

1. Secret

AMERICAN CONVERSATIONS

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Outline of Strategy

30.6.42.

1. We fire off with the Clearing Union.

We base our procedure upon the Atlantic Charter and Article VII. Taking the latter, which is more specific, we find that positive measures to expand production, exchange and consumption precede removal of barriers etc. This, whether designed or not, is good (i) because one must tell people what positive measures can be devised for **their** assistance before expecting them to remove their defences, and (ii) because on the whole the positive measures require less wide-flung assent and commitment than the negative, and can therefore be executed at an earlier stage.

The Clearing Union is a positive measure; it is also an indispensable preliminary to both classes of measures. It provides the bare framework of order necessary for planning other positive measures, and a basis of finance, if needed; and it provides an immediate relief from foreign exchange difficulties which might otherwise obstruct the removal of barriers.

There is thus a sound logical case for taking it early.

2. We hope that the Americans will accept it. We have it in mind that its constitution and powers may have to be severely knocked about to meet their point of view. It is put forward as an illustration, not an unalterable plan.

But supposing that the Americans do not like such an institution at all? Strong arguments have been advanced in favour of an institution of some such kind, which I need not rehearse. I think we should fight hard for it - and with some confidence. The Americans ought to be willing to accept it. But supposing that they are not?

3. If we reach this point of disagreement, we ought to revert to the fundamental principles which the Union embodies. These principles are more important than the Union itself and may, I suggest, be reduced to two.

(i) We need a permanent, reliable and semi-automatic mechanism by which the onus of securing an even balance of payments between nations is shifted to the creditor countries, so that an uneven balance shall not normally impose the necessity of deflation, or other internal disorders, upon the debtor countries nor compel them to adopt un-neighbourly measures externally. I call this the first principle.

(ii) We need an anonymous source of funds from which advances may be made for international projects. I call this the second principle.

An institution, (Clearing Union), however desirable in itself, is not absolutely indispensable for either of these principles. They could in the last resort be secured by a charter embodying rules of operation for the central banks of the signatory countries.

4. On the first principle we must take our stand absolutely. If it is not favourably received in the "conversations", we must press it, none the less, again and again and, if necessary, at the highest level. The evil it seeks to remedy is by general agreement the greatest cause of international economic difficulties, and I do not see how the Americans can pretend to be willing to co-operate if they do not accept it.

It has sometimes been argued in discussion that this or that plan will only work if we have the Clearing Union. I think that this is usually putting it too narrowly. In our very proper zeal for the Clearing Union, it is important not to forget that even without it we may get the "first principle" accepted. And it is really on that acceptance that the success of most of the other measures depends.

But, though not necessarily amounting to a Clearing Union, the mechanism must be permanent and in part automatic, embodied in a charter to which the signatory countries are pledged for a long term. I contrast this with ad hoc grants of credit for specific emergencies, which would provide no radical cure, and, if anything, injure the long-run outlook by undermining confidence.

The case is so overwhelming and the pressure from us will, I hope, be so strong, that I think that the Americans are bound for very shame to accept it. But if they do accept it, the greater part of the battle is won.

5. The second principle flows automatically from the first. Even if there is no Clearing Union, whatever serves in its stead to embody the first principle, let us call it a Mutual Central Banking Charter, would provide a means of international credit creation, which would give a sufficient credit basis for all international schemes likely to come forward. Thus victory as regards the first principle really entails victory as regards the second also.

6. I argue, therefore, that there is nothing in the second principle likely to lead to a tussle with the Americans if they accept the first. This is a point on which there is apt to be a rather important mis-conception.

It is argued for instance that the Americans, if they are in credit at the Union, will not wish to see their good American money parcelled out by a joint committee, but will prefer to use it for American-sponsored, American-controlled and American-profit-bearing projects. Against this argument I bring two minor points and, thirdly, a quite decisive one.

(i) It is not fair to call it American money. We hope that the Union or Charter will be durable. It is any one's guess what the balance of payments will be at the end of twenty years. It may be "American money" in the early years, but it is quite likely to be some one else's later. In such a scheme we take the rough with the smooth.

(ii) It seems doubtful whether any Administration would prefer American to internationally controlled schemes of investment. They do not presumably want their private citizens to make imprudent investments as in the twenties. But if it is a question of government sponsoring, do they really wish to get Congress to approve, or anyhow to have to publish orders, giving \$500 million for raising the nutritional standards of backward peoples, \$500 million for Balkan development and so on without end? Would it not be simpler for them to get Congress to approve membership of the Clearing Union and have done with it?

(iii) But the main point is this. We do not have to ask the Americans not to have American-sponsored, American-controlled schemes. We do not have to ask them not to use their own money in the way they like best. On the contrary, let them use up all their credit at the Clearing Union on American-controlled schemes; we like that; it saves us bother; it is precisely the effect that we want to produce. The trouble in the thirties was that the Americans did not use their credit balance for American-controlled or any other schemes.

Thus there is nothing of control or power that we have to ask the Americans to sign away. On the contrary we give them an increase of power, if anything. For they will not only be able to use their credit balance, as before, for any foreign investment they like, but they will also be members of the Clearing Union which, quite apart from American money, has its own resources (see para. 7).

The Clearing Union, or an affiliated body, will be authorised to make such advances from time to time, as may be deemed necessary to sustain world employment and purchasing power. If the Americans are lending abroad in sufficient quantity, it may be able to lie dormant as an investing body. It will have to operate if and when the Americans do not lend enough. In particular it will be a guarantee to the world that should the Americans, having begun a great career of lending, suddenly abandon it owing to a change of internal opinion, the world will be cushioned from the shock, the international body being required to fill the void in accordance with the terms of its charter.

It seems, then, that in the case of the second principle there is nothing additional that we have to get the Americans to accept. We merely point out that it flows automatically from the first.

7. There is another (allied) misconception caused by the idea that the Clearing Union - may I leave out "or affiliated body" in future? - would be using "American money" for its purposes.

The Union should, and, I hope, would determine the quantity of its advances from time to time by reference to world barometers of the state of trade, of employment, of inflation or deflation. Its will to make advances should be determined by these circumstances; its power to make advances has nothing whatever to do with America or any other nation having a credit balance there. Its power is derived from being the central bank of central banks, or, if there is no actual Union, from the links between a number of central banks provided by the Charter, so that for this purpose they would together be one gigantic super-national central bank. This power would exist in equal degree, whether some nations had built up ~~by~~ credits, others being overdrawn, or whether it so happened that, the balance of payments having been even, no one had a credit or debit there at all.

What is true is that if no nation was accumulating credit, the Union would not be likely to wish to make advances. For an even balance of payments is fair, though not conclusive, evidence that the world economy is in a healthy condition, and does not need tinkering.

8. While it is clear that the second principle should give no cause of offence nor require any onerous concession or renunciation by the Americans, yet it is vitally important for us that it should be recognised.

Whether as a custodian of world prosperity or a country needing export markets, we require that world purchasing power should be maintained. This may mean from time to time a fertilising flow of money. To sustain the flow of world purchasing power, advances may be necessary. Pure American investment may be insufficient. This brings us back to Article VII with its measures to increase production and consumption. Presumably the Americans contemplate international co-operation in such measures.

It is quite hopeless from our point of view, if, every time that there is an international project of betterment, the hat should be passed round for specific contributions by each nation. We already see the difficulty in the case of post-war relief. For us it is essential that the source of funds should be anonymous as between nations. This is provided once the second principle is recognised.

9. After the Clearing Union, or, in other words, the "two principles" we come to the measures to implement the first part of Article VII.

If the second principle were not accepted, or, rather, the first, from which the second flows as corollary, we should need to be very cautious here out of regard for our pocket. But I take it that in this case we should not move on so far in the conversations; retiring in order to make a stronger attack on the subject of "the principles".

Once they are accepted, we should press for bold plans. The danger is that too little may be done for lack of imagination and sense of responsibility, and that fair words may petre out in action.

The power of the Clearing Union to create credit is in principle unlimited. But its provision of credit would be confined to that amount which it thought it advisable to create from time to time in view of the state of the world barometers<sup>x</sup>. The demand would come from the particular plans and projects. In the early years after the war the demand might well outrun the supply and we should have the familiar problem of priorities. In the long run the problem is more likely to be to find sufficient demand. This is the time at which we need plans laid in advance and sufficient courage of conviction to act boldly if a great depression is to be averted.

10. So far I have tried to underline the logic of what I understand to be the official policy. I here interpolate a paragraph of my own for consideration.

- x It should dilute its credit creation by the public issue of stock in a ratio also determined by general economic conditions.

This affects us particularly as a country which has to exchange secondary for primary products but may be of relevance also to the well-being of the world.

In the proper desire to see the world primed up to full activity, there is danger of encouraging an excessive drive to universal industrialisation. This is perhaps the most obvious way of getting things going, but not necessarily the most healthy in the long run.

Amid more doubtful propositions, Mr. Colin Clark does seem to have shown conclusively that as a nation improves her standard of living, the proportion of effort devoted to "tertiary production" always increases. "Tertiary production" is, roughly, distribution and services.

I conceive, therefore, that our post-war strategy in the broadest terms should be to encourage resources released from primary production to go straight to tertiary activities by-passing the industrial phase. Since "tertiary products" cannot be exported, regions which cannot supply their own primary products have to export secondary products in exchange; thus they are bound to devote an abnormally high proportion of resources to secondary production; the rest of the world should devote an abnormally low proportion.

The worst possible combination of trends for us would be restriction of primary production, a rise in the prices of primary products and a universal trend to industrialisation. These would have a cumulative effect in turning the terms of trade against us and impoverishing us.

If we are to co-operate internationally it should be with a view to exerting our whole influence against these trends. Actually to favour and promote them would be the final lunacy.

Our general rule, subject to suitable exceptions, should be to veto plans for international assistance to secondary production. Nations with their unhealthy infatuation for autarky, will do enough to help themselves along this line in all conscience. They will do far more than is good for us and probably more than is good for themselves. They need no international encouragement.

International schemes for raising "production exchange and consumption" should (a) invest capital in agriculture with a view to lowering costs and prices, (b) assist the movement inside agriculture from cereals to protective foods, the net increase in agricultural production being absorbed by the better diet of the people whose standard of living has risen, and (c) invest capital in communications, public utilities, housing, etc.

Ideally the effect of this should be: for the backward nations to enable them both to export food at lower prices and raise their standard of living; to enable them to absorb the labour displaced from cereals and other staple crops by the production of a more nutritive diet for themselves, and by an increase in "tertiary production" in part assisted and in part the normal result of their own higher standards; to enable them to continue to import a high proportion of the secondary products they need at a price lower than they could produce them for themselves; the discouragement of industrialisation would thus be to their own economic advantage; and also in many cases to their own advantage in social welfare. Ideally the effect for us would be: to improve the markets for industrial products and keep down the prices of food and materials.

This outline of policy is exceedingly sketchy. It is not fully practical, for in certain cases we shall have to recognise that the forces of industrialisation are too strong. Measures under Article VII will depend on detailed regional studies and take into account the very diverse conditions prevailing. None the less the idea that certain parts of the world should be induced to by-pass the predominantly industrial phase and proceed straight to a high level of tertiary production combined with good agriculture should be a leading one with us and may be found to have rather wide application.

In this connection may I say a word about the buffer stock plan? Detailed regional study required for action under Article VII will take time; "tertiary production" can only be a matter of slow growth; it will take some time for the world to settle down politically; it will take some time before we can prognosticate the most beneficial lines of development in many cases.

Because it is desirable and necessary to proceed slowly in schemes of development, I regard the buffer stock plan (along with internal measures in the United Kingdom and the U.S.A.) as the main possible instrument of defence against a slump in the decade after the war. If Sir Donald Ferguson is right in holding that it will not cause a reduction of output and might even increase it and that the controls, or some of them, would get cluttered up, I do not much mind; indeed I am rather glad. With Clearing Union, or similar, finance, we can think in terms of thousands of millions of sterling over a decade; there is no risk of insolvency.

I contemplate the buffer stock not only as a buffer in its own technical sense, but as a buffer to absorb surplus labour during the period when we are planning a better world. Let the primary producers go on producing primary products until we can give them something better to do and are sure what that is. The accumulation of some surplus stocks is a small price to pay for preventing hot-house industrialisation and maintaining good employment and decent livelihood in the period of transition.

If we have universal restriction schemes, which are so much admired for their efficiency in securing an actual reduction of output, what will happen to the displaced labour? Every government will be at pains, as the line of least resistance, to set up some industry to absorb it; and the detriment to us will be twofold.

On the contrary; do not let us be too squeamish about surplus stocks until we can bring the influence of our "international co-operation" to bear to secure a healthy change-over in agriculture and a development of "tertiary" industry.

I think we have got to persuade the Americans of the force of the arguments in this paragraph. If they take the reference to "exchange" in Article VII seriously, as we believe they do, we should be able to secure their support in damping down the trend to autarky.

Note. If, as we are told, the Americans intend to raise the question of international trusts as a major issue, we ought to make the case for restricting them from establishing affiliates in backward regions. This is the policy they now tend to pursue, despite the higher costs due to inefficient labour there, in order to avoid the incidence of tariffs.

11. To revert to the main thread of argument.

I suppose the Americans to have agreed to the "two principles". The arguments for the first are overwhelming and the second follows almost automatically from it. But if the Americans will not agree we must reculer pour mieux sauter. If the Americans agree, the English-speaking Dominions will come in also.

I suppose confabulation and the institution of regional studies about plans of development to implement the first part of Article VII.

I hope that we shall press for a buffer stock plan, on the ground that, even if not perfect in regard to all particular commodities, it gives us sure means for operating against a slump during the next decade, when the more comprehensive regional plans cannot have come to maturity.

With so much achieved, we already have the elements of world economic order within our control. We can prevent shocks arising from the short-period foreign exchange difficulties; we can liquidate bilateralism; we can remove some motives for hot-house drives to autarky; we can prevent a major depression. We can guarantee to statesmen a far more stable economic background than they had in 1918-1939. This in itself would be a great achievement and enable us to look ahead with considerable confidence.

12. This result can be brought about by the collaboration of the English-speaking world. And because it can be brought about, all wider "international co-operation" in this part of the field is a matter only of diplomacy and frills. It is important that this should be understood by all concerned.

13. If after Anglo-American discussion it is thought desirable to bring in Russia or any other power as a founder-partner in any institution that may be set up, we should follow the precedent of Article VII. We should first draw up and sign the charter of principles and then ask the other power or powers to become co-signatories, either after or, if diplomacy requires, before publication.

14. We now come to the later part of Article VII - reduction of barriers and elimination of discrimination.

In reaching agreement about the "two principles" we shall have signed away the more astringent forms of bilateralism (payments, agreements, clearings, barter agreements, etc.). There will remain the question of tariffs and preference.

Here of course we cannot make much headway until we have wider international discussions, though, no doubt, we should go as far as the Americans offer in the way of mutual concessions to each other.

This puts us in a strong strategic position, since in the very matter about which we feel anxiety, there must from the nature of the case be some delay, with concessions only to be made as and when a large number of nations can be brought into the arena of discussion.

Is there any danger that the Americans would wish to hold up the major plans until they have collected their tariff concessions? Surely not. It is most important to push ahead with the major plans and we can put it to the Americans that if the other nations see a new monetary system promised or, still better, in being, they will be much less stand-offish about tariff concessions.

15. But though we cannot do very much at this stage about tariff concessions, the Americans may expect us to say much in return for conceding to us our "first principle"; we may not only have to say much but also to say it in a way that carries conviction.

It is for consideration whether enough authority has been given to enable us to speak to this topic in a sufficiently encouraging way to give the conversations a good send-off.

I do not think that our protestations in favour of greater freedom of trade ought to sound hollow, since in fact they will not be, save perhaps for the sore subject of Imperial Preference.

16. I understand that we have not yet officially recognised Imperial Preference to be a form of the "discrimination" referred to in Article VII. We may be asked point-blank by the Americans.

The present trend of the war does not suggest that there will be much punch behind the purely political plea for a tariff-bound British Empire. However, in case something of this spirit still remains, would it be politically acceptable to name some specific figure, such as 10%, as a maximum preference? By putting a modest limit to our ambition and relieving America of the fear of our one day taking the idea of a self-sufficient Empire seriously, we might induce her to accept the limited figure as a political anomaly.

17. But there is a further problem. The value of our essential imports per head are exceedingly high, and we can make a good case for some kind of special treatment as an exporter. The idea of zoning export markets might be raised for discussion, although I believe that we should get less by such bargaining than by competition in the long run; and the Americans would probably not care for it. If they admit that we have a special position as an exporter entitling us to special treatment, might they accept the existing Imperial arrangement as the way of solving the problem that creates least disturbance?

Since all this is a matter of general protestation rather than specific commitments at this stage, the ~~franker~~ franker we can make our discussion of it, the more reassuring it will be. There seems danger that our representatives may lack something of frankness, because they dare not say anything which would appear to forewear old-fashioned and now totally obsolete ideas of Imperial unity.

18. I have composed this sketch of policy rather hurriedly. Much has been taken for granted and connecting arguments have been omitted. I have not spurned colloquialisms to convey my meaning. I only hope that I have not again condensed to the point of obscurity.

(Initialed) R.F.H.