

FOREIGN LENDING, INDUSTRIALIZATION AND THE CLEARING UNION

1. The Clearing Union scheme contemplates that changes in foreign exchange rates shall be the primary method of securing an equilibrium in the balance of payments between countries. In the extreme case these are to be followed up by sanctions against a country which becomes too heavily in debt. I was informed at the committee that it is not part of our policy to work towards a state of affairs in which there is no foreign lending at all (but see paragraph 2 below). If this is so, the equilibrium we seek to secure cannot be taken as synonymous with an even balance of payments on current or income account (I shall call this hereafter "balance of trade" for brevity).

Not much is said about the scale of capital movement which we should wish or hope to see, save that we should desire it to be subject to control. Nor is there indication that the scale, whatever it be, should be changed from time to time to fit in with changes in the balance of trade.

Now there is no doubt that the international gold standard, when it was operating at its best, provided a mechanism by which changes in the trade balance were cushioned and for considerable periods offset by movements of capital caused by those very changes. It is not clear that, if we are to get the new system to work smoothly, we can afford to dispense with a mechanism of this kind; it is not clear that adjustment of the foreign exchange rates is alone a powerful enough weapon to secure a balance in all circumstances; and the consequent growth of debits might be too widespread for the "sanctions" to be appropriate.

There is, therefore, a strong case for reviewing our policy regarding foreign lending at an early stage, since, until that is defined, the Clearing Union plan is in one respect incomplete and its effectiveness open to challenge. Furthermore, if we are to press for the control of capital movements, it is incumbent upon us to mention the principles which should govern that control.

It certainly would not be helpful or right to wait to refer this matter to an International Investment Board, should that come to birth. The terms of reference of that Board would be quite different. It would be concerned with sponsoring investment projects designed to reduce the trade cycle (in so far as the efforts of the Buffer Stock control were not by themselves sufficient), to combat any endemic tendency to under-employment on a world scale and to assist "distressed areas". It would entirely confuse its counsels and practice if it had also to look after discrepancies in the ever changing balance of trade, which should be part of the routine work of the Clearing Union. Such a proposal to delegate responsibility would reduce the Clearing Union to the status of a mere facade, and its crucial duty would be referred to another body. But even if that were done, we should still have to ask what principles are to govern the discharge of that duty. Until we have answered that, we cannot be said to have a clear conception of the elements of our system as a whole.

2. It is worth while pausing to consider the possibility that we ought in fact to aim at an even balance of trade, under which each nation is self-supporting on capital account. This would have the advantage of freeing our minds from the obsessing question - what is to be the end of all this lending? I am not,

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however, sure that the obsession is a very profitable one, since it is idle to plan for more than, say, thirty years. Far reaching social and economic experiments may occur within that period giving rise to quite new relations and problems. We know how Bolingbroke despaired of the future of his country because Walpole let the National Debt continue to grow when it stood at about £40 million! *Again it seems a little hard-hearted to deny to the rest of the world any benefits which they might reap from the disposal of the surplus savings of the richer countries.*

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~~All the same, there is much to be said for pressing the use of capital at home as far as it will go.~~ Professor Hansen, in his recent stay, explained that he was anxious for an international body to be authorised to advise governments on their internal policy, in order to strengthen those elements in the credit countries which favour public works expenditure. ~~So far so good. We should certainly favour such a policy.~~

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But we must not build too much on this. It is important to remember that the export balance of the United States (or any country with a persistent tendency to a credit position) is due to insufficient vent for savings at home. It is sometimes argued - why should the United States wish to press her exports upon the world, when she has such a magnificent market at her own doors? This is an altogether fallacious way of regarding the matter. If the citizens of the United States did not save she could certainly find employment for her whole people in producing for the home market. The trouble is that her citizens do save, and the tendency to an export surplus is an expression of the existence of surplus saving. Such a country can only cut down her export surplus without causing unemployment and depression if she can find an outlet at home not for additional consumption goods but for additional capital goods (or for consumption financed by "deficiency spending"). Unemployment and depression is an unsatisfactory alternative, and we cannot present it for American agreement as the right way of obtaining equilibrium.

In regard to finding a vent for surplus saving at home, we must remember that the United States has already gone far on these lines, though not so far as to solve her unemployment problem. She has had an Administration which for a number of years has eschewed further tariff building and sought an internal remedy by public works and all manner of "deficiency spending." How much further can we expect her to go?

D *such as Public Works and "deficiency spending"*
~~But we cannot count upon such measures being sufficient to produce an even balance. Whatever the answer to this question may be, it seems that we must not make our system for international equilibrium depend on nations adopting internal measures, that may be the subject of domestic political controversies. We cannot have our bulwarks against deflation jeopardised by the issue of a Presidential Election. That would not be an international system worthy of the name.~~

This method of reducing the equilibrium, then, should be favoured. But we cannot rely upon its being completely efficacious.
Consequently, the only alternative that remains to us is not-indeed to require but to tolerate the continuance of a favourable balance in countries as an outlet for their excess savings. But we must secure that this favourable balance does not oppress the rest of the world, compelling it to adopt measures of deflation or autarky.

After all, it is not inherently unreasonable that rich capital-sated countries should, failing ideas for the use of their own savings at home, make them available for use where they are more needed.

3. At this point in the argument it is necessary to revert to the proposition that the fostering of manufacturing industries, competitive to our own, is contrary to our vital interests and likely to damage our standard of living.

It would be idle, of course, not to recognize that industrialisation is proceeding and will continue to proceed apace in many parts. That is an adverse factor with which we have to reckon. Our consciousness of our own vital interest can, however, have influence on development to the extent that the new system to which we shall be a party has the effect of aggravating or reducing the trend to autarky. In the last resort we should refuse our consent to any scheme likely to aggravate that tendency, as well as to all specific plans by an international investment board or other body, formal or informal, for ~~encouraging or assisting~~ by any subvention, open or illicit, direct or indirect, the growth of industry in competition with ours. As the scope of all such plans of one form or another may be large, if we exert our influence strongly throughout, the total effect of it may be considerable.

Our general principle would be open to exceptions. There may be minor industries of a character harmless from our point of view, which would be a valuable balancing element in a primarily agricultural community. There may be an occasional black spot, "a distressed area", where some measure of industrialisation may prove the only available method of salvage.

It has been suggested that our danger is illusory, on the ground that every new industry established gives rise to an equal and additional demand for other industrial products, perhaps of a higher type. Does not this really rest on wishful thinking or a mis-reading of the phenomena of the last age of very rapidly expanding population? Is there any foundation for it in correct thinking? The wider diffusion of a technique must surely reduce its value. If this diffusion proceeded in the course of nature, so to speak, we should have some compensation, although not necessarily a full one, from the additional demand due to the higher standard of living among the people adopting it. But if the diffusion is artificially fostered, for instance to correct a balance of trade, and the industry is fundamentally uneconomic, it will not engender a higher standard of living at all - rather the reverse. This would make the matter still worse for us.

It does not appear that we are entitled to regard these considerations in a detached and academic spirit. To the future economic historian taking a broad view, the danger of our being crowded out of markets by the universal growth of industry, while our need to import is not one whit alleviated - but on the contrary tends to be increased by measures favourable to primary producers - will seem much the most outstanding feature of our position. "What says the record", he will ask, "about what our representatives did in planning the foundations of a new system to help their country in this paramount issue?" If the record shows no sign of their having thought out and pressed hard for favourable solutions, the economic historian will certainly be surprised. What will he say if he finds that they actually became parties to, nay proposed, plans for fostering these unfavourable trends?

Is there any reason why there should be a major conflict of opinion with the United States on this topic? Does not her interest really run with ours? She also wishes and needs to export. Is it not more advantageous to her own economy that she should export a steady stream of motor cars for thirty years, the

limit of period for which we may suppose that we are planning, rather than a vast mass of gear and technical knowledge now for setting up motor industries, and then nothing? It is true that her need to export is not so vital as ours. But until she solves her surplus saving problem, she will need to do some export trade in order to sustain employment.

Our own interests may seem to conflict here. We do not want to encourage the United States to rely on an export surplus as an important means of giving employment at home, because we do not want her to compete too keenly in the export markets. On the other hand, we do not want her to be so careless of her own future interests as an exporter as to further plans for limiting her own markets (which are also ours). Is it so much a conflict of interests as of finding a via media? We want to encourage her to rely mainly on the internal re-investment of her savings, while thinking of herself as a moderate but steady exporter. The continued presence of the United States as a moderate competitor, waxing and waning according to her internal balance in the supply and demand of saving, is not nearly so destructive to us as the creation of new local industrial capacity which once built will be there for good. The United States will always have to take her chances in competition; the local industries will be able to gain unlimited protection in their own markets from their own governments.

4. I believe that there is a straightforward solution to these related problems, at once conformable to our vital interests and to those of the United States, and at the same time the correct economic prescription for world prosperity.

This may be approached by reference to what strikes me as a most dangerous and unsound doctrine which may, however, gain ground. In the spirit of paternalist planning the international consortium, whatever form it may have, taking cognisance of the debit balance of some half the world, may think it right to see that those parts are provided with industries which will enable them to get free in a not too distant future from their debit position. Loans, it will be argued, should be carefully planned so as to enable the receiving countries to bring their borrowing to an end at an early date. Investment should be primarily directed to rectifying the trade balance of the borrowers. That this policy, by increasing autarky, will tend to enhance our own exporting difficulties is evident. What is also true, but not so evident, and it is our first duty to make it so, is that this doctrine is entirely inimical to the idea of an "expansionist" world monetary system (as well as to the idea of enlarging the scope of international commerce so dear to the State Department).

To attain clear thinking on this head, it is necessary always to bear in mind that the position of debit countries is the inevitable corollary and indeed the mirror image of the position of **credit countries**. In assessing a prescription for the debit countries, one should always ask how it will affect the credit countries. (We are concerned here with the general run of debit countries and not those abnormally indebted, for which see paragraph 7).

Now with regard to the credit countries, we have already seen that it is very difficult to predict. It is all a question whether they wish to solve and succeed in solving the problem of ploughing back the whole of their savings at home by capital works and deficiency spending. It would be the greatest folly to dogmatize on this matter and we must therefore consider both possibilities.

If they have the will and the means to solve it (in the comparatively near future), the debit positions will disappear automatically. There will be no need to devise special industries for the countries concerned. This solution means that the man power of, for instance, the United States would be so heavily engaged by their capital works and deficiency consumption that there would not be enough over to do more than provide for their own needs and produce just enough exports to pay for their imports. An export surplus would no longer be a vital need for them from the employment point of view. Thus the American export pressure would wane (and also the pressure upon politicians to increase tariffs) leaving room for more British exports and more local industries. This development would be healthy and not injurious to us. With the American supply of manufactured goods curtailed, and our capacity to supply limited, local industries would in the natural course of things become remunerative. No special measures would be needed to encourage them.

But we are bound to consider the other possibility, namely that the United States and other credit countries will not absorb their surplus savings at home and will find an export surplus necessary to reduce their own unemployment. This state of affairs should not be intolerable and burdensome to the rest of the world. It is only intolerable if one is trying to work a gold standard without adequate facilities for lending; in that case the export surplus and the consequent adverse balance outside compel the rest of the world to deflate, restrict and obstruct.

Now if in these circumstances efforts are made to provide industries for the debit countries, designed to redress their balance, in other words to prevent the credit countries having a credit balance by measures outside them, these credit countries are put into great difficulties. Either they are to acquiesce in an aggravation of their own unemployment, or they will have to struggle to regain their favourable balance, despite the outside pressure, by intensified export drives and subsidies, or higher tariffs. We might cry out in horrified protest. How disgraceful of these countries which still perhaps have favourable albeit declining balances of trade to increase protection! This attitude is as illogical as it is governessy. We should never forget how strong the movement for protection had become in this country by 1930, despite her stalwart ~~free~~ trade tradition of decades, before her credit position disappeared in 1931. We thought it good enough to argue that it was the only way we could see for reducing unemployment and were not at all impressed by the idea that it would be a dastardly thing for a nation to do which had a credit balance. If this was the case with us, is it reasonable to expect anything different from the United States, with a strong protectionist tradition and the possibility of a Republican government at any time?

Nor would she be at fault in equity. It is not necessarily the country that raises the first tariff which begins the trouble. It is just as mercantilist and un-neighbourly in spirit to foster uneconomic industries with a view to improving a trade balance. If countries are led on to do this by international grants, or cheap loans or technical assistance, or any other form of subvention, open or illicit, or merely by the philosophy of the international planning body which encourages them to take their own measures, the credit countries could plead that it was the debit countries which really

re-started the protectionist race. It should be the main plank of "expansionist" policy that credit positions are to be tolerated unless and until the credit countries by their internal measures make them disappear; no measures should be taken by the outside countries designed to compel the credit countries not to have a credit balance.

This of course entirely coincides with British interests. It is not for us to encourage countries to build industries which will relieve them of their debit relation to the United States, because those same industries will make it more difficult for us to buy our food and raw materials. It would be the greatest folly if out of a tender anxiety that the United States should not continue indefinitely to be in a credit position - an anxiety for which they will have no reason to thank us - we deprive ourselves of our very means of life.

5. Supposing then that it is agreed to tolerate the continuance of credit positions, the next question is what is the best mechanism for transferring the surplus savings. I submit that from every point of view the fittest instrument is the machinery of the Clearing Union itself and that credits and debits should be allowed to stand and accumulate there.

This would not involve debarring other forms of foreign loan. To do so would be to ask an unnecessary and therefore excessive sacrifice of the credit countries. Let us take stock of what is being asked of them.

It is sometimes argued that the Clearing Union puts part of the onus of securing the balance upon the credit countries. Onus is really not a happy word in this connection, for in fact the new system is designed both to re-bounce to their advantage and to give them an additional freedom of action not present before. One may say that under the old system they had the option of using their surplus to make commercial loans abroad, or to acquire gold and that under the new system the option would be between commercial loans and *bancor*. It might be argued that this was a deterioration *bancor* being a less secure asset than gold. But the comparison, so stated, is not fair. Owing to the American accumulation of gold, its international status was already becoming artificial and its future uncertain; furthermore the greater the concentration of gold the less available the gold option was becoming, other countries not having the gold to remit. In fact the only alternative to using the surplus for commercial loans was exchange embarrassment and consequent restriction by the debit countries tending to squeeze down the American credit position and eliminate it. Thus *bancor* will be a more eligible and practicable alternative than the fast vanishing one of gold remittance. By it we restore to the credit countries something very like the old option which they had of taking gold in the days when gold was still well distributed and the gold standard system was working with its best efficiency.

There is no need, as a condition of this easement, to withdraw from the credit countries the other option of making commercial loans *if* and in so far as remunerative opportunities offer. If we allow that, we can say with perfect truth that we are enlarging their freedom of action. And since the new system, if properly worked, will not set up restriction elsewhere, the credit countries will have the advantage of living in the environment of a more buoyant world.

While not insisting on the prohibition of commercial loans and investments it is worth while to emphasise the disadvantages in relying upon them as the principal method of disposing of the surpluses. I re-capitulate certain well-known objections:-

1. They will only be attracted by relatively high prospective returns. This may restrict their scope much below the level required.
2. An investment may give high returns without enabling the borrowing country to remit them abroad. While we do not want artificially to equalise the payments of ordinary debit countries, we should avoid an unnecessary aggravation of the disequilibrium.
3. Private enterprise is apt to proceed by fits and starts, being influenced by and thereby tending to aggravate the trade cycle.
4. Foreign governments may give protection to uneconomic industries with a view to attracting this money.
5. The investors may have scant regard for social welfare in undeveloped countries. Imperialist "exploitation" should be no part of the new system.
6. They may create war potential in regions which cannot yet be regarded as unequivocally peace loving.

Well then, it might be argued that we should create a wholly new option, in addition to that of the Clearing Union, namely the organisation by an international body of foreign loans equal in value to the export surpluses of the credit countries. There are certain objections to this:-

1. It is undesirable to multiply planning authorities beyond need.
2. It would confuse and embarrass the work of the international investment Board (or whatever the world public works corporation may be called) which has totally different aims and standards (see paragraph 9).
3. It might be thought that such an official body could discover a greater number of remunerative projects than private enterprise because the yield required would be lower; but this might well be off-set by the fact that the projects would have to be more respectable and secure.
4. It would seem likely to give rise to political fictions, and to that extent it would fail to reduce the propensity of debit governments to foster uneconomic industries in order to be rid of their debit position.

I rely mainly, however, on the two great positive advantages of the Clearing Union method;

1. The Clearing Union method does not aggravate the debit position of the borrowing countries. The one per cent charge may be regarded as negligible and even that could be reduced if debits were large. Official loans presumably at low rates, would not be so bad in this regard as private enterprise, but none the less worse than the Clearing Union method.

26 Under the Clearing Union plan the use of the funds is much more likely to be sound. They will be guided by people on the spot through the ordinary channels of banking and commerce to where they are most needed. They will probably be dispersed over each debit country in small rivulets. It may be much more *healthy* helpful to have just a little extra investible money well distributed among all the minor trades and occupations, allowing a little expansion here and there precisely where needed, allowing the country to develop its own resources in its own way according to its natural bent and in directions which those on the spot know from experience to be economic, than to have large schemes foisted upon the country by the heavy-handed foreign investor. ~~This appeals to me as a decisive point.~~

Finally I should add that the size of the disequilibrium on income account likely to occur after the war is often exaggerated. If credits reached formidable totals very quickly, it might be awkward. The United States annual favourable balance on current account in the period between the wars was of modest dimensions, only about £54 millions on average in the eleven years 1928-1938⁺. I do not see why, after her strenuous efforts, she should come to have a very much larger one. But if the United States does not have a formidable active balance, what other country is expected to? Where else shall we find the mighty nation that is to put the rest of the world into her debt? The fear that many nations will suffer from heavy recurrent adverse balances may thus be ill-founded. Experience does not warrant it. The trouble is that quite a small deficit may necessitate un-neighbourly action, which forces other nations to follow suit; trade barriers, like inflation, proceed in a vicious spiral, and the cumulative effects may be out of all proportion to the initiating cause. But quite a small annual lack of balance may, if it is always in the same direction, cause large accumulations of credits and debits after a number of years. Thus if the debit "quota" were regarded rigidly, a minor but continuous ailment would in time exhaust the power of the plan to alleviate it.

6. How far does the draft scheme already embody these ideas? It is of course open to various interpretations. Some like to think of it as only giving temporary relief and being in effect a world wide but limited moratorium under cover of which debit countries must fairly quickly contrive to cease to be debit countries. There may be one or two phrases which invite such an interpretation. But I assume that "the Bible", although inspired is not yet canonical, that the scheme is still fluid, tentative and open to amendment both in the light of the "conversations" and ~~generally that it would be altogether~~ inappropriate to regard its detailed wording as narrowly circumscribing our interpretation of its main intention.

If it were only designed to provide a moratorium, I should suggest that it ought properly to be handed over lock, stock and barrel to the organisation concerned with post-war relief and rehabilitation, regretting that after a year of deliberation we had still no long range plan to propose to the Americans.

On the contrary; this narrow interpretation would conflict with its general arguments - and its claim to be an important contribution. It is to be regarded as a piece of machinery which will gear in to our world monetary system and have a

+ Reckoned at £1 = \$4.86, United States Department of Commerce (revised figures)

radical and continuing effect on its mode of operation. It may indeed be regarded as giving a moratorium, not however to the debit countries, but to the credit countries, allowing them to continue their credit positions if they so will, for an indefinite period. All the analogy, with ordinary deposit banks points to this; there is no provision in deposit banking for securing that depositors in a certain region must ultimately find the means for applying their deposits to making goods in their own part of the country.

What of the provisions? Those for securing stable but flexible foreign exchanges are unexceptionable. We do not want credits and debits to accumulate simply because foreign exchange rates are not at the best equilibrium level. The notion of a debit quota should be useful in securing the right adjustment. But it is doubtful if it is appropriate as a criterion for the application of sanctions against a debit country; for this would imply that we are not willing to tolerate the continuance of credit positions, or that, if any lending occurs, it must be otherwise than through the machinery of the Clearing Union itself. Even a small balance on the side of the credit countries would after a term of years precipitate the application of sanctions to one half of the world! If the system is to tolerate lending and if the arguments are accepted in favour of the automatic Clearing Union mechanism as the one best fitted to direct it, we need some other criterion for the application of sanctions.

7. It appears essential to recognise the difference not merely in degree but in kind between debit positions which merely reflect the amount of credit which the credit countries desire to accumulate, and debit positions which are due to the special improvidence or impecuniosity of particular countries, and are out of proportion to the general average of debit positions. I call these excess debit positions.

These excess debit positions will be of two distinct kinds, requiring different treatment. Against those due to exceptional improvidence sanctions of the kind outlined in the draft scheme are appropriate; against those due to exceptional impecuniosity salvage measures.

It is most important that the exceptional nature of the debit should be precisely defined and so defined that it only covers a small fraction of the total area adhering to the Union. If sanctions have to be applied over a wide area, the system will be reduced to absurdity; if a large part of the world is deemed eligible for salvage measures, that must mean that the system is not working properly and it would be most dangerous to British interests.

Now it happens luckily that the Clearing Union gives a precise method, otherwise lacking, for deciding which are the genuinely excess debit areas. A formula can be devised (it is discussed in the Appendix) for picking out the areas which in relation to their turnover are getting more rapidly into debt than the general average of debit areas. The total excess debit area ought to be so defined that in total it does not come to more than 10% at the very most of the whole area clearing through the Union.

Now in the impecunious part of the excess debit area it may be appropriate to foster uneconomic activities as the only method of retrieving the situation. Such areas may be compared to "distressed areas" within a country. This country might be asked to waive her principle in such cases against industrialisation. Under the aegis of a definition by which the greatest possible amount of "distressed area" could not be more than a fraction of 10% of the whole this would not be dangerous.

The need for precise definition is really very great. The specious view that uneconomic industries should be fostered in debit areas may gain acceptance with some who, in weighing the case, have the known difficulties of an excess debit area (e.g. Bolivia after the tin is exhausted) in mind. One party to the argument holds that "everyone tries to make his difficulties out to be insuperable but that the general working of the economic law, especially in a system that is expansionist, will bring an adequate solution in time". The other party is convinced, because he knows of a special case, where it may be quite evident to a fair mind that the situation is irretrievable, that his opponent is a mere "doctrinaire academic economist". Both parties may be right. The distinction between a debit position and an excess debit position supplies the answer. In a properly geared system, the great majority of countries should find remunerative work (although not of course a favourable balance); but there may be exceptional cases. If we segregate those cases by a definition based on the facts of trade, as recorded in the books of the Clearing Union, we can bless salvage measures even if they involve uneconomic industrialisation in special areas, without the danger that every area that happens to run a debit will be able to make a plea for similar treatment, so dangerous, if widespread, to our exporting interests.

8. It may be well to re-capitulate the principles so far set out:-

(i) It is proposed to establish a new medium of reserve against international payments, bancom, which will restore to countries that freedom of manoeuvre which they had when the gold standard was working at its best.

(ii) While there is much to be said for all nations being self-sufficient on capital account and we are prepared to support all means of encouraging credit countries to plough back their surplus savings at home, we recognise that they may have difficulty in so doing. Furthermore we feel that an international system should not depend exclusively on the continued pursuance of internal policies that are novel and bound to be the subject of domestic political controversy. Consequently we must contemplate the continuance of credit positions and arrange matters so that they do not cause deflation elsewhere.

(iii) In pursuance of the policy of tolerating credit positions, if they arise, we discourage all ordinary debit countries from artificially fostering any industry merely designed to improve the balance of trade, recognising that such fostering is identical in principle with raising trade barriers. A fortiori we should refuse to be party to any international plan for this purpose.

(iv) To safeguard the system from abuse, we should adopt a precise definition, based on the books of the Clearing Union, for segregating excess debit countries from the ordinary run of debit countries. The definition would be so devised that the area in excess debit would normally be at most 10% of the whole area clearing through the Union. The cases of excess debit countries would be referred to the appropriate body for decision whether their condition was due to financial recklessness, in which case the sanctions clause would be applied, or to genuine lack of resources, in which case salvage measures, including if necessary the fostering of uneconomic activities, would be more suitable.

(v) While not excluding private enterprise in foreign investment (albeit, if necessary, subject to control), we should recognise the Clearing Union itself as the appropriate channel through which most excess savings would flow to the debit countries. The credit countries would accumulate a perfectly liquid asset in bancor, realisable in principle at any time, and in practice whenever circumstances had so changed that credit countries became able to have an unfavourable balance. This asset though unremunerative would be no more so than gold, and the credit countries would not be debarred from finding more remunerative foreign investments, if they could. The debit countries would have the advantage of having surplus savings made available for them through their own banking system to be used for their own purposes whenever the need arose and diffused in small amounts to appropriate points all over the country. This would serve them better than a few large investment projects sponsored and directed by unsympathetic foreign profit-earners, bankers or officials.

These principles appear to me to constitute an outline of a coherent and acceptable international system. They have moreover this cardinal advantage. They give no encouragement whatever to uneconomic industrialisation; indeed by removing foreign exchange pressure from the majority of debit countries they would remove the most important single motive that has recently been driving countries in this direction so unfavourable to us.

To complete the picture it is necessary to touch upon two more topics, (i) the unemployment problem and (ii) standards of living.

9. Just as a particular country may have a surplus saving problem, so may the world as a whole. There is not agreement how far this is in fact likely to be an endemic world problem. Happily it is not necessary to reach agreement on this issue before making plans. That there is a world surplus saving and unemployment problem in the recession phase of the trade cycle is generally admitted. The body concerned with it would therefore be well advised to prepare projects primarily against recession, with the arrière pensée however that some investment, although not so much, might prove to be needed in good times as well as bad.

In Appendix III of R.P.(42)2 there is a proposal for such a body, entitled an International Investment Board. It may be that this title is ill chosen, since it might be supposed to indicate that this body was concerned with investing the surpluses of credit countries in the industries of debit countries. It is explained that the primary purpose of the body is to do for the world what a Public Works Board does for a particular country, and International Public Works Board might be a better title. Its object is to see that when private enterprise and the public works activities of governments between them do not use up potential ~~productive capacity~~, so that effective demand in the world as a whole falls short, additional capital projects are carried out so as to keep world activity well primed. It is an ingredient needed in any system that aims at guaranteeing expansion.

In the wording of the appendix, which of course does not even claim to be inspired, still less canonical, there is reference to the easement of the credit/debit position. Careful reading, however, will show that this *only* relates to what might be called the funding of credit positions, and there is no hint at all of the idea that the investment should be directed to making the debit countries cease to be debit countries. Had I appreciated that this idea, most ill-judged as I conceive it, was so much in the air, I might have thought it wise not even to refer to the general credit/debit problem.

If its purpose is properly defined at the outset, there should be no danger of the International Public Works Board providing cheap money for industries injurious to us. Its purpose is to increase net capital outlay in the world as a whole, if and when necessary; like any Public Works Board it would have to seek out projects which while not commercially remunerative may be deemed economically advantageous by their indirect effects. Scope is usually found in communications and public utilities and, if welfare is stressed, in housing. It would obviously be quite inappropriate and improper for such a body to assist the creation of industrial capacity in country A to produce goods formerly supplied by B. This would mean expanding employment in A at the expense of B. Any such project would be automatically vetoed at the outset. An exception, however, would be allowed in favour of countries which had been certified by the Clearing Union as in excess debit and had been investigated by the Board to make sure that their condition was due to lack of resources and not to financial recklessness. Again there is an analogy with a national Public Works Board which may take special measures for the benefit of a "distressed area". But it must be emphasised that this can only be allowed if there is an objective definition, such as could be supplied by the Clearing Union, of excess debit; ~~also~~ all countries not receiving such special treatment would have a grievance.

By proper instructions, therefore, we should be able to remove the danger of the International Public Works Board engaging in activities detrimental to us. But that is putting the matter too mildly. It is of great importance to have such a body. The proper management of foreign exchange and foreign lending by the Clearing Union should give great easement and release the natural forces of "expansion". But we cannot be sure that those natural forces will be strong enough to prevent chronic dolldrums in the world, to say nothing of the urgent trade cycle problem. British interests are especially affected. As a great exporter it is essential to us that our markets should be active, that world employment should be well keyed up. Furthermore unemployment is second only to foreign exchange difficulties in impelling countries towards autarky. As we wish to prevent that, we should have an alternative recipe not only for foreign exchange difficulties but also for unemployment. That would be provided by the Public Works Board which would inject new purchasing power as needed from time to time.

Its finance should rest upon the basis of the Clearing Union. But it is strictly wrong, as I have already urged, to think of it as using the credits of the credit countries. Those credits are automatically used up in financing real capital increase in the debit countries as and when they become overdrawn, and it would be double reckoning to suppose that they are also available for international public works. Funds can be found for public works (i) by "credit creation" and (ii) by raising money from governments or, better, by the public issue of bonds. In what proportions the Board uses these two sources should not be prescribed in advance. The world need for additional effective demand (public works) and the world need for more liquidity (credit creation) are related, but not identical. The Board should regulate its provision of each by reference to the appropriate barometers. (This is the kind of thing we ought to mean by "world planning"!)

10. Raising standards of living. In the last analysis this can only be done by making people more efficient. International labour conventions and agreements may be useful in eradicating particular abuses, but cannot avail to give more cake than is produced.

This does not mean that no international assistance is possible. People can be taught to be more efficient, and an international body could supply technical assistance along with the necessary capital.

The most natural way of proceeding is to teach people to do better what they are used to doing already. I understand that there is no lack of scope in backward regions for improving methods of extraction. This chimes in happily with the aspiration now in vogue that nutritional standards should be raised. I am sure that it agrees with what is wanted for social welfare and happy living among less advanced peoples. It is also in accord with British interests. Improved methods of extraction will enable the populations concerned both to live better and to sell their produce (to us and others) more cheaply. It is objected that this will cause an increase of output for which there is no room. But part of the extra output will be absorbed by the better nutrition of the producers who will have given themselves the power to enjoy a higher standard, and part will be taken by the enhanced world demand due to the easements of the new system. This second is difficult to gauge, but we have no grounds for premature pessimism. It has been observed that the demand for industrial crops should be especially elastic. If there is still a residue of displaced labour this may be absorbed to some extent indeed by minor balancing industries and for the rest in "tertiary" activity (communications etc) which the Public Works Board will always be ready to assist if there are signs of an unemployment problem.

Thus there is no reason why the idealism which seeks to assist the backward and distressed should be twisted so as to produce effects injurious to us. An anthropologist should be associated with every committee concerned with teaching backward peoples to be more efficient. He will not recommend premature industrialisation.. In backward countries that means not the Slough Trading Estate but conditions worse than we had the privilege of living through in the early days of the Industrial Revolution.

We are much too ready to accept the plea that there is excessive primary production. On the contrary; so long as we have difficulties with our balance of payments, we ought to insist that there is excessive world industrial capacity for producing goods for which we have idle plant and skilled man power. I am convinced that with world trade in equilibrium at a level of good employment, we, as a rich capital-sated country, should be on the credit side. We do not seek a large credit position. By a radical policy of deficiency spending at home we may just be able to give full employment - and we must make every effort to give it if we are to avoid social unrest-without a large surplus. But only just. Until therefore we have a well established easy balance of trade inclining to the credit side, we should take the line that we cannot be party to any plans for increasing capacity of which we have an unused supply.

11. I emphasise that in this kind of planning it is essential in every connection to have regard to the balance of supply and demand in the system as a whole. This is not to deny that regional studies should be carried out at an early stage. I hope that the very first "conversations" will lead to the formation of joint Anglo-American committees to draft reports on each region, not in the detail appropriate to the peace-time investigations of Professor Hansen's "World Resources Survey", but giving broad quantitative indications of the scope of possible public works and improvements in the extractive industries. But regional planning must be controlled by general principles relating to the world balance; otherwise the solution of a regional problem will itself create a problem in another region. Thus for instance plans should not be designed to rectify a regional balance of payments unless it is clearly established that the region in question will be in "excess debit."

It may be asked whether all this implies a planned order or a reversion to laissez-faire. It certainly implies a planned framework of order, it would be inappropriate to go beyond the framework in this early stage. The choice whether the production and distribution of everything to the last lipstick are to be planned and controlled or whether there is still to be some scope for private enterprise is left open. Indeed it must be. Different nations will no doubt want to choose differently and an international system worthy of the name must not so far interfere with the internal affairs of nations as not to leave that question open. But one thing is certain. This planning of a world framework is an indispensable preliminary to effective detailed planning. As in the case of regions, so in the case of commodities, whether crops or lipsticks, detail planning merely sets up new problems in another field and is finally self-defeating, unless it is conducted within the framework of a world plan which maintains the total world balance between supply and demand, between capital creation and saving.

12. With some diffidence I should like to add a word about tactics.

I submit that the foregoing note gives a sketchy, but none the less coherent outline of what we wish to happen. If we know that, we have won half the battle. I do not think that there is any major conflict of interest with the Americans. There may be minor conflicts. A Treasury member observed with undeniable justice that the Americans regard trade practices

as objectionable if they hurt their interests and we regard them as objectionable if they hurt ours. In our efforts to agree upon the general pattern, detailed questions about kinds of trade barriers should recede to a secondary place. There may be a conflict with some incompletely thought-out ideas now in vogue in the United States. It would in itself be a great source of strength if we could meet any incoherence of this sort by our coherence.

If our main interests do really lie together, as I conceive them to, there is much to be said as a matter of tactics for stating our whole case frankly at the outset, including our attitude to industrialisation.

There is no doubt that the Americans nurse strong suspicions of us. These rest mainly, as I understand, on the belief that we are wily and cynical members of the old world stock and apt to play a clever game which will trick them in the end. The best antidote to this is to be obviously stating our whole case with full emphasis upon our own interests.

The Americans have one great virtue which we should do well to exploit. In the whole world of ideas, of science and letters, they have a faculty for "spotting the winner", giving praise and recognition to British people where it is due, while we ourselves limp falteringly at a long distance behind. But in this world planning we have a battle of ideas much more than of interests; our adversary is not the other nation but the old Adam in all of us. In this contest the Americans are likely to be stronger than we are ourselves in support of our own constructive ideas. The Clearing Union scheme as now drafted seems to be a little too cautious, as though it were the Americans who had to be broken in to new ideas with kindness in gradual stages. For this reason I suggest that we should follow the Clearing Union up as soon as possible by further proposals for dealing with the foreign lending question which it leaves unsettled.

APPENDIX

DEFINITION OF "EXCESS" DEBIT COUNTRIES.

I do not wish to challenge the view that the occurrence of "ordinary" debits is a good criterion for recommending changes in the foreign exchange rates. The criterion may by itself be insufficient*, but this is a technical matter not involving clashes of principle and may be left to be handled at a later stage in the planning of the Union or during the course of its operations.

*For instance in the case of a debit country with full employment at home, the stimulus to its exports afforded by exchange depreciation might cause a disproportionate rise in its internal prices and an actual aggravation of its debit position. Domestic monetary contraction or public economy may be the only remedy for her. The converse case must also be admitted, though with our uncharitable feeling towards credit countries, we may be loth to do so. A credit country suffering from internal slump might find that exchange depreciation not only benefited herself but by its stimulus to domestic investment activity actually reduced her credit position.

What is important is that the accumulation of "ordinary" debits should not be discouraged, and that sanctions should be applied. (as suggested by the clause in brackets in para. 85 (4)(c)) only when countries are in "excess" debit, i.e. when they are out of step with the average of debit countries.

One way of defining the class to be penalised (excess debit countries) would be to add after "year" in line 2 of 85 (4)(c) the words "and represents a fraction (or multiple) of its quota not less than three times that represented by the average indebtedness of all members." To this a footnote could be added stating that the fraction (or multiple) showing the average indebtedness of all members is found by dividing the sum total of the indebtedness of all members by the one half of the total of the quotas of all members (whether in credit or debit).

There is another way of reaching a similar result which has attractions. It has already been observed that a large cumulative total may be reached through small annual deficiencies if these are persistent. There is much to be said for the view that the record of past history constituted by outstanding cumulative credits and debits has no great relevance to what it is expedient to do on a given occasion, and that it would be more sensible to have regard to the rate at which debits are increasing. Thus under the present plan a country which having had large debits had reached a much more favourable position might yet be brought within the arm of sanctions by the addition of some comparatively trifling additional debits.

Thus it might be laid down that a country would become liable to the provisions of 85 (4)(c) if it increased its debit balance by more than 15% of its quota in a year (or for 15% we might substitute 10% in an ordinary year and 20% in one declared by the Economic Council to be one of world trade recession).⁺

Thus bygones would be bygones, but the credit countries would know that they could always utilise accumulated credits as soon as a turn of events occurred which made it possible for them to do so.

It is evident that many different kinds of formula could be devised. The ideal would to combine the formulae proposed above so that a country would be in excess debit if it was increasing its indebtedness at three times the rate of the average of debit countries. Such a mixed formula might be rather too complex to be included in a first draft. What is essential is the recognition that a nation shall not be penalised for having a growing debit, provided that the rate of growth is not out of line with that of the average of debit countries.

⁺The illustrative figures given here are based on the assumption that the quota is equal to the sum of the country's annual exports and imports on the average of three years. (cf. 85 (2)).