

THE TREASURY  
WHITEHALL.

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Great George Street.

April 27, 1942

Dear Roy,

Your Memorandum on Forthcoming U.S. Conversations

I find this very interesting, and it brings to a head a number of issues on which we have got to make up our minds. With a very large part, particularly of the earlier portion, I am in agreement. The comments which seem worth recording are the following:-

1. I agree with you that we should not bring forward our own troubles at too early a stage in the discussion. That would not be the appropriate introduction to the constructive schemes, and until we have some notion how sympathetic the Americans are to the schemes we shall have no means of measuring how serious our troubles are likely to be. This applies, not only to the nature of our troubles, but also to the possible protective means we might have to adopt to deal with them.
2. To your Anglo-American Service I have no objection of principle. On the contrary. But it seems to me to raise considerable diplomatic and practical difficulties, the seriousness of which I cannot easily judge. These relate particularly to the position (a) of Russia, (b) of the Dominions and (c) of the rest of Europe. You bring in Russia, though rather perfunctorily towards the end, saying that they can presumably participate at a later stage if they want. But it seems to me that you are essentially thinking of it as a new version of what you previously called the Anglo-American Condominium.

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Your idea is that it should be worked out by ourselves and the Americans alone, and only at a later stage should others be brought in. The same difficulty applies to some extent to the Clearing Union and the Commodity Scheme, and at the ministerial committee it was raised prominently in connection with the former. But it seems to me to arise more decidedly in relation to your proposed Anglo-American Service. If the Americans themselves seem disposed to this method of operation, it would certainly deserve to be considered very seriously. But, even so, on merits I am not clear how far it is right or prudent for us to distinguish ourselves too sharply from Russia and the Dominions, whatever we may feel about Europe. These difficulties about the position of other countries arise more particularly because you conceive this Service as dealing with relief and reconstruction, which I mention separately below.

3. You are quite right in arguing that the initial work of such an Anglo-American Service will be primarily concerned with relief and reconstruction. In view of what has happened in the Pacific and the Indian Ocean, this is more clearly so than it was even a short time ago. The damage effected there means that all over the world relief and reconstruction is likely to absorb all outside aid available for such general purposes for a considerable time to come. But this seems to me to make it more difficult to give to this country such a special position as you claim. How can you justify this for a country which, particularly in the early days, whatever may happen later on, so far from having any surplus resources available to help other people, may herself come very near

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to being one of the applicants for assistance? When one was thinking of a long-term programme applicable to undeveloped countries rather than to Europe, a special position to ourselves was easier to justify. It still is perhaps, so far as Asia is concerned; not so easily in regard to Europe.

4. It is not clear in your memorandum how conscious you are of the extent to which your proposal cuts across the preliminary scheme which Leith-Ross has been drawing up for relief and reconstruction. The position of that is that he is working hand in glove with the European Allies. There are also semi-separate conversations between ourselves and Russia. So far, not particularly through any fault of our own, the United States is completely aloof. Indeed I have felt in the last week that the plans were in danger of going a good deal further than was wise without bringing the Americans in. The Russians have appealed to us on the subject in a document in which even the name of the United States never appears. I am not saying that Leith-Ross is necessarily on the right lines. But obviously you are going to the opposite extreme, and the possibility of going to that extreme is already somewhat prejudiced by what has already happened.

5. I agree with you in thinking that the question of capital control should not be put in the forefront of the programme but should emerge at a later stage out of other discussions. On the other hand, I disagree most strongly with your view that the control of capital movements may very possibly be unnecessary, especially if a Clearing Union comes into existence. My points of difference

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can be listed as follows:-

(a) I do not agree that the question of the precise nature of the control we exercise over such surplus for investment as may be developed in course of time is more fundamental than that of hot money and, therefore, due for prior discussion. The majority of the countries concerned, and certainly ourselves, will have no such **surplus** in the immediate future. On the other hand, we shall end the war with somewhere approaching £2,000 of overseas liquid funds in London to which we cannot possibly afford to allow immediate freedom of movement. This is a subject about which we must speak as little as possible at the present stage for fear of increasing the tendency, which is already showing itself, towards an unwillingness to hold sterling balances. But for us some system for the control of capital movements is absolutely indispensable the moment the war is over.

(b) I am exceedingly averse to the idea that the Clearing Union should facilitate speculative movements by estimating their amount and then apparently behaving as though money which had gone abroad and been turned into a foreign currency still remained as part of the effective reserve of the country from which it has fled. In my opinion, this would tear to pieces the reliability of the Clearing Union Scheme and makes no sense to me whatever.

(c) I see no reason to feel confidence that the more stable conditions, e.g. the partial remedy of the trade cycle and the prevention of sharp movements in exchange rates, will remove the

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more **dangerous** movements. These are likely to be caused by political **issues**. Surely in the post-war years there is hardly a country in which we ought not to expect **keen** political discussions affecting the position of the wealthier classes and the treatment of private property. If so, there will be a number of people constantly taking fright because they think that the degree of leftism in one country looks for the time being likely to be greater than somewhere else.

(d) You overlook the most fundamental long-run theoretical reason. Freedom of capital movements is an essential part of the old laissez-faire system and assumes that it is right and desirable to have an **equalisation** of interest rates in all parts of the world. It assumes, that is to say, that if the rate of interest which promotes full employment in Great Britain is lower than the appropriate rate in Australia, there is no reason why this should not be allowed to lead to a situation in which the whole of British savings are invested in Australia, subject only to different estimations of risk, until the equilibrium rate in Australia has been brought down to the British rate. In my view the whole management of the domestic economy depends upon being free to have the appropriate rate of interest without reference to the rates prevailing elsewhere in the world. Capital control is a corollary to this. Both for this reason and for the political reasons given above, my own belief is that the Americans will be wise in their own interest to accept this conception, even though its immediate applicability in their

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case is not so clear.

(e) In my opinion you are grossly over-estimating the amount of our speculative profits through the pre-war freedom to remit money in any direction. The figure of £m200, if that is the correct estimate, is the aggregate of all gains during the period of a capital description, which Leak's balance of trade figures deliberately leave out of account, since they only pretend to cover current transactions. They include, for example, the fortunes of American heiresses, capital funds transmitted to this country for charitable or similar purposes, such as the Pilgrim Trust, the Rockefeller money, the Dartington Hall Trust, etc. They include the fortunes accumulated by Englishmen abroad as, for example, our merchants in India, subsequently repatriated, if the maker of the fortune or his heirs return to residence in this country. They include the profits of our merchants, acting not merely as agents but as principals. I have myself stressed the importance of the item of actual capital profits through investment, but I have never supposed that these could be responsible for anything approaching the whole of the £m200 arising from capital gains and increments of every sort and description.

(f) As you know, I have no objection in principle to some formula, if one can think of a sensible one, on the lines of your Annex II. This seems to me a detail which we can discuss when we get down to details. Meanwhile I have not been able to understand just how your new proposal would work out in practice,

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so I am unable to judge whether it would lead to reasonable or to unreasonable consequences.

Let us suppose that a country has a debit index of  $\frac{1}{4}$  and that the world debit index is  $\frac{1}{2}$ . If the world debit index increases to  $\frac{3}{8}$ , does this entitle <sup>the</sup> individual country's debit index to increase to  $\frac{3}{8}$  or to  $\frac{5}{16}$ ? I cannot work out practical examples without knowing the answer to this question. But there is a further difficulty, whatever the answer may be, namely, that your formula deprives a country of any security as to the potential amount of its overdraft unless it is made, not alternative to mine, but as capable of giving a different higher limit. Otherwise a country, without having changed its debit balance at all, may suddenly find itself breaking the rules simply because other people's debit balances have gone down. There remains the objection that, so far at any rate, the formula is unintelligible to the ordinary man, and no-one can see what it means in practice. Whatever embroideries one may feel strong enough to pin on at a later stage, I think it undesirable at this stage to make so essential a feature of the scheme unintelligible to the average reader.

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J.M. Keynes