Post-war Commodity
Policy and Relief Dept.,

Berkeley Square House, W.1.

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With the compliments

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NOTE ON THE TREASURY MEMORANDUM

The International Control of Raw Materials

1. The Treasury Memorandum suggests (a) that stabilisation of production and trade in raw materials should be attained primarily by way of price control through buffer stocks and only secondarily, and almost in the last resort, by way of control of supplies through regulation schemes; (b) that buffer stocks, by absorbing or making available supplies of raw materials within defined price limits, will check short period fluctuations in market prices, and will thereby operate as a wider check on the trade cycle. It may be readily agreed that a buffer stocks scheme may be of great value as a means of ironing out short-term fluctuations in the prices of individual raw materials and as a contribution to the stabilisation of commodity prices generally. There is, of course, a range of raw materials in which long-term productive capacity and effective demand could be expected to adjust themselves within a reasonable period after the war, such as certain metals and wool. In these cases a buffer stocks scheme might be of considerable assistance in liquidating end of war stocks and might continue to be of use thereafter in offsetting short-term disparities between supply and demand.

2. But a buffer stocks scheme can be effective in stabilising prices only if long-term conditions are reasonably sound. In the earlier commodity control schemes, especially those in the years immediately following the last war, e.g. in the earlier coffee, rubber, tin and other schemes, the emphasis was on price control rather than on the regulation of supplies. But the disastrous results of the Stevenson Rubber Scheme and of Brazil's coffee control scheme of 1925/29 led to the abandonment of direct price control in favour of output control. The character of the buffer stocks scheme under consideration is, of course, very different from any of these schemes, but they throw light on the difficulties which have to be faced.

3. The control of world prices and production of raw materials on the lines suggested in the Treasury memorandum could be effective only if -

(a) production and consumption are in reasonable long-term balance at the outset;

(b) production and consumption are related to and not insulated from world prices;

(c) productive capacity is adaptable and responsive to variations in demand or world prices.

4. The important commodities to which these conditions apply are the exception rather than the rule. Few of the chief agricultural products comply with any of them. The most important of these products are in chronic surplus supply, and are subject to political factors such that world prices have little or no effect on the prices in particular countries. State intervention in one country after another has prevented the free play of laissez faire principles, under which the world price was the determining factor regarding the quantity of a commodity going into international trade. In countries where production is still responsive to world price, a decrease in price often results in increasing production and not decreasing it, as the producers seek to get the same cash return despite the lower price. Tree crops, some of which take as long as seven years to mature, are not capable of rapid adjustment to changes in demand, and if the quantity of competitive planting was left to be determined by price, productive capacity might get seriously out of balance with demand. The same argument applies in varying degree in regard to capital development in other raw material industries, in particular in regard to certain metals such as tin, in which an appropriate margin of capacity is unlikely to be established as a result of the influence of market prices alone.

/5. Some form

5. Some form of regulation has proved necessary and is in accordance with political tendencies in cases such as those mentioned above. To establish a rigid control of marketing but to leave production quite uncontrolled is illogical and in fact likely to prove unworkable. Without regulation of production and stocks, the control must either limit its holdings - in which case prices will be highly unstable - or undertake unlimited liabilities - in which case the buffer stocks scheme will soon become insolvent.

6. Regulation is not, however, necessarily restriction. The term restriction seems to be used in the Treasury memorandum to cover not only attempts by groups of producers to exploit their monopoly position, but also export quota arrangements (with or without internal control of production), which seek to balance supplies and demand by international agreement. The reputation of such quotas as an instrument of international planning has suffered from their association in people's minds with "restriction". That association is, however, largely due to the fact that the chief commodity regulation scheme came into being to deal with serious over-production for the market as it existed under increasing measures of protection of varying kinds; and restriction was necessary to work off the excessive stocks which had accumulated, and to bring production into line with effective demand. It is not the case (as suggested in paragraph 1 of the Treasury memorandum) that "producers are too easily interested in restriction". On the contrary, producing countries, especially the big economic producers, are almost invariably anxious to increase production, even at the expense of lower prices, and the difficulties experienced by the bodies administering the regulation schemes have not been to keep production up to a level which would meet all demands, but to keep it down to somewhere near effective requirements and avoid the piling up of excessive stocks. Shortage of supplies was rare and the big short-term price fluctuations have often been due to speculation. If, after the war, the trend of restriction of imports is reversed, commodity regulation schemes would be able to operate on an expanding instead of shrinking market, and their task of balancing production with demand would no longer be a question of "restriction", but of organising sufficient productive capacity to meet all additional requirements. Vice-President Wallace has put forward the idea of an "ever-normal granary" as a method of dealing with variations of output due to weather and other natural forces, but he associates the idea of reserve stocks with other positive measures of Governmental planning and control of production and marketing. Regulation schemes which plan production ahead would be fully in accord with his ideas.

7. The outstanding examples of commodities, the production and consumption of which is not responsive, at any rate in the short run, to world price variations, are wheat and sugar, but the same is true, broadly speaking, of other cereals, meat, dairy products, etc. In all these cases uneconomic production has been stimulated by Government action, supported by subsidies and protection; the result of this is,

(i) to develop a chronic surplus capacity in the world as a whole;

(ii) to maintain high prices in many of the consuming markets and consequently to restrict consumption;

(iii) to restrict the volume of international trade and to depress the open market prices.

For example, as regards wheat, in 1934 the world market price c.i.f. Liverpool was about 5/- per cwt.; the import duties in force were, in France 10/1d. per cwt.; in Italy 12/4d.; in Germany 18/11d.; even in countries like Czechoslovakia and Austria, the duty was over 5/- per cwt.; and the internal price in France was 15/6d. per cwt., and in Italy and Germany about 14/-, or about three times the world market price. The maintenance of this high internal price tended to restrict consumption but stimulated production until these countries were self-supporting and, in the case of France, developed an export trade in wheat. The world market was correspondingly contracted and the open market price fell to levels unremunerative to any producer.

/8. The case of

8. The case of sugar is even more striking. The open market price c.i.f. United Kingdom, ex duty, averaged 4/8d. per cwt. during the three years 1934/36. Java, Peru and other economic producers, dependent largely on the world market, could just afford to maintain production at this price but their production had to be severely restricted and the markets open to them were constantly declining till they supplied less than 20 per cent. of the world consumption. Sugar was grown in other countries under every variety of protection and preference at all sorts of higher prices. The United States grew a quota of beet sugar at home and gave a protected market to the Phillipines and a preferential market for a quota of Cuban sugar. The United Kingdom grew a quota of sugar beet at home and gave a preferential market to Empire sugar at much above the world price.* Australia sold her cane sugar production at home at 23 to 24 shillings a cwt. and exported a substantial quantity to the United Kingdom at the Empire price. But it was the subsidised production of beet sugar, above all, which disorganised the market. Out of a total world production of about 28 million tons, over 10 million tons represented the amount of beet sugar, produced in almost every case on the basis of a subsidised price much above the open market price. Moreover, the European beet sugar industries produced not only sufficient for home requirements, but also considerable quantities for export. The retail price in most European countries was determined, not by the open market price, but by the cost of subsidised production, on top of which was often added heavy taxation for revenue purposes; and total consumption in the different countries varied inversely with the retail price, e.g.,

	Consumption per head per annum (in kilos)	Retail price
Denmark	55.9	4.6d.
Sweden	48.8	4.5d.
Great Britain	47.8	5d.
Finland	29.7	6.9d.
Norway	31.9	7.0d.
France	25.1	7.6d.
Germany	23.4	15.0d.
Hungary	10.55	11.4d.
Italy	7.9	15.9d.

9. If subsidies and taxes were limited retail prices could be reduced and consumption would expand. Unless the reduction of subsidies was considerable this would not directly help the economic producers, as they would still be unable to compete with the subsidised home industry, but indirectly it would do so as the additional outlet on the home market would tend to decrease subsidised exports and thus increase outlets for economic production on the world market. Without some such increase of home consumption in the beet sugar countries or some reduction of their subsidised production, the outlet on the world market for economic producers shrinks continually and the dumping of subsidised sugar depresses world prices to levels which are unprofitable even to economic producers.

10. Owing to the large amount of labour employed and the saving of foreign exchange involved, the uneconomic production of sugar in Europe has become an important part of the agricultural systems of the more densely populated European countries. It might be reduced in time, if free exchanges could be restored and there was a general turnover in Europe to dairy farming and the growing of protective foods. But it will not be affected by any reduction in the world market price. In cases such as wheat and /sugar

* In 1937/38 the United Kingdom sugar supplies were obtained as follows:

	tons	price per cwt.
Foreign	509,000	5/5
Other Empire	824,000	9/2
Colonial certified	537,000	10/2
Home-grown beet	418,000	18/10 (excluding assistance given to beet sugar factories which represented in 1936/37 5/3d. a cwt.)

sugar it would appear quite unreasonable (as suggested on page 7 of the Treasury memorandum) to provide that "any reduction in the permitted scale of production was accompanied by appropriate reduction in price". Owing to the dumping of surpluses from protected markets, the world market price may be too low, not too high. What is needed in such cases is that the higher cost producers should undertake to reduce both their subsidised production and the internal price to their consumers, whereas the memorandum (page 7) proposes that "individual Governments should be free to subsidise their own producers and to make any other arrangements for their benefit". But it is precisely these arrangements which are at the root of most of the difficulties, and mere consultation, with a buffer stocks control, will do little to eradicate them.

11. If any serious attempt is to be made to stabilise commodity prices, particularly of agricultural products, the difficulties created by subsidised production have to be faced. This is the malady which requires to be cured. The Treasury memorandum, in paragraph 13, admits that the effect of subsidies is likely to be to maintain a larger volume of production than is desirable, and goes on to say, "It would seem to be important 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". This is, in fact, the essence of the problem. But none of the subsidising countries is likely to accept the simple abandonment of their subsidised production. The best that can be hoped for is that they will limit it to some agreed production quota on condition that the non-subsidised producers also limit their production so that total supplies are kept in reasonable relation to effective demand. It would be desirable for the limit to be so fixed as not only to exclude all exports of subsidised production but also to leave a proportion of the domestic requirements of the countries subsidising production to be covered by imports from non-subsidised producers, the price to customers being averaged (e.g. on the basis of the United Kingdom wheat and sugar quota). The situation would be still further improved if general agreement could be reached that any subsidies given to domestic producers should be financed by the budget and not passed on to consumers by means of import tariffs or controls, as in that case the consumer would get the benefit of world prices and consumption would expand. Subsidised production has, however, such strong political support on grounds of employment and exchange difficulties that it is unlikely to be possible to get agreement on either of these proposals. It is only likely to be limited as part of an international agreement regulating the volume of production of the particular commodity in all countries and, unfortunate though it is, the more economic producers will probably be forced to limit their production in order to leave room for the output which the subsidising countries insist on maintaining.

12. There are certain other agricultural products which are not affected by heavy protection and subsidised production in importing countries, but which, nevertheless, have been in chronic surplus supply, and are likely to be so for a considerable period after the war. In the case of coffee and cotton, there was already excess productive capacity before the war. During the war stocks of coffee and of certain grades of cotton have been accumulating, new sources of supply have been developing, and the production of substitute fibres has increased enormously. Unless some international arrangement can be reached on the basis of quantity regulation which takes fair account of all these factors, there is almost certain to be a scramble for markets, in which the producers of various countries will doubtless be helped by direct or indirect State subventions, both in the case of coffee and cotton. The United States is in a position to subsidise exports of raw cotton indefinitely at the expense of producers in other areas and might well provide supplies at a differential price to United States manufacturers of cotton textiles for export. The United States has adopted a quota system for imports of coffee and might use this to support a Latin American coffee regulation scheme. The United States is unlikely to join in financing a buffer stocks scheme which would throw on them the main burden of carrying excess stocks and still less likely to finance such a scheme if it depressed world prices and compelled them to increase the subsidies paid to their own producers. They are more likely to agree to some form of direct regulation of production and trade in which they will be able to use their financial and economic power to negotiate an acceptable quota.

/13. Rubber and

13. Rubber and tin are cases of industries which after the war will require considerable reconstruction. Large capital outlays may be needed if the natural products are to regain a position in world markets. In view of the enormous development in the production of synthetic rubber, possibly of plant substitutes (such as are now being grown in Russia) and other less directly competitive substitutes, it is important that the productive capacity of the natural industries should be re-established at a rate which takes account of effective demand and of these substitute materials. Otherwise, there will be little prospect of stabilising the market. A very complex network of prices would be necessary under the buffer stocks scheme and it would be difficult to arrive at one which would not lead to extreme maladjustment of investment in the industries concerned, which would disturb markets for years. An International Investment Board might do something to regulate the situation in these industries, but sooner or later countries which produce the natural product, those in which substitutes have been developed, and countries which are importers pure and simple, will have to agree upon a rational distribution of production and trade, and it would seem advisable to arrange this sooner rather than later.

14. The proposals in the Treasury memorandum relating to stocks also appear to require further consideration. The memorandum (page 18) speaks as if the control was to finance all stocks. "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 in liquid cash, which it can employ on maintaining its normal volume of imports and its normal standard of life". This would involve an immense liability, if production is not controlled, but it would give the control an effective means of stabilising prices and possibly producers' incomes. But is this intended? Other passages in the memorandum present quite a different picture. Paragraph 5 (vi) draws a distinction between domestic and other stocks. No clear distinction of this kind is practicable. International trade in the commodities under consideration is maintained from reserves of bumper crops, now in one producing area, now in another, and import requirements are met (including those of countries which normally export, but which find themselves with a short crop) by foreign stocks as well as foreign current production. Domestic and other stocks are not, therefore, independent. If each country had to maintain adequate reserves for all the contingencies of its domestic market, total reserves would have to be larger than they need be now, and also, ordinary international trade would shrink. The memorandum proceeds to suggest that the control should be safeguarded from being overloaded by a provision that it would not be compelled in any one year to buy from a producing country more than, say, 25 per cent. of that country's average annual exports. This might be far from adequate as an "ever-normal" granary for some commodities. But, apart from this point, what is to happen to the stocks which the Control refuses to buy? The producing countries must presumably be allowed to market them for what they would fetch; the open market price would fall and the control would be left carrying a frozen surplus which it could only liquidate at a loss, unless a world shortage should develop. The memorandum also contemplates that there may be countries which remain outside the scheme. But if important producing countries, particularly subsidised producers to whom the level of world prices is of less interest than it is to unsubsidised producers, stand out, and from time to time sell their exportable surplus to importing countries, possibly at dumped prices, would not this similarly have a disruptive effect?

15. The difficulties might be met if all producing countries would agree to accept export quotas. This is the form of regulation which the U.S.S.R. prefer; they have categorically refused to accept any regulation of internal production or stocks, but have been willing to accept export quotas. If such a system were adopted generally, it would make a buffer stock scheme unnecessary. But, in fact, other producing countries do not adopt the same position as Russia, nor have they the same opportunities of absorbing variations of crop yields by increasing domestic consumption. A rigid system of export quotas would therefore create difficulties for them. Moreover, in order to safeguard the needs of consuming countries, the system must provide for reserves to be held sufficient not only to fill the agreed export quotas of each separate country but to enable deficiencies due to crop failures in one area to

/be met from

be met from another source. In fact, any scheme which aims at giving international effect to the principle of the "ever-normal granary" has to provide for the maintenance of adequate stocks, to equalise year to year variations in producing countries and to meet any sudden increase in demand. This need has been met in some of the more recently negotiated international commodity agreements, e.g. sugar and wheat, and in the national regulation schemes adopted by the countries party to those agreements, by providing for the maintenance of considerable stocks by the principal exporting countries, in addition to any stocks held by importing countries. It would greatly facilitate the operation of a buffer stock scheme, and it may well be essential to its successful operation, if not only the volume of production but also the stocks held by the various countries of each commodity taken up by the control, or at least any stocks likely to be placed on the open market, were the subject of international agreement.

16. It would no doubt be possible for all stocks to be carried by a Buffer Stocks Control and indeed this might prove to be necessary. If there is a buffer stock, other stockholdings will tend to be reduced to a minimum and the Buffer Stock Control must therefore be prepared to hold enough to meet world variations both in production and in demand, either of which may be very considerable. The buffer stock would probably, therefore, have to carry all the normal stocks for each commodity. In the case of many agricultural commodities, one year's volume of world trade is usually only a small percentage of total world consumption; so that a small change in total production may mean a very large change in the amounts thrown on to or taken off the world market. This is often the reason why (as stated in paragraph 3 of the Treasury memorandum) stocks often turn out to be insufficient. Such changes have to be provided for. Sugar stocks have, for instance, been for many years equivalent to about one year's world trade; wheat stocks are now as high as about three years' world trade. The chief disadvantages of the international holding of such large buffer stocks seem to be, (i) the amount of public finance required (and it may, incidentally, be difficult in practice to ensure that the financial relief given to normal holders of stock is reflected in lower prices and not in larger profits); (ii) the wide power which would have to be given to the expert management if the administration was to be efficient, which might be politically quite unacceptable; (iii) certain technical difficulties, e.g. that of making satisfactory arrangements for the prevention of deterioration of stocks held by the buffer stock control; (iv) the fact that internationally held buffer stocks would not have the same psychological value as a brake on over-production as nationally or industrially held stocks now have. It is true that there is great advantage in having stocks in strong hands, as they would be with a buffer stock control, and not liable to be thrown on the market when more than ample supplies are for the moment available, but this could also be largely achieved by having coordinated national stocks in each exporting country. The best approach would probably be, in the case of each commodity for which regulation is desirable, to examine whether nationally held stocks, or an international buffer stock, or possibly some combination of the two, is or is likely to be the best solution.

17. The final paragraph of the memorandum suggests that the buffer stocks 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 source of supply of raw materials". This seems a dubious argument. Any international control of stocks would not give the countries which need raw materials any better assurance that supplies would be available to them than a free market does; indeed, the organisation of a control would, as is suggested in the footnote to page 6, enable supplies to be kept out of the hands of aggressive countries. But in fact, there is no difficulty in regard to the availability of supplies and if any meaning is to be attached to the undertaking about free access to raw materials, it is that the countries needing raw materials shall be enabled to secure the means of payment for them. The stabilisation of raw material prices would help to maintain purchasing power in producing countries, but this would not help the countries which need their raw materials unless the exporting countries are willing to give outlets for the exports of their would-be customers. The solution of this difficulty is to be found in the currency union proposal, rather than in the buffer stocks scheme.

/To sum up:-

To sum up:-

(a) The buffer stocks scheme proposed in the Treasury memorandum might be useful for the liquidation of war stocks in the case of commodities where the long-term position is reasonably stable, such as certain metals, and possibly wool, and thereafter to smooth out short-term fluctuations.

(b) As the memorandum recognises, the scheme is not likely to be applicable for long-term stabilisation in the immediate post-war years. In the case of most of the principal raw materials, price control through buffer stocks on the lines proposed would not be an effective means of regulating production and trade in the conditions which are then likely to exist.

(c) In the case of the chief agricultural staples and of many other primary products, production and consumption are not responsive to the world price, either for technical reasons or because of State intervention of one kind or another, and regulation of production and/or of exports and stocks will be necessary. In such cases a properly managed buffer stock scheme may be a very useful complement to a scheme of regulation; but in the case of crop commodities, it will be very difficult to administer and without regulation, it is likely to be a costly failure.

(d) Regulation need not, however, imply restriction, and on an expanding market the task of the regulation schemes would be to plan sufficient future production to meet increasing demands. The regulation schemes should be directed to encouraging economic, as opposed to uneconomic production, instead of basing quotas, as hitherto, largely on past performance and to securing increased consumption, particularly in those countries where the per capita consumption is now very low, owing to the high retail prices resulting from subsidies and taxes.

(e) Regulation of production in this sense would be of importance, not only from the point of view of the commodities as such, but also from the point of view of general economic recovery and particularly of the recovery of our export markets. The position was well summarised from this point of view in the report on Agricultural Protectionism of the Economic Committee of the League of 1935, a copy of whose conclusions I attach.

20th May, 1942. (sgd.) F.W. LEITH-ROSS

EXTRACT FROM LEAGUE OF NATIONS ECONOMIC COMMITTEE'S

Considerations of the Present
Evolution of Agricultural Protectionism:

1935

CONCLUSIONS:

(1) The principal industrial countries of Europe have been engaged since 1925 in stimulating the domestic production of agricultural commodities at artificially high prices. These high prices prevent consumotion from expanding and absorbing the increased production.

(2) In order to maintain high prices, the imports into these countries from the more economic agricultural producers have been restricted. The latter have to force their produce on the restricted world markets, with the result that world prices fall and, in an effort to recoup themselves for lower prices, they also tend to expand production, thus accentuating the fall of world prices.

(3) In view of the resultant decline in their income from exports, the agricultural countries have rectified their balances of payments by reducing their importation of manufactured products from the industrial countries of Europe (and also in many cases by depreciating their currencies and in some cases by defaulting on their debts).

(4) The shortage of manufactured products in the agricultural countries stimulates the development of local industries in those countries. These local industries then claim protection against the competition from the more efficient industrial producers in Europe and, in the course of time, tend to invade their export markets, thus forcing down the prices of industrial products in the world market.

(5) The distress created for the efficient agricultural producers by the loss of their markets for agricultural products in the main European industrial countries accordingly ends in distress for the efficient industrial producers of Europe, owing to the loss of their markets in the agricultural countries, to the general impoverishment of the whole world.