.

J.M.K.

14.4.42.

APPENDIX I.

<u>The violence of individual price fluctuations and the inability of an unregulated competitive system to avoid them.</u>

Wide fluctuations in the prices of raw materials between general boom and depression and between years of exceptional abundance and scarcity for particular commodities are well understood. But superimposed on those broad swings there are disturbing short-term fluctuations on a surprising scale, which are apt to be concealed from those who only watch the movements of index numbers and do not study individual commodities; since index numbers, partly by averaging and partly by including many commodities which are not marketed in fully competitive conditions, mask the short-period price fluctuations of the sensitive commodities.

The results of an enquiry made in 1938 into the price fluctuations of rubber, wheat, lead and cotton will provide an illustration. This enquiry examined by what percentage the highest price in each of the last ten years exceeded the lowest price <u>in that year</u>:-

<u>Rubber</u>. There was only one year in the decade before 1938 in which the high price of the year exceeded the low by less than 70 per cent. The average excess of the year's high over the year's low was 96 per cent. In other words, there was on the average some date in every year in which the price of rubber was approximately double its price at some other date in that year.

<u>Cotton</u>. Since rubber may be regarded as a notoriously fluctuating commodity, in spite of its having been subject to an organised restriction scheme, let us consider cotton. Only twice in those ten years did the high price of the year exceed the low by less than 33 per cent., and the average excess of the year's high over the year's low was 42 per cent.

<u>Wheat</u>, however, was nearly as fluctuating in price as rubber, which may be a surprise. If we take the Liverpool contract as our

standard, there was only one year in the decade when the highest price of the year exceeded the lowest by less than 47 per cent.; and the average excess of the year's high over the year's low was no less than 70 per cent.

Lead is mainly marketed by a small number of powerful producers acting with some measure of consultation. Yet, even so, the annual range of price fluctuations was on much the same scale as with the commodities already examined. Only twice in the ten years was the price range from lowest to highest less than 35 per cent., and the annual average was 61 per cent.

Thus for these four commodities - rubber, cotton, wheat and lead - which are fairly representative of raw materials marketed in competitive conditions, the average annual price range over the decade before 1938 was 67 per cent. An orderly programme of output, either of the raw materials themselves or of their manufactured products, is scarcely possible in such conditions.

There is a good theoretical explanation of this unfortunate state of affairs. It is an outstanding fault of the competitive system that there is no sufficient incentive to the individual enterprise to store surplus stocks of materials beyond the normal reserves required to maintain continuity of output. The competitive system abhors the existence of buffer stocks which might average periods of high and low demand, with as strong a reflex as nature abhors a vacuum, because such stocks yield a negative return in terms of themselves. It is ready without remorse to tear the structure of output to pieces rather than admit them, and in the effort to rid itself of them; which should be no matter for surprise because the competitive system is in its ideal form the perfect mechanism for ensuring the quickest, but at the same time the most ruthless, adjustment of supply or demand to any change in conditions, however transitory. It is inherently opposed to security and stability, though, for the same reason, it has the great virtue of being also opposed to stability in the sense of stagnation. If demand fluctuates, a divergence immediately ensues between the general interest in the holding of stocks and the course of action which is most advantageous for each competitive producer acting independently.

There are several reasons for this. The cost of storage and interest is fairly high, especially in the case of surplus stocks which strain the capacity of the normal accommodation. Reckoned <u>ad valorem</u> there is a wide range of storage costs between different types of commodities, from (say) 5 to 25 per cent. per annum. In the case of many commodities, however, the charges are probably in the neighbourhood of 10 per cent. per annum;[1] whilst the length of time for which holding will be necessary and the ultimate normal price are both matters of great uncertainty. The costs of centralised storage schemes, especially if interest charges can be kept at a minimum, should be very much lower.

There are, however, two other still more dominating factors. Experience teaches those who are able and willing to run the speculative risk that, when the market starts to move downward, it is safer and more profitable to await a further decline. The primary producer is, as a rule, unable or unwilling to hold, so that, if the speculative purchaser holds back, he will get the commodity still cheaper. Thus, even if it would pay him to buy at the existing price on long-period considerations, it will often pay him better to wait for a still lower price. The other factor arises out of the lack of incentive to the retailer or the manufacturing consumer to purchase in advance. By purchasing in excess of his immediate needs he may make a speculative profit or loss just like any outside

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(1) Mr. Benjamin Graham in his book on <u>Storage and Stability</u> (p.108) estimates the average commercial cost to dealers in the commodity exchanges of storing 23 standard raw materials at 13½ per cent. of their value per annum, exclusive of interest, whilst he considers that organised government storage could be provided at a quarter of this cost. His estimate of the commercial cost is considerably higher than the above, which is intended to include interest, but his average is considerably affected by the exceptionally high <u>ad valorem</u> cost of storing maize, oats and petroleum.

speculator, but as a trader or a manufacturer his position will be competitively satisfactory when the time comes to use the materials, provided he is paying the <u>current</u> price. Thus a cautious user would rather pay the current price for his raw materials on which his own selling prices are based than run a speculative risk; and this attitude is reinforced by the fact that his interests are already bound up with activity in the demand for the commodity in question, so that he is multiplying unnecessarily the same kind of risk if he buys his material in advance of his needs. On the other hand, the long-term holding power of the outside speculator is limited - most participants in the market being more interested in a rapid turn-over - and can only be called into action on a sufficient scale by a drastic fall in prices which will curtail current output substanially and appears to be a long way below any probable normal cost of future production. This adjustment of prices has to be all the more violent because, for a variety of technical and social reasons, both the consumption and the production of primary products have become increasingly insensitive to changes in their prices; and it is all the more disastrous because the tendency of international trade is to make many countries increasingly dependent on individual crops, for which they are specially suited, so that the social consequences of large movements in the prices of these specialised products are severe and the dangers of instability are enhanced.

APPENDIX II.

World Trade Valued.

Commodity	1935	1936	1937	1938	Aver. 1935/38	Price* per long ton in 1942	Value of 1935/38 Aver. at 1942 Price	Price per long ton in August 1939	Value of 1935/38 Aver. at 1939 Price
	World Net Exports ≠ '000 metric tons					f.o.b.	£mn	f.o.b.	£ mn.
Wheat	14750	14500	15300	15000	14900	£8.2	120	£7.1	104
Maize	9000	10000	13000	9000	10250	£3.2	32	£4.8	48
Sugar	9650	10000	10500	10500	10200	£12.4	124	£9.5	95
Coffee	1610	1630	1550	1800	1650	£70.3	114	£28.5	46
Cotton	2650	2900	3000	2540	2770	(3/4 at £100 (1/4 at £70	252	£54	147
Wool	950	940	880	940	930	(1/2 at £168 (1/2 at £130	136	(1/2 at £168 (1/2 at £130	136
							778		576
	World Absorption '000 long tons					c.i.f.			
Rubber	936	1038	1095	934	1000	£112	115	£79.3	79
	World Consumption '000 long tons					c.i.f.			
Tin	150	160	199	160	167	£275	46	£225	38
	Totals of above values						939		693

* Ministry of Food and Ministry of Supply f.o.b. programme prices except rubber and tin for which approximate U.K. c.i.f. prices.

≠ Average of total net exports and total net imports as shown in Yearbook of International Institute of Agriculture.