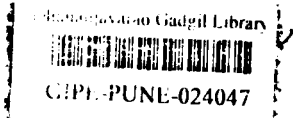


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JOINT COMMITTEE
CARNEGIE ENDOWMENT-INTERNATIONAL CHAMBER OF COMMERCE

**THE IMPROVEMENT
OF
COMMERCIAL RELATIONS
BETWEEN NATIONS**

**THE PROBLEM
OF
MONETARY STABILIZATION**



Separate memoranda from the Economists consulted
by the Joint Committee and practical Conclusions
of the Expert Committee appointed by the Joint Committee

Headquarters of the Joint Committee :
INTERNATIONAL CHAMBER OF COMMERCE

38, cours Albert I^{er}
PARIS VIII^e

**THE IMPROVEMENT
OF COMMERCIAL RELATIONS
BETWEEN NATIONS
and
THE PROBLEMS
OF MONETARY STABILIZATION**

JOINT COMMITTEE
Carnegie Endowment-International Chamber of Commerce

SEPARATE MEMORANDA
from the Economists consulted by the Joint Committee
on
**THE IMPROVEMENT
OF COMMERCIAL RELATIONS
BETWEEN NATIONS**
and
**THE PROBLEMS
OF MONETARY STABILIZATION**
followed by
the Practical Conclusions of the Committee of Experts

JUNE 1936

2^d EDITION

Headquarters of the Joint Committee :
INTERNATIONAL CHAMBER OF COMMERCE
38, cours Albert I^{er}
PARIS VIII^e

PREFACE

The following Declaration was made by the Joint Committee of the Carnegie Endowment for International Peace and the International Chamber of Commerce at a meeting held on June 25th, 1936 :

The Carnegie Endowment for International Peace and the International Chamber of Commerce having separately passed resolutions affirming that Peace, Trade and Human Happiness lie along the same road, and having joined to consult economic experts of many nations and of diverse views as to how and by whom and what immediate action can be taken to strengthen the will to peace, to stabilize currency and to restore trade, the reports and conclusions of their experts are now submitted to the Carnegie Endowment and the International Chamber for detailed consideration without delay.

The series of 30 memoranda contained in this book have been prepared by 17 economists from various countries, at the invitation and on behalf of the Joint Committee of the Carnegie Endowment and the International Chamber of Commerce. The purpose and composition of the Joint Committee is explained in the Introduction.

In the preparation of these memoranda, the Joint Committee had the assistance of a Committee of Experts composed of six eminent economists who were responsible for the general direction of the research undertaken.

On the basis of these memoranda, the Committee of Experts have drawn up a set of conclusions, printed at the end of this book, in which they set out those solutions and recommendations which appear to them of the greatest immediate practical interest.

In view of the gravity of the present world economic situation, the need for finding rapid solutions and the individual value of the opinions expressed in these various memoranda by outstanding economists of the day, we believe that it is of public

interest that their work should be made available without delay.

It must be clearly understood, however, that the Joint Committee, as well as the Carnegie Endowment and the International Chamber of Commerce, in publishing these memoranda, express no opinion on any of the expert's views, and reserve their entire liberty for the formulation of their own practical recommendations in regard to the problems dealt with in this book.

Signed :

Nicholas Murray BUTLER,
President of the Carnegie Endowment
for International Peace;

F. H. FENTENER VAN VLISSINGEN,
President of the International Chamber
of Commerce

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The improvement of commercial relations between nations

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The technological, long-term factors in the reduction of the volume of overseas trade :

(a) The replacement of overseas supplies by " home-grown " products (e.g. agricultural changes in Continental Europe). What has been the economic cost of self-sufficiency ?

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4. Experiences with bilateral treaties, both with and without the most-favoured nation clause; a study of actual experiences
5. The place of regional pacts :
 - (a) The British Empire since Ottawa;
 - (b) The efforts made towards a greater freedom of trade in Central Europe.
6. The problem of reducing the level of tariff rates by means of international agreements covering particular groups of articles.
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INTRODUCTION

Brief summary of the work accomplished by the Joint Committee

By two resolutions, the first of which was adopted at the International Conference held at Chatham House, March 5th 1935, under the auspices of the Carnegie Endowment for International Peace, and the second at the eighth Congress of the International Chamber of Commerce, held in Paris from June 24th to 29th, 1935, it was decided by these two organizations to collaborate in an exhaustive survey and study of the principal aspects of international economic relations. Following this decision, a Joint Committee Carnegie Endowment-International Chamber of Commerce, was appointed by these two bodies. At a first meeting held on October 8th, 1935, the Joint Committee agreed to call upon a Committee of Experts to prepare the technical basis on which they would ultimately found their own opinions and recommendations. It was further agreed, at a second meeting held on November 16th 1935, to limit the Joint Committee's present investigations to the two main problems of the *removal of trade barriers* and *monetary stabilization*, whereupon the following statement was adopted, as constituting a summary of the guiding principles to be followed by the Committee in its work :

CURRENT PROBLEMS OF ECONOMIC RELATIONS BETWEEN NATIONS

The International Chamber of Commerce which was called into existence by the businessmen of the world for the promotion of international economic intercourse, and the Carnegie Endow-

ment created for the purpose of assisting efforts towards the maintenance of peace, believe that economic dislocation leads to worlds impoverishment and this in its turn is a fruitful source of conflict between nations. They therefore think that there is no more urgent task than an examination of the conditions which would most immediately contribute both to economic improvement and to a more harmonious state of international political relations. It appears to both these bodies that the following subjects should in the first place be subject to expert investigation.

The improvement of commercial relations between nations and particularly the conditions under which it may reasonably be expected that existing barriers of trade can be lowered including a study of the technique by which this end can be most effectively reached.

The improvement of monetary relations between nations and more particularly the conditions under which a satisfactory currency stability can be attained internationally.

These problems of course do not exhaust the field of investigation of the economic relations between nations which influence both prosperity and peace. There are, for instance, the questions of internal planning in its relation to international intercourse; the question of raw materials in all its complex implications; the whole problem of population and immigration, and so on. But the International Chamber of Commerce and the Carnegie Endowment are of the opinion that the two problems specifically set out above should be attacked in the first place. Any solution found for these problems would not only greatly help towards political pacification and economic recovery, but would make a solution of the other problems ipso facto the easier.

It was finally decided that the work to be undertaken by the experts should be divided into the four following parts :

1. Firstly, a series of separate memoranda dealing with the Improvement of Commercial Relations between Nations;
2. Secondly, a series of separate memoranda dealing with the problem of Monetary Stabilization;
3. Thirdly, a general report by Professor Ohlin, of the University of Stockholm, on "The Problem of International Economic Relations";

4. Fourthly, a final report of the Committee of Experts, by Professor T. E. Gregory, of the University of London, stressing the remedies capable of bringing about a more orderly state of affairs.

These reports, once approved of by the Joint Committee at a third meeting (June 25th 1936), constitute the basis upon which have been laid the practical recommendations formulated by the members of the Joint Committee at a fourth and last meeting (August 4th 1936) and published in the press after their approval by the Council of the International Chamber of Commerce and the Trustees of the Carnegie Endowment for International Peace.

The Joint Committee is composed as follows :

Chairmen :

- Dr. Nicholas Murray BUTLER, President of the Carnegie Endowment for International Peace.
- Dr. F.H. FENTENER VAN VLISSINGEN, President of the International Chamber of Commerce.

Members :

- Sir Alan A. ANDERSON, G.B.E., M.P. (Great Britain), Honorary President of the International Chamber of Commerce; Chairman of the Orient Steam Navigation Co. Ltd.; Member of the Board of Governors of the Bank of England.
- Mr. René P. DUCHEMIN (France), Vice-President of the International Chamber of Commerce; President of the Etablissements Kuhlmann.
- Mr. Alfred FALTER (poland), Member of the Council and Executive Committee of the International Chamber of Commerce; President of the Central Union of Polish Industries; General Manager of the " Robur " coal-mines.
- Dr. Otto Christian FISCHER (Germany), Vice-president of the International Chamber of Commerce; Mitglied des Vorstandes der Reichs-Kredit-Gesellschaft, Berlin; President of the Reichsgruppe Banken.
- Mr. A.E. JANSSEN (Belgium), Former Minister of Finance; Professor of Economics, University of Louvain.
- Mr. Ernest MERCIER (France), Managing Director of the Union des Syndicats de l'Electricité.

- Mr. Peter MOLYNEAUX (U.S.A.), Trustee of the Carnegie Endowment; Editor of "The Texas Weekly".
- Mr. Hisanori MUNAKATA (Japan), Superintendant of the London Agency of the Bank of Japan; Member of the Board of Directors, Bank for International Settlements.
- On. Gr. Uff. Avv. Gino OLIVETTI (Italy), Member of the Council of the International Chamber of Commerce; President of the Associazione Italiana Fascista gli Industriali Cotonnieri.
- Mr. Björn PRYTZ (Sweden), Member of the Council of the International Chamber of Commerce; Managing Director of the Aktiebolaget Svenska Kullagerfabriken.
- Alternate* : M. K.G. LUNDBLAD, Former Minister of Commerce; General Manager of the Sveriges Industriförbund.
- Lord RIVERDALE, K.B.E. (Great Britain), Vice-President of the International Chamber of Commerce; Chairman and Managing Director of Arthur Balfour & Co. Ltd., Capital Steel Works, Sheffield.
- Dr. James T. SHOTWELL (U.S.A.), Trustee of the Carnegie Endowment; Director of the Division of Political Economy and History of the Carnegie Endowment.
- Mr. Harper SIBLEY (U.S.A.), President of the Chamber of Commerce of the United States.
- Dr. Hans SULZER (Switzerland), Member of the Council and Executive Committee of the International Chamber of Commerce; President of the Swiss National Committee of the I.C.C.; President of the Swiss Union of Commerce and Industry; President of the Sulzer Brothers Ltd., Winthertour.
- Alternate* : D. E. WETTER, Member of the Council of the I.C.C.
- Dr. Ernst TRENDELENBURG (Germany), Staatssekretär i.e.R.; Stellvertretender Leiter der Reichswirtschaftskammer.
- Mr. Eliot WADSWORTH (U.S.A.), Vice-President of the International Chamber of Commerce; President of the Boston Chamber of Commerce; former Assistant Secretary to the Treasury.
- Mr. Thomas J. WATSON (U.S.A.), Member of the Council and Executive Committee of the International Chamber of Commerce; President of the American National Committee of the I.C.C.; Trustee of the Carnegie Endowment; President of the International Business Machines Corporation.

The Associate Director of the European Centre of the Carnegie Endowment for International Peace : Mr. Malcolm W. DAVIS.

The Secretary General of the International Chamber of Commerce : Mr. Pierre VASSEUR.

The *Committee of Experts* is composed as follows :

- Professor T.E. GREGORY (Great Britain), Chairman; Professor of Economics, University of London.
- Professor Dr. E. BOEHLER (Switzerland), Professor of Economics, Technische Hochschule, Zurich.
- Professor Bertil G. OHLIN (Sweden), Professor of Economics, University of Stockholm.
- Dr. Leo PASVOLKY (U.S.A.), Member research staff of the Institute of Economics, Brookings Institution, Washington, D.C. ¹.
- Professor Dr. Andreas PRUDÖHL (Germany), Professor of Economics, Institut für Weltwirtschaft, Kiel.
- Professor Charles RIST (France), Former Professor of Economics, University of Paris; Honorary Deputy-Governor of the Bank of France.

The *Following economists* were also consulted by the Joint Committee :

- Dr. Antonin BASCH (Czechoslovakia), General Director of the Manufactures Réunies de Produits Chimiques et Métallurgiques, Prague.
- Mr. Dag HAMMARSKJÖLD (Sweden), Member of the Finansdepartementet.
- Dr. Hubert Douglas HENDERSON (Great Britain), Joint Secretary Economic Advisory Committee since 1930.
- Mr. Per JACOBSSON (Sweden), Economic Advisor to the Bank for International Settlements.
- Dr. Ludwig von MISES (Austria), Professor of Economics, University of Vienna.
- Dr. Feliks MLYNARSKI (Poland), Former Vice-Governor of the Bank of Poland; Professor of Banking at the Academy of Commerce in Warsaw.

¹ Dr. Pasvolksy served on the Committee during the early stages of its work. He resigned on taking up an official Government appointment.

Professor Giorgio MORTARA (Italy), Professor of Statistics at the Royal University and at the Università Commerciale Luigi Bocconi, Milano; Director of the « Giornale degli economisti e rivista di statistica ».

Professor Lionel ROBBINS (Great Britain), Professor of Economics, University of London.

Mr. A. A. VAN SANDICK (Netherlands), Secretary General of the Rotterdamsche Bankvereeniging.

Professor Jacob VINER (U.S.A.), Professor of Economics, University of Chicago.

Secretary of the Joint Committee and of the Committee of Experts :

Dr. G. COURTOIS DE VICOSE.

Separate memoranda
from the Economists consulted by the Joint Committee
on
THE IMPROVEMENT
OF
COMMERCIAL RELATIONS
BETWEEN NATIONS

**JOINT COMMITTEE
CARNEGIE ENDOWMENT-INTERNATIONAL CHAMBER
OF COMMERCE**

**Separate Memoranda
from the Economists consulted
by the Joint Committee
on
THE IMPROVEMENT
OF
COMMERCIAL RELATIONS
BETWEEN NATIONS**

JUNE 1936

**Headquarters of the Joint Committee .
INTERNATIONAL CHAMBER OF COMMERCE
38, cours Albert I^{er}
PARIS VIII^e**

Contents

The following series of reports on the general subject of "the improvement of the commercial relations between nations" has been divided into four main headings, between which the separate memoranda have been allocated as follows :

PART A : THE DECLINE OF WORLD TRADE AND ITS SIGNIFICANCE IN ECONOMIC AND HUMAN TERMS

One memorandum by Professor Eugen BOEHLER on "The technological, long-term factors in the reduction of the volume of overseas trade" :

- (a) The replacement of overseas supplies by "homegrown" products (e.g. agricultural changes in Continental Europe). What has been the economic cost of self-sufficiency ?
- (b) The replacement of "natural" products by "artificial" substitutes (e.g. artificial silk versus cotton). To what extent has the movement been artificially fostered ?

PART B : THE FUNDAMENTAL REASONS FOR INCREASED PROTECTIONISM

One memorandum by Professor Lionel ROBBINS on :

1. The growth of local unemployment as cause of increased protection.
2. The growth of philosophies of "self-sufficiency" and their limitations. How far in fact is it true that even under modern conditions of technological progress nations really are self-sufficient ?
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6. The problem of reducing the level of tariff rates by means of international agreements covering particular groups of articles.
7. The possibility of multilateral agreements.
8. How far has past experience with a tariff truce been conclusive ?

One memorandum by Professor Charles Riser on : " The past and the future of the most favoured nation clause in its limited and unlimited forms. "

One memorandum (XXX) on : " Trade between the industrial and agricultural countries of the world. "

Memorandum
on the technical long term factors in the reduction
of the volume of overseas trade

by

Professor Dr. Eugen BOEHLER,
Professor of Economics, Technische Hochschule, Zurich

Experience shows that the importance of economic changes is generally overrated, especially if they are the results of state interference. Owing to the lack of comparable figures for longer periods, slight variations are made the basis of revolutionary theories.

In reality there exists, in the long run, a remarkable constancy of relations between the different economic factors which resists state interference and political change as well as cyclical fluctuations and war influences. Contrary to popular ideas, invention and technical progress exhibit an astonishingly constant growth for about a century. Likewise a striking constancy of relation between the prices of the chief commodities as well as between the different cost factors can prevail for longer periods, in spite of fundamental technological changes.

The same constancy of relations can be ascertained in international trade for longer periods: between exports and internal production as well as in the distribution of world trade between countries and between groups of commodities. In spite of the rising tide of protection since the seventies the average annual rate of growth of world trade between 1883 and 1913 was 3,6 %, which is practically equivalent to the yearly growth of basic production during the same time. Even the reenforced tendency to self-sufficiency after the war could not hinder the increase of the said rate of growth to 4,85 %, average of 1925-1929, against 4,52 %, average of 1908-1913, which again seems to have equalled the rate of growth of the world's basic production.

Of course, there have been changes in the distribution of

world trade between continents and countries as well as between commodities. The percentage of European trade to world trade and the share of consumption goods have fallen. But these tendencies are not at all consequences of the war or of political measures, but they have been going on for decades in a continuous way and they need not be objects of concern for the future.

There is not the slightest scientific reason why this constancy of relation should have been upset by the present crisis and its political consequences. For it is due to the polar structure of the economic reality which implies that every force has its opponent force, every motion its opposing motion, and to the fact that every country must keep its balance of payments in equilibrium, whilst there exists a fairly constant relation between internal production and foreign trade which excludes arbitrary manipulation to a greater extent.

In fact, the available statistical data show that between 1929 and 1932 the volume of foreign trade and of internal production have diminished to the same extent. Only since the low point of 1932 foreign trade seems to lag behind the development of internal production, the basic production of the world reaching in 1934 about 99 %, industrial activity about 84 % of the average of 1925-1929, whilst the quantum of international trade was standing at 85. This disproportion has given rise to grave apprehensions which suppose that certain structural changes, especially the tendency to self-sufficiency, the industrialisation of overseas countries and technological changes might reduce the volume of international trade in the future. Though comparative statistical data are lacking to a great extent, we are trying to appraise these changes in the light of past experiences and tendencies. Reactions on the distribution of world trade are, however, not within our reference.

(a) *The replacement of overseas supplies by " home-grown " products.*

(The first chief aspect of the tendency to replace overseas supplies is the *attempt to restrict the supply of foreign foodstuffs and raw materials by industrial countries*, partly for political reasons, partly as emergence relief for agriculture, partly as protection against the inflow of cheap overseas produce resulting from mechanization, partly as a result of internal planning, Whilst most countries are satisfied with protecting their food

supply by duties, quotas, price guarantees, grants, and subsidies, others, like Germany, and Italy and to some extent France, are also trying to develop their inland production of raw materials by the replacement of imported material by home-grown, by the development of substitutes, by the regeneration of scrap and secondary materials and by different other methods of economizing foreign commodities.

Though this policy was actively pursued since the close of the war, it did not result in a reduction of the *ratio of imports to total consumption of breadstuffs* (wheat and rye) until 1929, owing to the replacement of rye by wheat in Central Europe. On the contrary, between 1909-1913 and 1927-1929 the percentage of net imports of breadstuffs to total consumption increased for Central and Western Europe from 27.3 % to 30.8 %, the percentage of net imports of foodstuffs (barley and maize) falling at the same time from 49.0 to 47.5 %. During the present depression, the tendencies to self-sufficiency not only became stronger, but were reenforced by the difficulties of the balances of payments. So the percentage of net imports of wheat and rye to total consumption decreased for Europe as a whole from 21.9 % to 17.8 % whilst the corresponding share of barley and maize remained practically constant, decreasing only from 22.2 to 21.7 %. To show the net result of these changes since the war the following figures for important countries are added. The percentage of net imports of *wheat* was in the following countries :

	1909-1910	1913-1914	1930-1931	1934-1935
Great Britain	78.4 %		82.8 %	
Germany	34.2 %		6.7 %	
France	11.7 %		7.8 %	
Italy	22.4 %		9.8 %	
Belgium & Luxemburg	76.1 %		74.2 %	
Netherlands	81.5 %		69.3 %	
Switzerland	85.5 %		80.1 %	

Here we find indeed an important reduction in the volume of foreign trade which is going on in spite of very big differences in costs of production.

For the *agricultural products of animal origin* we do not possess the corresponding percentages for longer periods. In the years 1930 to 1932 they varied in the said countries for butter

between 14 % (Switzerland and Belgium) and 91 % (Great Britain), the Netherland having a net export of 23 %. For cheese they went from 16 % (Germany) to 75 % (Great Britain), Switzerland and the Netherlands being exporting countries. To get an idea of the changes brought about by home-production of formerly imported products for Europe as a whole, we must rely on *net imports only*. Here we find very different developments. The net imports of Europe between 1925-1929 and 1930-1933 have increased for cattle from 83,000 heads to 85,000 heads, for butter from 1,236,000 q to 2,231,000 q, for cheese from 797,000 q to 916,000 q and for eggs, including egg products, from 1,256,000 q to 1,291,000 q. The net imports of Europe have decreased for pigs from 222,000 heads to 140,000 heads and, for milk from 991,000 q to 960,000 q. The reductions in net imports of bread-stuffs have, therefore, been compensated in part by increased net imports of other kinds of food.

(Besides, there are also opposite tendencies at work, namely, the replacement of "home-grown" products by imported, because of their cheapness, the most striking example being the substitution of home-grown animal fats by vegetable oils or imported whale oil.) The production of vegetable oils (excepting olive oil) has increased between 1909-1913 to 1931-1932 from 41,1 mill. q to 67,1 mill. q or by 63 % and the net imports of the oil fruits into Europa have increased even during the depression, namely from 60 mill. q in 1925-1929 to 64 mill. q in 1930-1933.

The total quantum of international trade in articles of food has, therefore, suffered from a smaller decrease than is generally assumed. It fell between 1929 and 1934 from 100 to 85, showing a little increase since 1933. The volume of imports of the five chief countries has diminished even less in volume, namely, from 100 to 91. The problem is, therefore, not so much a matter of volume as of values.

Nor is it probable that this process will go much further, though several countries make efforts in this direction, the chief reason being that the increase cannot be obtained largely by an extension of the acreage, but practically only by an increase of the yield which is a very slow and changing process. In Italy the "corn battle" had to be fought eight times, until the record yield of the year 1925, in the beginning of the battle, could be consolidated, and the increase was not much different from that of other countries. In Germany the average yield for 1929-1934

as to wheat and rye was still lower than before the war (1911-1913). Then the one-sided promoting of the production of bread-stuffs had unexpected reactions on other branches of agriculture, so that their production decreased and greater imports became necessary. In Germany this planning has partly reversed the agricultural situation from a buyers' market to a sellers' market, forcing restrictions on consumption.

There is, further, the aspect of costs. (Self-sufficiency can be bought at a high price only) Whilst before the war and even in 1929 the prices of the same agricultural articles in the different countries differed by a relatively small percentage only, there are at present differences of 100 % and more. In 1913 the difference between the average annual wholesale price in Berlin for home-grown wheat and the price for Plata Rosario in London was only 2.93 s. fr. or 14 %. In 1934 the difference had risen to 16.0 s. fr. or 212 % of the lower price. As to other agricultural products, we find in December 1935 between England, Germany, France, Italy and Switzerland differences of wholesale prices, ranging from 68.8 to 121.5 s. fr. for beef per kg live weight, from 88.7 to 125.0 s. fr. for pork per 100 kg live weight, from 0.097 to 0.224 s. fr. for milk per kg, from 1.80 to 4.15 s. fr. for butter of first quality and from 1.03 to 2.02 s. fr. per kg home made Emmental. Though such international comparisons of agricultural prices are always questionable, because different qualities prevail or corresponding quotations are not available, these figures will give an idea of the cost of self-sufficiency.

For these reasons, in the long run a much further progress of the tendency to replace foreign articles of food seems improbable. We may even expect a reversal of the movement during the recovery, because during the depression every country naturally gives access to the most necessary articles only, the considerations of the balance of payments outweighing all others. When recovery progresses and balances of payment find their equilibrium, the cost factor comes again to the front, especially for countries with an important export business. For in the long run this policy raises the cost level and restricts export from the cost side, whilst the reduction of imports reacts in the same direction on exports. So experience shows that the tendency to protection rises and falls with rising and falling turnover and prices. With improving business most ideologies making a virtue out of emergency will disappear and give place to the

opposite tendencies showing the advantages of international trade and division of labour.

A less hopeful prospect seems to prevail in regard to the opposite tendency, viz. : the *replacement of imports of industrial articles by overseas countries* or industrial competitors, which has been fostered by the fall of agricultural prices, by the monetary difficulties and by the increasing tendency to industrial protection. Unfortunately, we have no comprehensive figures, so that everybody is impressed by individual information in regard to the development of overseas countries. Only a few (mostly European) agricultural countries publish indices of industrial activity. So the composite index of industrial production for Chile, Denmark, Finland, Greece, Roumania and Hungary shows that their industrial activity fell below the average during the depression (to 86 against 69 in the average) and has since then recovered to 115 during the first term of 1935, the average world index being 90. The index of the textile industries alone has gone up to 159 (1929, 100). Though these indices reflect the cyclical variations only, there is no doubt that such an increase could not be reached without an increase in manufacturing capacity, especially in the textile industry.

Still the importance of *these figures must not be overrated*. The lower the absolute basis of the index, the greater the increase in the percentage, even if the absolute change is small. Then the increase is not much greater than the increase of the index of industrial activity of several of the old countries. Lastly only a part of the extension of industrial capacity of newer countries means competition to the older industries. The whole building activity, the public utilities, the industrial branches in connection with transportation, the printing trades and several branches of consumption industry have practically no competitive influence on the old industrial countries, but form a new outlet for their products. A real loss arises chiefly from the replacement of the textile and related staples like clothing and shoes. This fact is clearly shown by the trade figures after the war up to 1929 : whilst the quantum of textile exports of the five chief exporting countries was lower in 1929 than in 1913, the quantum of the other consumption goods as well as that of the production goods showed a further increase. The result of overseas industrialization is therefore not a decline of world trade, but a change from staples products to products of higher quality and workmanship, as well as from

consumption goods to production goods like in internal economy. There is no scientific reason why this experience should lose its value for the future. Most pessimists in this connection confuse the first occupation of newer countries with their development. In fact the latest trade figures, as far as available, show that since 1931 and 1932 the percentage of overseas trade to total trade is quickly rising in the older industrial countries owing to the recovery of agrarian countries.

A much greater danger lies in the *reduction of foreign trade between the industrial countries* themselves which were for a long time the best customers of each other. Before the war the foreign trade between the old industrial countries (United Kingdom, Germany, France, Netherlands, Belgium and Switzerland) increased considerably, though the percentage of their reciprocal trade to total trade declined somewhat since the nineties. After the war even the absolute growth ceased and the percentage of total trade was for some time greatly reduced, though it recovered a great part of the loss subsequently. This diminution of relative importance of the trade of the older industrial countries is wholly natural, because their commercial relations have attained their optimum. Long term technical factors are implied inasmuch as the technical differentiation of these countries is decreasing owing to the exchange of technical experience and owing to transplantation of industries from one country to the other as a consequence of protection.

But even this tendency must not be overrated. One of the most conspicuous examples of such a *replacement* is that of *coal by hydraulic electric energy*. The quantity of coal necessary to produce this hydraulic energy by caloric would be at least about 100 mill. tons. Nevertheless world production of coal was in 1929 by more than a 100 mill. tons higher than in 1913, though various methods of economizing coal were introduced in the meantime. As to the coal imports of the countries which have mostly developed their hydraulic energy, namely, Italy, Norway, France, Sweden and Switzerland, it is surprising to state that they were in spite of this replacement considerably higher in 1929 than in 1913, viz. 58 mill. tons in all against 45 mill., and even in 1933 during the depression only by 3 mill. tons lower than in 1913. The reason is to be sought in the fact that the development of this source of energy has so stimulated industrial activity in general that the other uses of coal increased. The same applies

to the attempts of replacing heavy and light mineral oils by inland production and to other similar processes. They are in the long run not reducing the volume of foreign trade, but just keeping its equilibrium.

If, therefore, between 1925 and 1929 the trade between industrial countries no longer increased in absolute terms, it is not owing to technological changes, but owing to protection. Nevertheless during the depression this trade has shown more resistance than the overseas trade. In fact the percentage of European exports to the total exports of the said industrial countries increased considerably (France only excepted) and was still higher in 1934 than in 1929, though a certain reversal has taken place since 1931 owing to the recovery of overseas countries. Lastly it must not be forgotten that even today European exports still form more than two thirds or even three fourths of total export trade of the European countries (with exception of the countries with empires like England and France), so that the greatest stimulus may be expected by the abolishing of trade barriers between these countries.

(b) *Replacement of natural products by " artificial " substitutes.*

(The replacement of natural by artificial products with the possible effect of reducing foreign trade has chiefly progressed in two forms : 1) by the development of real substitutes and 2) by the recovery of used materials by the way of regeneration.)

(The most flagrant example of real substitutes is the *replacement of nitrate of Chile by synthetic nitrogen*,) with the result that the percentage of the Chilean natural product of the total production has fallen from over 50 % in 1913 to 23 % in 1929-1930 and to only 5 % (or 9 % of the consumption) in 1933-1934. But a reduction of world trade has in no way resulted from this process. Even the quantum of exports of Chile nitrate was higher in 1929 than in 1913, though its value was cut to a small percentage. But what is more important, the exports of the substitutes have so increased owing to the diminution of price and the growing use of artificial fertilizers as a consequence thereof, that total volume and value of foreign trade in fertilizers is even in the depression higher than in 1913.

A second important example of substitution is the replace-

ment of *natural silk, cotton and wool* by "artificial silk" or rayon,) the production of which has increased from 16,200 t in 1913 to 349,700 t in 1933, whilst the Index of production of textile materials in general has increased from 100 to 131 only. But this development as such has certainly not reduced the volume of international trade, the consumption of all other textile materials in fact having increased. After the war the export of textile products somewhat diminished in volume, but not in consequence of the rising competition of rayon, but of the said industrialization of overseas countries. On the contrary, the rising exports of rayon and its products have counterbalanced the loss of other products and have especially alleviated the crisis of the European textile industry. During the crisis the exports of rayon and rayon products have, in addition, resisted better than those of the other textiles. So this substitution too did not result in a reduction of world trade.

A third example of substitution, viz. the *replacement of lumber by other building materials* like steel, cement and bricks has certainly retarded the rapid increase in the exports of sawn softwood, which mounted from 2.7 mill. stds. in 1880 to 6.3 mill. stds. in 1913, but increased only to 7.5 mill. stds. in 1929. But this delay has been compensated not only by increased exports of steel and cement, but also by the increased export of wood-pulp, so that even here no net reduction of foreign trade has resulted.

An exact idea as to the possibilities of *replacing mineral oil by synthetic products* cannot be formed at present, as comprehensive data are not available. But it is evident that the increase in consumption of motor fuel is progressing so rapidly that a net reduction of foreign trade in mineral oils will not result therefrom in any case, even if the replacement should progress more rapidly than at present.

(Still less the possibilities of *replacing natural rubber by a synthetic product* (Buna) can be foreseen; though it is said to have reached the phase of commercial production. Its chances depend naturally to a great extent on the cost of production for which no reliable data are available. In addition it is not probable that the volume of world trade will be affected materially, because even in the case of a complete success centralized production and decentralized consumption will prevail for some years to come.

For several smaller substitutes like artificial leather or resin we have not statistical evidence. But it is very improbable that international trade will be materially affected thereby.

A second form of replacement of natural products by internal production constitutes the *recovery of used materials*. If this development should reach greater dimensions, it would not only lead to a greater decentralization of production, but also to a reduction of international trade. The chief examples are the following.

During the last two decades the *production of iron and steel from scrap* has so increased that since 1910 the curves of pig iron and steel production materially diverge, because less iron ore is necessary to produce the same quantum of steel. As, however, about two thirds of this scrap result from the production process, the percentage of really recovered iron is estimated to be about 0,53 % of the total supply or about 11 mill. tons. But it is to be supposed that this percentage will steadily increase. Its reaction on foreign trade lies (a) in the reduced demand for iron ore, (b) in the tendency to decentralization of the production, for example, by the development of iron works in Italy and Hungary and (c) in the tendency of hindering the export of scrap. But it is questionable whether this has resulted in a net reduction of foreign trade. In the after-war expansion period, the trade in iron and steel products as well as in scrap has continuously increased. During the depression the exports decreased less than production, while since 1932 they have not increased at the same rate.

For the *non-ferrous metals*, the recovery of waste or secondary metal has in part quickly developed during the last decades, so that for example in the United States for every three tons of mined lead one ton was recovered from scrap. But this replacement has attained greater dimensions only in the United States and in the countries with exchange difficulties, whilst for the rest it depends on price, because under normal conditions the recovery pays only where consumption is high and increasing. Therefore a net reduction of foreign trade is improbable.

The same applies to the recovery of waste in the textile industries which has been intensified especially in countries with exchange difficulties. The continuous increase in the consumption of the new materials shows also in this case that the total international turnover has not been reduced thereby.

Among the other raw materials the secondary production has reached the greatest dimensions with *rubber*. Here the dependence of the recovery on prices is evident. During the war the percentage of regenerated rubber to total production rose up to 57 %. After a fall to 23 % it rose again to 51 % in 1923, when prices mounted gain. During the crisis the percentage was reduced to about 22 %, and for other countries a similar percentage is stated. In spite of this large share of recovered produce total consumption is rapidly rising, so that no harm to foreign trade has resulted.

To summarize, it may be stated that most apprehensions in regard to a possible reduction of world trade on technological grounds could not be verified in the long run. But it is probable that the attempts to increase the percentage of internal production of foodstuffs and raw materials for political reasons will increase for some time to come. Owing to the unavoidable reactions one may expect that this tendency will find a growing objective resistance, so that in the long run the relations between inland production and imports will not be changed.

On the contrary, the greatest theoretical possibilities of a recovery of world economics lie in the reversal of this policy, because the exchange between agricultural and industrial states has also in the post-war period contributed most to the increase of international trade. It would mean a short-sighted policy to stifle these economic possibilities for European countries by an excessive policy of self-sufficiency. Likewise, for most European countries the exports to other European countries comprise still the highest percentage of total trade. So a reciprocal loosening of restrictions on foreign trade with these countries would certainly mean one of the most efficient stimuli of recovery of the world as a whole.

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(Signed): Eugen BOEHLER.

Memorandum on the fundamental reasons for increased protectionism

by

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I. The object of this memorandum is to examine the fundamental reasons for the great increase of protectionism which has been characteristic of the last half-century of human history.

It should be clear that this increase is something which needs to be explained. (The last half-century has been a period of rapid increase of all means of communication.) The Railway systems of the world have been extended and consolidated.; Shipping services have been increased and made more reliable. Today the aeroplane is making distance still more negligible. Yet in spite of all this, we find that the nations of the world are busily engaged in erecting ever greater and greater obstacles to the increased volume of trade which these developments make possible. An inhabitant of another planet, informed of the scientific progress of the last hundred years, might expect to discover a world organized to take advantage of the increased division of labour which these increased facilities for communication permit. If he actually paid a visit of inspection he would find the queer animals which inhabit this earth devoting much of their energy to what must appear to be a sort of self-frustration, destroying with one hand the riches which the other has created.

To discover why this has come about is the object of this memorandum.

II. I. If the different parts of the world were organized into one state, there is no reason to suppose that the existence of inter-local obstacles to trade would be regarded as desirable. It

has been characteristic of the development of modern states that, within their boundaries, the obstacles to trade have been removed. The formation of the German Empire, the reforms of the French revolution, are conspicuous examples of a process which, when there has existed a sufficiently powerful state-machine, has everywhere been thought to be desirable. If by the accident of history the Roman Empire had persisted and its dominions had been continuously co-terminous with the borders of the known world, it is hard to believe that the persistence of local barriers to free exchange would have been thought to be consistent with the greatest benefit of the majority of its inhabitants. Whether a world state was organized on individualist or on socialist lines, a division of labour not limited by artificial territorial divisions would clearly be in the interests of the majority of its citizens.

2. But the world is not organized on these lines. It is organized into a number of territorial groups, constituted very largely as a result of historical accident, whose boundaries in a world state would have absolutely no economic significance. The controllers of these states do not profess to legislate for the benefit of the world as a whole. They claim only to legislate for the benefit of their own members; and though from time to time they may pay lip-service to international solidarity, there can be no doubt that if there were a conflict between the interests of the world as a whole and those of their own group they would unhesitatingly choose the latter.

It follows therefore, if we are to examine the evolution of policy, that we must always take as our starting-point the interests, real or imaginary, of the national state. We need not inquire why the economic activities of the world as a whole are not deliberately organized with a view to the benefit of the majority of its inhabitants; given the absence of an international authority there is no problem there. We must ask rather why it is that the policies of the different national states are such as to create international disharmony.

3. Now it is conceivable that there may be a real clash between the interests of the world as a whole as regards trade and the interests of particular national groups. As we shall see later on, it is doubtful whether *real* clashes of this sort have played a very large part in bringing about the present international chaos. But it is clearly possible that such clashes may exist; and it is

obvious that, in a vague way, many people believe that they do exist. It will be convenient therefore to commence our investigation by inquiring in what way such clashes may be conceived.

To do this, two issues must be very clearly separated. We must separate the question of what people want, of how they conceive their interests, from the question of how best they actually may secure what they want. It is obvious that disharmonies may arise, either as a result of differences of ultimate aim, or as a result of differences in opinion as to the best way in which ultimate aim may be realized. It is conceivable that the different nations of the earth may entertain fundamentally different conceptions regarding the ultimate aims of national policy and that disharmony may arise in this way. Or it is conceivable that they may each be striving after the same thing and yet, by reason of differences of opinion regarding the best way to get it, their policies may create disharmony.

4. Let us commence with disharmonies originating in the ultimate aims of policy. If the government of a particular area regards it as an end in itself that the organization of production should be self-sufficient, it is obvious that its trade policy will be inimical to international division of labour. Such ideals of self-sufficiency have indeed from time to time exercised some influence on political thought. It was held by Plato and other Greek philosophers that foreign trade was in itself to be regarded as inimical to the atmosphere of the ideal state. The austerity of the alleged self-sufficiency of Sparta was contrasted favourably with the cosmopolitan atmosphere of Athens, whose prosperity depended on foreign trade. In recent times similar views have been held by less worthy and less interesting writers : Fichte, Adam Müller and the so-called romantic school of German economists, whose writings have unquestionably influenced the thought of the leaders of present-day Germany, exalted the idea of the *Geschlossene Handelsstaat*. To eat home-grown rhubarb has been held to be more virtuous than the consumption of the foreign lemon. But it is doubtful how far ideas of this sort have been responsible for the development of policy. From time to time they may have been used to defend measures introduced for other reasons. But although at the present time they are undoubtedly rapidly attaining great ascendancy in certain parts of the world, their influence on policy hitherto has probably not been very great.

5. But although it is possible to exaggerate the influence of the idea of self-sufficiency as a means of preserving the characteristic *ethos* of the national state, it is important not to underestimate the influence of the ideal of economic self-sufficiency, regarded, not as an end in itself, but as a means of military defence. It has always been conceded by Free Traders that if the location of any particular form of production within the borders of the national state was regarded as essential to security against attacks from other states, then measures designed to foster this industry could not be regarded as contrary to national policy. And even before the Great War considerations of this sort played some part in the determination of policy. The German agrarian policy was defended on military grounds. Since the War, experience of the difficulties which may arise in case of blockade or widespread interruption of international commerce have led to a vast extension of such measures. The extensive protection of industries capable of being used for munition making has also been defended on this ground.

The cost of such measures is obvious. The factors of production which are used for producing expensive supplies at home, might have been used to obtain them less expensively from abroad by exchanging goods for whose production local conditions are better fitted. It is arguable, moreover, that, even granting the necessity for regarding the danger of war as a permanent factor in international relations, much protection is ill-conceived. The experience of the last war, while it undoubtedly shows the value of security from blockade, has shown also the advantage of the riches which come from international commerce. It is not possible to have both of these, and it is not certain that in the majority of cases the latter is of less importance. But in recent years such considerations have tended to lose influence. As the danger of widespread international conflict becomes more acute, the area of military protectionism increases.

6. It is possible however to regard policies based on circumstances of this kind as being essentially abnormal. It is still arguable that the average citizen, even of the more bellicose areas, regards war as an evil which ought eventually to be eliminated, and conceives the main object of policy to be the inception of conditions in which the non-military requirements of the race are satisfied as far as the niggardly provisions of nature

make possible. It is arguable, that is to say, that the main aims of national policy may still be conceived as being the maximisation of what some would call "economic" welfare. There are obvious difficulties in furnishing a precise definition of this object, but for the purpose of this memorandum these difficulties may be ignored. We may proceed therefore to inquire whether in the realization of such an aim the interest of one national group may conflict with the interest of others, whether one country can gain by a policy of trade restriction.

7. Now it is quite true that it is possible to conceive of cases in which one national group may gain at the expense of others by erecting obstacles to trade. Theoretical economics demonstrates clearly that in certain circumstances it is conceivable that a tariff may have the effect of turning the "terms of trade" in favour of the inhabitants of the country imposing the tariff, that is to say, of bringing it about that they get more imports for a given quantity of exports. This, after all, is only what we should expect from the most general propositions of the theory of exchange. We know that if particular groups of producers happen to occupy a position of strategic advantage in the market, then by suitable restrictions they can secure monopolistic gains. This clearly applies not only to industrial groups but to geographical groups also.

In fact, however, it is possible greatly to over-estimate the applicability of this argument. The circumstances in which an unequivocal gain of this sort is realizable do not often occur in practice. The geographical group which attempts to turn the terms of trade in its favour by restrictionism will as likely as not find that it is merely raising up competition for itself in other quarters. Moreover, the whole argument depends upon the assumption that conditions in the outside world remain unchanged, that other nations pursue a passive policy in the face of isolated protection. In practice these conditions are not likely to be realized. The erection of a protective tariff by the members of one national group is likely to be countered by the erection of protective tariffs elsewhere; and though it is not *certain* that all the possible gains will be cancelled out, the probabilities are overwhelmingly in favour not merely of cancellation but also of net impoverishment all round.

Exactly the same circumstances apply to the other arguments

by which it is attempted to establish the possibility of a permanent gain from the erection of protective tariffs. Other things being equal, for instance, it is possible that the erection of a bargaining tariff may result in a lowering of tariffs all round, in which case these tactical manœuvres would have been productive of lasting benefit. But experience suggests that in practice other things are not equal. It is generally probable that the erection of a bargaining tariff will bring about a situation in which that tariff becomes permanent- to say nothing of the increases elsewhere which its erection may have occasioned. Similarly, it has always been conceded that cases are conceivable where protection to infant industries may result in national benefit, but again experience shows that such a form of assistance to infant industries is almost always abused. The industry is called into being and the tariff is not removed. If there be a case for the fostering of infant industries by national states (and having regard to the arbitrary nature of national boundaries, this case is bound to be very slender) a subsidy rather than a tariff seems to be appropriate instrument. It is much less likely to be prolonged once the occasion for its use has disappeared.

8. The foregoing arguments however apply to be possible long-run gains from protection. It should be clear that the prospects of such gains are very slender. If we restrict our view to the immediate effects of protection there are other cases where some benefit may be conceived. If a tariff is imposed at a time when trade is bad and a considerable margin of the factors of production are unemployed, it is possible that the result may be a net gain of production; though it is almost certain that the gain achieved will not be as great as that which might have been achieved if the unemployed factors of production had been re-employed by recovery under Free Trade conditions. It is true, too, that if a general tariff is imposed at a time when the central bank of the country imposing the tariff is losing gold, some credit contraction may be made unnecessary and the tariff itself will be productive of some permanent maldistribution of resources and its existence will be no safeguard whatever against a similar drain of gold in the future.

It is notorious that arguments of this sort have played a considerable part in determining the policies which have been actually adopted during the recent depression. But the result of

such policies indicates the rebutting argument. If, in an otherwise stable world, a single nation has recourse to such policies, it may conceivably snatch for itself some gain — or perhaps better said, some avoidance of loss. But if such policies are applied simultaneously by a number of nations, their effects, so far from being productive of gain all round, have in fact cumulative results of a negative order. If all countries impose emergency tariffs at a time of crisis the effect is almost certainly deflationary. More unemployment is produced than would have occurred in the absence of such policies. Historically it is probably true that the increase in the height of international obstacles to trade has taken place in this way. Analytically it cannot be argued that the world is richer than it would have been if no such increase had taken place.

9. In recent years the case for trade restriction has sometimes been argued from a different point of view. It has been defended as a policy of national planning. To protect planned industry at home it is necessary, it is said, to restrict foreign imports. The tariff is essentially to be regarded as an instrument of that "scientific" control of economic activity which is to replace the individualistic "chaos" of the free market and private enterprise.

Such a view however betrays a most paradoxical conception of the aims of national planning. If national planning is intended to bring "economic" advantage — if, that is to say, it is desired for the sake of "wealth" rather than military power, aesthetically pleasing lay-out of the countryside, etc. — it must surely be designed to use the national resources in the most productive manner. Now resources will not be used in the most productive manner if they are used to produce at home what could be obtained more cheaply from abroad. It is the essence of the case for free exchange that it permits local resources to be specialized to produce the things which they are best fitted to produce and thus to procure by way of exchange from abroad *more* of the things which they cannot produce so efficiently at home. A national plan which does not proceed on the same principle is not a national plan but a national muddle.

10. Against all this, however, and against the case for free trade in general, it is sometimes argued that the advantages of international division of labour are really very small. The tech-

nique of modern machine production, it is said, renders the location of industry a matter of comparative unimportance. There may be some sacrifice in greater self-sufficiency, but it is more than compensated by the greater stability of a more autonomous system. Such arguments find support not only among those who attach importance to the abracadabra of planning but also among those monetary reformers who hold that their attempts to secure the advantages of a constant domestic price level would be considerably eased by the diminution of the dependence of particular industries on events in other parts of the world.

All this is surely very much in the air. The sacrifices involved by a policy of self-sufficiency must depend essentially upon the size and natural equipment of the particular national area in question. They would be one thing for an area such as the United States, another for an area such as Belgium or Holland. While it is perhaps arguable that, if the benefits to be secured by a policy of national planning undisturbed by outside forces were very great, an area such as the United States might make such an experiment without catastrophic impoverishment, it is clear that, for smaller areas, more dependent upon international trade such a policy would inevitably be catastrophic. Vague talk about national planning which takes no account of the differences in the international situation of different national areas is not merely useless, it is positively misleading.

This becomes much clearer if we inquire at all into details. If modern machine technique is to be maintained (and it is the existence of modern machine technique which is usually the pretext for this type of argument) it is clearly impossible that the different national areas should become entirely self-sufficient. The necessity for obtaining raw material supplies makes that out of the question for almost every national area in the world. Yet, if trade in raw materials is to continue there must be also trade in finished products. The distribution of natural resources between the different national areas is not such as to permit trade to be carried on only by the exchange of one kind of raw material for others. If the exporters of raw materials refuse to import manufactured articles, then the would-be importers of raw materials will be unable to secure the means of paying for them. The dislocation which would thus be occasioned in a world which hitherto had been organized for fairly extensive international

trade, must be such as for all, save a few specially favoured areas, more than to counterbalance the extremely doubtful benefits of increased national planning. The distribution of men and natural resources in different parts of the world is not such as to permit most at least of the existing national areas to plan far towards self-sufficiency without grave loss. Here as elsewhere the belief that it can be otherwise rests on the naive assumption that while you plan to produce everything save raw materials at home, others will pursue a more or less free trade policy.

But even if this were not so, it would still be untrue to argue that the existence of modern technique renders the international division of labour any less advantageous. The case for international division of labour rests on differences of costs. So long as the costs of production of different commodities are different in different areas, so long will it be advantageous for each area to specialize on producing those things in which its costs of production are least and to procure the rest by way of exchange from elsewhere. And these cost differences depend in the last resort on the different relative scarcities in the different parts of the world of the different factors of production — depend, that is to say, on the existence of differences of efficiency wages, differences of rents, differences of raw material costs, differences of transport charges, etc. And there is really no presumption that modern technique renders any less essential nice attention to these particulars. On the contrary indeed. Moreover, it is clear that in so far as the achievement of the economics of large scale production depends upon large markets, the general case against trade restriction is all the greater. There may be some national areas, such as the United States of America, offering so wide a market that the maximum economies of mass production can be secured at home. But in the majority of cases it is safe to say that limitations on trade are a definite hindrance to the achievement of these economies. The world would be much richer today if markets were more extensive.

III. 1. If all this is true it follows that, save as a means for securing military security — and a rather dubious means at that — policies of protection are not likely to secure to the inhabitants of different nations any of the aims which most of them would acknowledge if they were to reflect on these matters. The problem we are trying to solve, the problem namely of the causes of

the increased protectionism characteristic of the actual benefits of the modern world, finds no solution in consideration of the actual benefits to be secured by policies of restrictionism. The phenomenon of increased protectionism is essentially a manifestation of irrationality.

What then are the roots of this irrationality, and why is it more prevalent at the present day than in earlier times? To see this it is necessary to look a little more closely at the influence shaping policy and the general conditions under which these influences are exerted.

2. It is a fundamental argument for Free Trade that the market brings about that specialization of the use of national resources which is conducive to the greatest national income measured in price terms. But this argument, while it promises advantage for the majority of the inhabitants of the national area, does not promise advantage for lines of industry in which the comparative advantage of the area in question is less. The process whereby, under free trade, international division of labour is brought about, has thus a double aspect. It brings profit to those industries in which the advantages of local specialization are greatest, but it brings loss to those industries whose products it is more expedient to obtain by way of exchange from elsewhere. The argument of those free traders who sometimes suggest that the disappearance of any industry as a result of foreign competition is the result of gross inefficiency on the part of the management of that industry, is false. Under free trade conditions an area cannot keep within its borders branches of *all* types of industry; it will keep only those branches in which it has the greatest comparative advantage.

Now in conditions of equilibrium such a state of affairs would be advantageous for everyone. But equilibrium seldom exists. The general conditions of supply and demand are continually changing and with them the conditions of most advantageous specialization. In such circumstances some groups suffer disadvantage. Unless the members of these groups are willing to transfer their services to other lines of production, they may suffer considerable impoverishment. Such cases of hardship attract attention. The general public, which as Bastiat explained, is always more impressed by what is seen than by what is not seen, perceives the losses of the groups which are being squeezed

and tends to ignore the general gain which are the obverse side of this process. Unless there exists a body of vigilant and informed opinion continuously active to resist the appeals of special interests for protective measures, the tendency to impose such measures is very strong.

But it is not only under such conditions that the tendency to protection is active. It sometimes happens that changes in general trade conditions bring it about that, in order to maintain international equilibrium, some credit contraction within a national area is necessary. In such circumstances the disadvantages of such contraction are not limited to special groups. The effects of the contraction are widespread. Although general considerations of long-period advantage are all against resort to the tariff instrument, considerations of short-term alleviation seem all in its favour. Again, if there is not a powerful intellectual tradition of adherence to free trade principles the arguments for imposing a tariff may appear almost overwhelming.

3. In the modern world resistance of this sort has been conspicuously lacking. It is probably true to say that the majority of competent economists are still convinced believers in the advantages of free exchange. But their numbers are few and in recent years the weight of their advice has been greatly weakened by dissensions upon special issues. It is probable that the majority of the English economists, for instance, who for special reasons of monetary policy, were willing to countenance a departure from free trade in England in 1931 would have still acknowledged the validity of the general arguments for free trade. But the confusion caused in the minds of the general public by their attitude was great, and the abandonment of the policy of free trade by Great Britain substantially weakened the resistance to free trade all over the world.

Moreover it must not be forgotten that the political resistance to protectionism which used to be maintained by the parties of the Left so long as these parties were inspired by the nineteenth century liberal tradition, has greatly weakened. The modern socialist, fascinated by the prospect of political power and the possibility of a little planning in his own national area, is apt to regard arguments relating to the advantages of international division of labour and exchange as having only academic importance. And if, as is very likely, he is supported financially by

groups of workers whose employment may be endangered by the incidence of foreign competition, he may be as willing as the politician of the Right to support a protectionist policy. Moderate socialists, though they may still render lip-service to the ideals of international economic co-operation, in fact for the most part support policies which lead in exactly the opposite direction.

4. This weakening of the intellectual resistance to the persistent tendency of lay opinion to acquiesce in measures of protection is paralleled by important changes in economic organization, which make the apparent ravages of foreign competition more conspicuous and damaging. In a system in which movement of resources from one branch of industry to another is easy, the damage caused even to particular groups by foreign competition is likely to be small : the displaced resources can be rapidly transferred to other lines of occupation and the benefits of increased cheapness are shared by all. But if mobility is hindered by the existence of monopolistic obstacles of one kind or another, then the damage to the groups affected is likely to be of much longer duration. If rigidity of wages impedes the absorption of displaced labour into other industries, if restrictions on investment and artificially sustained monopoly impede free enterprise, then the difficulties of the transition are likely to be considerably enhanced. It is well known that obstacles of this sort, themselves the product of the decline of economic liberalism, are characteristic of the economic organization of most countries in the post-war period, and it should be noted that their effect tends to be cumulative. The existence of protective tariffs gives rise to monopolistic obstacles ; the existence of monopolistic obstacles give rise to resistance to free exchange; resistance to free exchange increases the difficulty of new adaptation; new protection is therefore granted, and the accumulation of obstacles to international trade makes the incidence of change in the remaining parts of the system which are free, much more oppressive and productive of sharp disequilibrium. In the panic atmosphere of general depression, measures which would have been resisted in times of good trade are willingly agreed to. There are few politicians who can refrain from measures which promise hope of any alleviation of unemployment, however ultimately damaging such measures may promise to be.

IV. 1. We can see the truth of these considerations if we survey the growth of protectionism in Europe during the last sixty years.

The turning point in the tariff history of the last century was Bismarck's re-imposition of the iron and steel duties in Germany at the end of the 'seventies. Up to date time the tendency had been in the opposite direction. The Free Trade movement had moved from victory to victory and it did not seem absurd to suppose that within a short period comparatively free exchange would become general. The fall of Delbrück and the creation of the new German tariff changed all that. Henceforward protectionism was to grow.

This reaction was the result of a conjunction of influences. On the one hand the growth of an anti-liberal social philosophy in the German universities had provided intellectual weapons for the representatives of special interests. The Historical school, which was then dominant, was imperialist, anti-utilitarian and anti-intellectualist in outlook. Moreover, it was led by men who had never really understood the classical arguments for freedom of trade. This created an intellectual atmosphere favourable to the growth of protectionist ideas among the masses. The prolonged crisis which followed the collapse of 1873 provided the economic atmosphere in which the intellectual reaction could be politically effective.

In the same way, the growth of agrarian protectionism later on, was the product of the conjunction of painful economic change and confused thinking. Throughout the 'seventies and the 'eighties the competition of the agricultural products of the New World caused difficulties to the agricultural interests of Europe. Again German economists provided the appropriate apologia for policy. The ideal of a "just balance" between agriculture and industry, which from the "economic" point of view, is completely devoid of meaning, was exalted by such men as Wagner and Oldenberg. The agricultural interests were not slow to make political terms with the representatives of industry. Henceforward agrarian protectionism and industrial protectionism advanced hand in hand.

2. But the reversal of free trade policy which had been achieved up to the outbreak of the Great War was slight com-

pared with what has happened since. The War itself produced a great extension of the branches of industry devoted to the manufacture of war materials. When the War was over it was desired as far as possible to safeguard these industries against the consequences of a falling-off of demand for their products and the increased competition from similar industries abroad. The creation of new states under the Peace Treaties and the fear of new wars gave rise to high protection for manufacturing industries in areas which from a purely economic point of view would have been well advised to concentrate on other development. Resistance to the changes brought about by the catastrophe of the War is a conspicuous feature of the policy of the post-war period; and protectionism is one of the manifestations of this tendency.

3. By the middle of the 'twenties of this century another influence was making itself felt. The great increase of agricultural production which had come about during the war years and in the period succeeding the War produced a depression among agricultural producers. The absence of opportunities for migration deprived the agricultural populations of the most obvious relief from their distresses. Fear of war on the one hand and fear of the socialism of the urban populations on the other led the politicians of the day to grant ever-increasing measures of agrarian protection.

The effects of all this were cumulative. The products of the New World, deprived of easy access to the markets of the Old, showed a greater tendency to fall in value. The capacity of the inhabitants of these areas to import manufactures was diminished. In a desperate attempt to maintain international equilibrium they themselves imposed tariffs on industrial products, thus increasing the difficulties of the manufacturing countries and rendering the market for their own products less stable. For a time the incidence of these measures was warded off by the inflationary expansion of the pre-1929 period. But when the boom broke their effects were manifest and the speed of restrictionism redoubled.

4. In the Great Depression, all these tendencies have been multiplied. Widespread unemployment, the contraction of markets, the political uncertainty and unrest which has accompanied it, have driven one government after another into policies

which, in happier times, better judgment would have restrained. Since the autumn of 1931 and the abandonment of the Gold Standard by Great Britain, to the other causes making for restrictions and depression there has been added the instability of currencies. The depreciation of the pound sterling and the currencies which followed the pound sterling, meant increased financial difficulty to those countries which remained on gold. To meet these difficulties resort has been had, not merely to high protection, but even to more rigorous forms of restrictionism. In many important commodities trade is limited within narrowly imposed quantitative margins. It is a conspicuous feature of the history of the last few years that what recovery has taken place since the worst of the depression has been almost exclusively limited to trade within the different national areas. The policy of restrictionism has had full experimental trial.

V. If the analysis of this memorandum is correct, two conclusions seem to follow.

In the first place, since the growth of protectionism is essentially a manifestation of the progressive development of wrong ideas regarding the benefits of such policies, it follows that only by the education of public opinion to more correct views can the process be reversed. From time to time something may be achieved by tactics. Distressed governments may be manoeuvred into a position in which without settled views as to policy they adopt measures conducive to greater freedom of trade. But in the long run the chronic disposition to succumb to the temptation of the seen, rather than the calculated, effects of policy, can only be resisted by an educated public opinion.

But in the second place, since the intensification of protectionism is to be ascribed to the cumulative effects of all kinds of restrictive policies, of which protectionism is only one, it follows that this process of education is likely to be much more effective, if it is part of frontal attack on measures conducive to restrictionism and instability in general, than if it is limited to an attack of tariffs. There is much more hope of inducing the public to tolerate the absence of protection to special interests if the incidence of change on these special interests is minimized by an absence of hindrances to transfer to other lines of enterprise. The public is much more likely to tolerate the disturbances incidental to tariff reduction, if at the same time it has not to

contemplate the disturbances incidental to monetary instability. Only by a general rehabilitation of the principles of sound policy can the present vicious circle be reversed.

February 1936.

(Signed) : Lionel ROBBINS.

**Memorandum
on the technique of present-day protectionism**

by

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(The period of the current economic depression has been extremely fruitful in the development of techniques for the regulation of international trade.) Some of the devices employed today have been in use for a long time and have been merely extended, during recent years, in scope and effectiveness. Some are distinct innovations. Enormous energy and ingenuity have combined to create as tangled and as obstructive a system of trade barriers as the world has ever seen. As a result, businessmen engaged in international trade and government departments concerned with commercial policy are confronted with unprecedently complicated techniques of protectionism.

The purpose of this memorandum is to present a bird's-eye view of the salient features of the vast problem involved in these developments. Accordingly, attention is centered on the principal forms of protection, the nature of which is briefly described, and on the different objectives which the devices employed are designed to serve. At the end, a few striking results of present-day protectionism are brought together.

I. Principal Forms of Protection.

The devices for the restriction or regulation of international trade in operation at the present time are so numerous and so varied in character and objective that it is impossible, in the scope of a brief discussion, to describe them all or even to classify them with any degree of completeness. For the immediate purpose of this memorandum, however, it is necessary to name the principal

forms of protection and to describe briefly the devices involved. These forms are as follows :

(Customs duties.

Excise and other special taxes.

Subsidies and measures growing out of their use.

Currency depreciation and measures growing out of it.

Embargoes.

Import Licences.

Import quotas.

Customs quotas.

Milling and mixing requirements.

Exchange Controls.

Monopolies.

Sanitary regulations.

Administrative regulations.

The first four of these forms of protection are designed to restrict the volume of imports without any direct control of the physical quantities of goods brought into the country.) They are based, generally speaking, upon the principle of creating a differential in the return per unit obtained by the domestic and foreign producers — in favour of the former and against the latter.

The purpose of a customs duty, excise tax, or any other fiscal charge imposed upon the importation of any commodity is to raise the price at which that commodity sells in the protected market and to enable the domestic producer to obtain the full benefit of that price, while the return to the foreign producer is based upon that price minus the amount of the duty or other charge. To the extent that any duty or charge thus improves the competitive position of the domestic producer *vis-à-vis* the foreign producer, it is restrictive so far as the latter is concerned. It is not prohibitive, however, so long as even the lower return obtained by the foreign producer is still remunerative for him. This happens when his costs of production are sufficiently lower than those of the domestic producer to enable him to compete with the latter in spite of the duty. It becomes prohibitive if, in order to market his products in the protected country over the duty or charge, the foreign producer must sell at a loss. Depending on the relative costs of production, a small duty may be prohibitive, while a large one may be only mildly restrictive.

The form in which a duty is imposed has an important bearing on the degree of burden it places upon imports. A specific duty tends to be less burdensome when prices go up and more burdensome when prices go down, while an *ad valorem* duty has just the reverse effect. The relative effectiveness of an *ad valorem* duty may vary substantially with the choice of the method of determining dutiable value. It may make a great deal of difference in the amount of duty collected if the *ad valorem* percentage is applied to the invoice value of the imported goods or to a value of such goods based upon the price at which they sell in the importing country. An arbitrary valuation placed upon imports for customs purposes or an arbitrary rate of exchange used in the conversion of currencies for such purposes may change a relatively low *ad valorem* duty into a severely restrictive one.

(Subsidies also have for their purpose an improvement in the competitive position of the domestic producers. They may be direct, in the form of outright grants of pecuniary assistance, or indirect, in the form of remission of taxes, drawbacks of various sorts, etc.) (They may be granted with respect to the entire output or with respect only of that portion which is exported. When the entire output is subsidized, the competitive position of the producer is improved both in the domestic and the foreign markets. When only exports are subsidized, the improvement occurs primarily in the producer's competitive position in the foreign markets.)

Countries to which subsidized goods are shipped, especially when subsidies are granted specifically with respect to exports, frequently take counteracting measures. Such measures usually consist of the imposition of countervailing duties, amounting approximately to the subsidies granted, which are collected in addition to the ordinary customs duty or other charge on imports. This action neutralizes the advantages secured by the exporter through the receipt of subsidy. Alternatively, the granting of subsidies by one country may be effectively neutralized by a similar action on the part of a competing country.

Currency depreciation produces effects similar to those produced by the granting of subsidies. Its immediate result is to improve the competitive position of the domestic producer both in the domestic and the foreign markets, although this advantage tends to be nullified in the measure that the depreciation itself

induces a rise in domestic prices. And as in the case of subsidies, the trade advantages of currency depreciation are frequently neutralized by the competing countries either when they adopt a similar course of action or when they impose countervailing import charges or other special restrictive measures.

The other forms of protection enumerated in the list given above are, with one exception (customs quota), based upon the principle of control over the physical volume of goods permitted to be brought into the country. There is a radical difference between this principle and that which underlies the previously discussed forms of protection. In the latter case, there is no restriction on the volume of imports, except that imposed by the process of price competition. Quantitative regulation, on the other hand, is based in effect upon a complete prohibition of imports, which may be in part modified by specific exceptions.

In practice, complete embargoes on imports are not frequent. More common is the use of a licensing system, under the operation of which no imports of a particular commodity are permitted unless licenses authorizing such importation had been issued in advance. Such a licensing system is highly arbitrary in character, since the issuance of licenses can be discontinued at any time. It permits of a somewhat more orderly development of trade when combined with a quota system.

Under a quota system, the amount of particular commodity which may be brought into the country during any specified period is fixed, usually in advance. When the quota is unallocated among the supplying countries, no cognizance is taken of the origin of imports. As soon as the quota for a particular period has been filled, no more imports are allowed until the beginning of the next quota period. When a quota is allocated among countries, each country may supply its permitted share at any time during the quota period. The application of a quota system necessitates a large amount of technical and administrative detail, relating to the determination of quota basis; the handling of carryovers, from one period to another and from one commodity to another; sub-allocation of the quota among individual traders; and many others.

A clear distinction should be drawn between an import quota and a customs or tariff quota. The former is an arrangement under which the physical quantity of imports is fixed; the latter is one under which a fixed quantity of imports can enter at a

certain favorable rate of duty, while any additional amount may come in on the payment of a higher rate. Thus a customs quota partakes of the nature of both a quantitative and a non-quantitative restriction.)

(Milling and mixing requirements constitute another form of quantitative regulation. Certain industries are required by law to use specified proportions of domestically produced raw materials. In some cases, the volume of imports is regulated indirectly by the pre-emption for the domestic producers of a fixed portion of the domestic market.) In other cases, quotas or import licences are used at the same time.

(Exchange control involves regulation of trade through the fact that payment for imported goods can be made only at the discretion of the control authorities. In some cases, no imports are permitted unless the control authorities had agreed in advance to provide the necessary foreign exchange.) In some cases, imports are permitted without prior authorization with regard to exchange, and some of the funds owing to the foreign exporter become blocked or frozen. When this happens, the accumulation of such blocked balances acts as a brake on further imports. In the releasing of foreign exchange, the control authorities frequently set up scales of preference as between various categories of commodities and, in rarer instances, between countries.

Exchange controls give rise to a large variety of devices which have a direct or indirect influence upon trade. Among these can be mentioned clearing and compensation agreements and arrangements; the use of multiple exchange rates, either in connection with such agreements and arrangements or independently of them; embargoes on movements of capital or on transfers of interest and dividend payments; and many others.

(Monopolies represent another powerful device for controlling the volume of imports. They constitute arrangements under which governmental agencies or specially designated private agencies are authorized to be the sole purchasers of imported commodities, although they may or may not be the sole domestic distributors of such commodities.)

(Measures of quantitative control of imports are frequently accompanied by the collection of special fees. In some cases, such fees are purely nominal.) Not infrequently, however, the fees are so substantial that they have the effect of imposing extremely heavy fiscal charges upon the strictly limited quantities

of goods permitted to be imported under the quota and other systems.

(Sanitary and administrative regulations, the latter including marking requirements,) etc..., are too numerous and variegated to be discussed here. Their avowed purpose is usually something quite different from restriction of competitive imports, but they are, in fact, frequently operated in such a way as to provide an effective bar to imports.

II. *Objectives of Protectionism.*

There are two primary objectives which the various devices for the regulation of trade are today intended to serve. (One is the safeguarding of individual domestic industries. (The other is the safeguarding of more general national interests — such as currency stability, the preservation of basic monetary reserves, etc. — through direct regulation of the country's international balance of payments. In the first case, protection is designed to operate with respect to particular commodities, the purpose being to restrict the importation of each individual commodity. In the second case, protection is designed to affect the total volume of imports, with or without reference to particular commodities, the general purpose being to regulate the total volume of payments to be made to foreign countries.) The use of protectionist devices for the safeguarding of individual industries is of long standing. Their application to the safeguarding of the international balances of payments is of more recent origin.

During the decades immediately preceding the World War, international trade operated mainly on the basis of price competition. Customs duties constituted the only important protectionist device, utilized, generally speaking, for the purpose of regulating the terms of competition between domestic and foreign producers in the marketing, within protected countries, of more or less closely competitive commodities. There was little, if any, preoccupation with the problem of the international balances of payments, but rather a general assumption — which was, in fact, borne out by actual practice — that accounts between countries will tend to adjust themselves through the operation of the various elements comprising them and through the functioning of an adequate international monetary and credit system. The safeguarding of individual domestic industries was the clearly

recognized objective of protectionism, and, judged by post-war standards, the degree of protection was small. Moreover, again as compared with post-war conditions, the pre-war decades were singularly free from sudden disturbing factors in the operation of the highly integrated international trade, monetary, and credit systems.

These systems were completely disrupted by the war and its aftermath. Although they were gradually rebuilt during the first post-war decade, their reconstruction took place in conditions which constituted a fertile breeding ground for far more drastic and extensive protectionism than existed before the war. Changes in the sources of supply of many vitally important commodities, induced by the exigencies of the war; alterations in the relative values of national currency units; the heritage of enormous international debt obligations bequeathed by the conflict; and many other factors conspired to bring about a vast increase in the level of protection accorded individual industries, and to bring to the fore the problem of direct adjustment of international balances of payments. Both types of protection became intensified as the current economic depression unfolded itself.

The circumstances attending the depression inflicted a number of severe shocks upon the structure of international economic relations. The sharp decline in commodity prices and the consequent reduction in the value of international trade led debtor countries into attempts to adjust their balances of payments by a drastic contraction of imports and a forcing of exports. The creditor countries found some of their industries subjected to extraordinary competition resulting from forced exports, and they began to seek means of counter-action. The collapse of currencies and the whole-sale movements of funds across international frontiers, which ushered in the second and more severe phase of the depression, served to intensify the search for protection both for individual domestic industries and for balances of payments.

Customs duties which, before the depression, were fast regaining their pre-war position as the principal form of protectionism, have, during the depression, lost a part of their importance. It is true that almost all countries have, during the past few years, raised their tariffs and that other factors, to be noted in the next section of this memorandum, have served to

increase the effectiveness of customs duties. But such duties and other fiscal charges on imports, while powerful enough under conditions of ordinary price competition, are not always suitable instruments of protection under emergency conditions, when the significance of price competition as the basis of international trade becomes greatly impaired and other considerations acquire an over-riding importance.

It is characteristic of customs duties that, unless they are made prohibitive and shut out imports altogether, it is impossible to determine with any degree of assurance the precise effect that any increase in the rates will have upon the volume of imports of the commodities involved. This is true under conditions of ordinary price competition, since foreign producers may be willing to lower their prices and thus absorb a part of the duty. It is far more true when tariffs are used against forced exports and when price competition is affected by such powerful promotive factors as currency depreciation and subsidies.

When nations find themselves in conditions in which they believe that they need quick, certain, and drastic reduction of imports, they are likely to resort to quantitative restrictions, which permit the accomplishment of this result. Hence, many creditor countries have added import licences and quotas to the arsenal of their protectionist weapons, while most of the debtor countries have introduced exchange controls, frequently combined with the other forms of quantitative regulation. In addition, the other protectionist devices described above have come into use or have been intensified in their application.

Whether or not the particular protectionist devices are designed primarily to safeguard individual industries or the balance of payments, they operate in practice largely through reduction of imports of individual commodities. It is true that when all tariff rates are raised by a uniform percentage or when currency depreciation is applied in its protective rather than trade-promotive phase, the effect is likely to be on the total volume of imports, rather than on the imports of particular commodities. A similar effect is produced when foreign exchange control is applied in such a way that exchange is released on the basis of a certain uniform percentage of past performance on the part of countries of individual importers. But cases of this sort are the exception, rather than the rule. By and large, restriction is applied to individual commodities.

(The result is that even when the primary objective of protection is the safeguarding of the balances of payments, in effect the action involved leads to the according of an extraordinary measure of protection to individual industries. Usually in order to reduce the requirements for foreign payments, drastic limitation is imposed upon the importation of those commodities which happen to be less indispensable or which happen to be of such a nature that with respect to them expanded domestic production may, with relatively greater ease, supplant imports.) It frequently happens that the safeguarding of the country's balance of payments, becomes merely an excuse for increased protection of individual industries.

This consideration is of great importance in any examination of what may be regarded as the normal and the emergency functions of protectionism. In this connection two problems are of outstanding significance, although there are, of course, many others. The first relates to the safeguarding of the balances of payments by means of trade protectionism. The second is concerned with the choice of protectionist devices in the safeguarding of individual domestic industries.

There is no doubt that, under the impact of sudden disturbing factors, a nation may find it desirable to exert a direct regulatory influence upon its international balance of payments, principally in order to maintain the stability of its currency. It may happen that under such conditions the measures adopted may, without being expressly intended to do so, inevitably have a restrictive effect upon trade. It may also happen that direct limitation of imports may have a decisive significance in attaining the objectives in view. But however wise such a course of action may appear in an emergency, when converted into a more or less lasting policy its effects upon the process of international trade relations is bound to be disastrous.

(Protracted maintenance of currency stability by means of control measures applied to the balance of payments is fully as disruptive of an international monetary system as unstable foreign exchange rates, since an effective functioning of such a system requires not only stability of exchange rates but also freedom for traders to buy and sell international means of payments.) Without these two factors, trade becomes a halting and unsatisfactory process.) Multiangular trade movements and multiangular settlement of international commercial obligations

become obstructed, and nations are pushed in the direction of trade-diverting and trade-destroying bilateral balancing .

The use of quantitative restrictions, even when they are directed primarily toward the safeguarding of individual domestic industries, also alter substantially the character of the trade process. Assuming their suitability under emergency conditions, their use under ordinary trade conditions is a wholly different matter.

The characteristic feature of customs duties noted above — namely, the fact that they do not allow of certain and predictable determination of their effect upon the volume of imports — which militates against their use under emergency conditions, renders them far more desirable as an instrument of protection under normal trade conditions. While customs tariffs unquestionably interfere with a full functioning of price competition in the operation of international trade, they do not, when used in reasonable moderation, destroy such competition or even seriously impair it. They leave a substantial scope both for the exercise of business initiative and enterprise and for a play of the forces of supply and demand in the formation of the prices which consumers in the protected market have to pay for the products of the safeguarded industries.

Quantitative controls place trade on a wholly different basis. They either lead to a system of regimentation of trade, inescapable in any more or less effective attempt to allocate the market between the domestic and the foreign producers, or else they give rise to monopolistic tendencies, which may or may not be successfully tempered, in the interests of the consumers, by direct governmental interference. They tend to deprive trade of its essential flexibility, while their power to create strongly entrenched vested interests is far greater than is the case with customs duties.

In short, on the assumption that, in the present state of the world, some measure of protectionism is practically inevitable, it is clear that there are great differences between the various objectives of protectionism and the various devices by means of which these objectives are attained, from the viewpoint of their basic economic repercussions.

III. *Some Results of Present-day Protectionism*

Any examination of the techniques and objectives of present-day protectionism inevitably raises the fundamental issue of the future of international trade relations. While it is not the purpose of this memorandum to deal with this phase of the problem, some of the considerations involved in the choice between different forms of protectionist policy have just been indicated. Further light upon the problem may be shed by a brief resume of some of the results of present-day protectionism.

Mention was made earlier of the fact that the burden of customs tariffs has increased greatly during the depression. This tendency is strikingly illustrated by the following figures, showing the percentual relation between total customs revenue and the total value of import trade for ten countries during the years 1929 and 1933. (The data are from *Index*, February, 1935.)

Country	1929	1933
The Netherlands . . .	2	8
Belgium	4	10
United Kingdom . . .	5 ¹	16 ¹
France	7	15
Germany	8	25
Switzerland	9	17
Italy	11	26
The United States . .	13	19
Argentina	17	29
Spain	18	29

These figures require a word of explanation, since they represent a tendency rather than tell the whole story. The effective burden on trade is really much greater than these figures indicate. The import trade of every country includes a varying percentage of goods admitted free of duty. Therefore, on the dutiable portion of import trade the tariff burden is much greater than would appear from the ratio applying to the value of the

¹ Tobacco duties, which are exceptionally high, are excluded from the computation. Had they been included, the percentages for the two years would have been respectively 12 and 30.

entire trade. For example, in the case of the United States the ratio between total customs revenue and the dutiable portion of the import trade was 39 per cent in 1929 and 54 per cent in 1933.

The increases in the tariff burden resulted partly from the rise in the tariff rates and partly from the fall in commodity prices. (To the extent that duties are levied on the specific rather than *ad valorem* basis, the percentual relation of the duty to the price of the imported article increases automatically with the fall in the price.)

Another striking development in the past few years has been a contraction of triangular trade. The section on "The Tendency towards Bilateralism" in the League of Nations *Review of World Trade, 1934* contains the following significant comments :

(There are at least two reasons why the tendency towards bilateralism has contributed to the recent fall in the value of world trade. First, measures taken by any country to reduce its trade deficit with another are likely to influence, not only the trade of the latter, but of a whole series of countries.

A move in the direction of bilateralism may cause a reduction in world trade many times greater than that in the trade between the two countries originally concerned. Secondly, the fall in the demand for the products which the victims of this policy can no longer buy to the same extent as previously — owing to the lack of currency available for purchases in markets freely chosen by the importers — causes a reduction (or prevents an increase) in world market prices affecting the value of the trade of all countries.)

The combination of increased tariff burdens, the use of quantitative restrictions and foreign exchange controls, and the trend towards bilateral balancing growing out of attempts at safeguarding balances of payments has resulted not only in an absolute diminution of international trade in both value and volume, but also in a relatively greater decrease in international trade than in total production. Again turning to the calculations of the League of Nations experts, the physical volume of the world production of foodstuffs was, in 1933, approximately equal to what it had been in 1929, while during the same period the world trade in foodstuffs decreased, in physical volume, by 16 per cent. The

volume of world production of manufactured goods declined by 23 per cent, while the volume in the world trade of such goods became reduced by 41 per cent.

February 1936.

(Signed): LEO PASVOLSKY.

Memorandum
on the technique of present-day protectionism

by

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I. *The Measurement of the "Height" of Tariff Levels.*

No clear and unambiguous meaning can be given to the concept of the "height" of tariffs, and no precise economic significance can be attached to any of the current methods of measuring the height of a tariff. Interest in the height of tariffs is presumably based on interest in the economic effects of tariffs and rests on the assumption that there is a close and positive relationship between the height of a tariff and its effects. It would be better procedure, therefore, in discussions centering about the effects of tariffs, if for discussion of the *height* of tariffs there were substituted examination of the possibility of finding approximate measures or indices of the *effects* of tariffs. It is necessary, however, to distinguish between different types of effects of tariffs, since what may be an acceptable measure of one type of effect may be seriously misleading as a measure of another type of effect.

(The significant long run effects of a tariff of a particular country, from the strictly economic point of view, may be distinguished as: 1) the restrictive effect on imports; 2) the economic burden, in the form of loss of real income, resulting for the country imposing the tariff; 3) the economic burden, in the form of loss of real income, resulting for the rest of the world.)

I will endeavour to show that, whichever of these classes of effects is taken as the primary consideration, the ordinary modes of measuring the heights of tariffs by averages of rates of duty in the law, or by averages of rates of duty actually collected on imports, are seriously inadequate as measures or indices of such

effects, and in general have a strong bias in the direction of minimizing such effects.

1. (The immediate purpose of protective import duties is to reduce the volume of imports of the commodities upon which they are imposed. Where there would be any imports in the absence of duties, the imposition of a duty, whether protective or revenue or a mixture of both in intent or in its actual mode of operation, must necessarily tend to reduce the physical volume of the imports of the commodity subject to duty.) The higher the duty also, the greater must be its restrictive effect on imports, until the duty has reached the point where it is absolutely or virtually prohibitive of import, when further increases in the rate of duty would have no effect on the volume of imports. It might seem, therefore, that by comparing the heights of the tariffs of two countries, one would obtain at least an approximative measure of the restrictive effects on imports of dutiable articles of the two tariffs, where the degree of restriction is conceived of in terms of *percentages* of reduction of physical volume of imports resulting from the tariffs. It will be shown that this inference, on its face so plausible, is subject to such serious qualifications that it establishes, at best, only the weakest of presumptions.

Let us take first the most commonly used measure of the height of a national tariff, namely, (the ratio of the total duties collected by a country to the value of its total imports). In such a measure, the duties are weighted by the quantities of the commodities paying the respective duties, with the result that the duties which quantitatively are most restrictive of imports are given the least weight. Since it may be accepted that high duties, other things equal, are more restrictive of import than low duties, this method tends to exaggerate the "height" of the moderate tariffs and to minimize the "height" of the extreme tariffs, from the point of view of restrictive effect on imports, and may even make the tariff most restrictive of imports seem the least burdensome. A duty of a given height, moreover, will ordinarily cause less percentage reduction of import if it is a revenue duty than if it is a protective duty, since in the latter case imports will decline both because the higher price to the consumer reduces consumption and because a greater proportion of the consumption is supplied from domestic sources, whereas in the former case imports fall off only because of the decline in consumption. The

use of the average duty collected as a measure of the height of the tariff will, therefore, tend to make a revenue duty of say 20 per cent ad valorem appear a more serious restriction on trade than a protective duty of the same amount, whereas the reverse is ordinarily the case in fact.

The inadequacy of this type of measure can perhaps be most clearly brought out by a hypothetical illustration. Let us suppose that two countries, otherwise identical, follow different tariff policies, one country levying an import duty of 20 per cent on all imported commodities, while the other levies a duty of 1000 per cent on all commodities whose import it wishes to restrict, and no duty at all on other commodities. Suppose also that, in the case of this second country, the 1000 per cent duty is levied on a wide range of potential imports, and that it is absolutely prohibitive of import. The country with the moderate tariff, much of it purely fiscal in its effects, will appear by the test of ratio of duties collected to total imports to have a 20 per cent tariff, while the country with the prohibitive tariff will appear by the same test to have no tariff duties at all!

Similar objections must be raised against acceptance of another widely-used measure of the height of tariffs, namely, the ratio of total duties collected to the total value of *dutiable* imports. Within the range of the dutiable commodities, greater weight is, by this test also, given to the less-restrictive, (i.e., normally, the lower) duties than to the more restrictive (i.e., normally, the higher) duties. This method, on the other hand, gives no weight whatsoever to the zero duties, and a country with one high duty (say 100%) and all other commodities free of duty would appear by this method to have a more restrictive tariff than another country which levied duties of 90 percent on all imports.

We are led to the conclusion that since weighting by the value quantities of imports gives exaggerated weights to the less-restrictive duties and minimized weights — reaching zero in the case of absolutely prohibitive duties — to more-restrictive duties, it is wrong to use quantities of imports subject to particular duties as weights for the respective duties in measuring the restrictive effects on imports of national tariffs. It may be suggested, therefore, that the restrictive effect of tariffs on imports should be measured by simple averages of rates in the tariff schedules, without weighting of any sort. But this is open to equally serious objections. Rates on commodities of trifling importance

would be given equal weight with rates on major commodities, or on major classes of commodities where an " omnibus " rate in the tariff covers a wide range of different commodities; revenue duties would be given the same weight as protective duties; duties nominal in their effect because levied on commodities which would not be imported even in the absence of duty would be given the same weight as duties which force the consumer to derive his supply of a major commodity from domestic instead of foreign sources.

How, then, are the restrictive effects on imports of different tariffs to be compared? It seems to be necessary to conclude that no satisfactory basis for comparison exists, and that whatever rough index is accepted, *faute de mieux*, as a presumptive measure of the restrictive effects of tariffs, it must not rely on comparisons of levels of rates of duty, whether weighted or unweighted. I suggest, (as the best measure available, although admittedly both imperfect and difficult of application, the percentage of total imports to total national consumption) consideration being given, in interpreting such a comparison, to : (a) the respective areas of the countries; and (b) their per capita incomes. This method of comparing the restrictive effects of tariffs on imports dispenses with the need of reference to the tariffs themselves, and judges of the effects of the tariffs by directly comparing what may be presumed to be these effects. The more restrictive of import a particular country's tariff is, the smaller will be the percentage of its consumption of foreign to its consumption of domestic commodities, other things equal. But the larger the area of a country, the more important will be transportation costs to and from the frontier as a " natural " barrier to foreign trade supplementing the tariff, and in using as a measure of the restrictive effects on imports of the tariffs of two different countries the ratios of their consumption of foreign to their consumption of domestic commodities, it would be necessary to make allowance for the influence of internal transportation costs of there was a substantial difference between the distance from the frontier, along important trade routes, of the average consumer, or producer, in the two countries. The " frontier ", moreover, should be interpreted here as the economic, rather than the political frontier, as it is the comparative distance between producer and consumer according as production is for domestic or for foreign consumption which is significant. A

further reason for making allowances for a small ratio of consumption of foreign to consumption of domestic commodities for a country large in area is that extent of territory and diversity of natural resources and of climatic conditions will tend to go together, so that the country large in area will even under free trade typically produce for itself a wider range of products of the soil than will the country with a restricted area. On the basis of similar reasoning, the ratio of consumption of foreign to consumption of domestic commodities should be discounted somewhat for countries with relatively high per capita incomes, since as relatively expensive and luxurious commodities can best bear transportation costs, such countries would, under free trade, tend to go further afield for their consumption commodities than would poor countries.

It is a further argument in support of the use of the ratio of consumption of foreign to total commodities to total consumption in preference to average rates of duty as a measure of the restrictive effect of governmental commercial policy on imports that the former automatically takes into account, while the latter completely ignores (the substitution for formal import duties of administrative regulations, burdensome formalities, governmental preferences in purchases, official propaganda against purchases of imported commodities, quotas, etc., as means of restricting imports.) The growth in recent years of "administrative protection" in all its varied forms and of direct participation in foreign trade of governments make this consideration an important one.

Too much is conceded, however, (to the modern obsession for "quantification" and for precise measurement, when it leads to the suppression of commonsense and judgment) and to the acceptance in lieu of it of arithmetically precise measurements of something which has an uncertain and variable relationship to the phenomenon which is the real subject of interests. Persons well-informed as to the general economic structure of two countries can, from a general examination of its tariff legislation and the make-up of the imports, of the range of the free list, of as to which is more seriously restricting foreign trade, and can certainly reach a conclusion of greater probable validity than by reliance on any of the common measures of the "heights" of tariffs based on average of duties. Consideration of the volume and of its foreign trade, come to an adequately reliable judgment

the extent of administrative barriers to trade, of the height of the maximum duties and the range of commodities subject to relatively high duties, all in the light of the economic status of the countries concerned, will to competent inquirers tell much more about the extent of governmental restriction of trade than will any of the mathematical formulae, with their spurious air of precision, which have been applied, or advocated, in this connection.

(It should be noted that a given set of import duties is likely to be less restrictive of the total volume of imports than of the imports subject to duty.) If the imposition of a duty, or increase of an existing duty, on a particular commodity, makes that commodity too expensive for consumers in the duty-levying country, they may substitute for it, in part, not only competing domestic commodities, but some other foreign commodity not subject to duty or whose duty has not been raised. When a duty is imposed or raised on a commodity fabricated from a raw material that country does not produce, and the duty results in the establishment or expansion of a domestic fabricating industry and in the suppression of import of the fabricated commodity, the decrease in import of the fabricated commodity will be in part offset by the increase in import of the raw material. A country which does not produce rubber and which hitherto had imported its automobile tires will by imposing a high duty on tires decrease its import of tires but increase its import of rubber. But the increase in the latter will normally be much less, in value, than the decrease in the former import. This, incidentally, is a further consideration against the acceptance of the ratio of amount of duties collected to total value of *dutiable* imports as a measure of the significance of a tariff.

2. For the country levying the tariff, (the burden of long-run protection consists primarily of the excess of the cost at which the protected commodities are produced at home over the cost at which, under free import, they could have been obtained from abroad in exchange for exports.) Protection will in addition tend to alter the distribution of the national real income among the different classes of the population, both by changing the relative rates of remuneration of the different classes of productive services and by changing the relative prices of the commodities predominantly consumed by these respective classes, but whether

such redistribution is to be regarded as favorable or unfavorable will depend upon the nature of the redistribution in each case, and presumably also on the personal views of the observer.

If the sole governmental barriers to trade consist of formal import duties, and if none of these duties exceeds a very moderate level, then we can be certain that the country levying these duties is not incurring a heavy economic burden as the result of the tariff. But if the tariff contains high as well as low duties, it is impossible to obtain even the roughest of measures of the burden of the tariff from any kind of average of the import duties. Where a 5 per cent duty suffices to keep out imports, but the actual duty is 50 per cent, 45 per cent of the duty is surplusage, of no significance except as it may enable a domestic monopoly to exploit its customers under the shelter it provides against foreign competition. It is to be noted here that a duty which may cut off a large volume of imports is not necessarily also a duty which imposes a heavy economic burden on the levying country. Where the domestic cost of production of an important commodity is but slightly in excess of the price at which it can be imported, a low duty will suffice to cut off a large volume of foreign trade, but will not involve a correspondingly large economic burden for the levying country. Great burdens cannot result from low duties, and will not result even from high duties on important commodities, if low duties would have sufficed to keep out imports. The extent of the burden depends on (a) the volume of domestic production dependent on the tariff for its continuance, and (b) the minimum level of duty essential for such continuance.) It is impossible to obtain any measure of this from analysis of imports and actual duties alone, but a satisfactory measure of the burden of its tariff to a country can be found by computing the excess of the aggregate cost of the domestic production of all commodities whose production is dependent on tariff protection over what its value would be at world prices, laid down free of duty in the ports of entry. This would somewhat exaggerate the burden of the tariff, since if its tariff were to be removed, the world prices, in money, and still more in terms of its own export products, at which it could obtain the quantities it would wish to purchase of the protected commodities would rise somewhat. The degree of exaggeration would ordinarily be slight, however, when a single country was under consideration. Unless it were a very large country, its commercial policy would be unlikely to have

market effects on the world price levels of its imports, while if it would under free trade be so important a source of supply for the world of its export staples as appreciably to influence their price, this would indicate that its comparative advantage in producing these staples was so great that its rates of duty, and therefore the burden to it of protection, would have to be correspondingly great to force its producers to abandon specialization in the production of these staples. In so far, moreover, as the removal or reduction by one country A of its restrictions on trade, would lead other countries, either unilaterally or as the outcome of bargaining, to remove or reduce their restrictions on the import of country A's products, the *joint* removal of the tariffs would operate to check the tendency for the terms on which A could obtain its imports in exchange for its exports to move unfavourably to A, and might move them favourably to A. In so far, therefore, as the maintenance by countries B and C of a tariff on A's products can be regarded as the result of A's maintenance of a tariff on the products of B and C, or in so far as A, by removing its tariff on their goods, can obtain the removal of their tariffs on its goods, the total excess in the aggregate money cost of production in A of the commodities whose domestic production is dependent on the tariff over what these quantities would cost at their prevailing world prices free of duty is an approximative measure, in terms of money, of the aggregate economic burden of the tariff, which does not call for substantial correction downwards. The measurement should be on the basis of wholesale prices, since retail prices reflect national differences in retailing costs which apply more or less equally to domestic and to imported commodities, and should be on the basis of *delivered* or *c.i.f.* prices, since if there are special costs (or economies) associated with import other than those resulting from trade restrictions, they could be permitted to influence the calculation.

The actual use of this measure would involve substantial effort, but would not otherwise be subject to serious difficulties. International price comparisons would have to be made for a large number of important commodities, and allowances would have to be made for differences in quality, where the protected article and the article available for purchase in the world market were not identical. The results would undoubtedly be striking, and highly educational.

3. (The tariff of country A, in addition to the burden which it imposes on country A, results in economic loss to the countries whose exports are reduced in volume and/or lowered in price in consequence thereof.) This latter burden of protection even ardent protectionists are willing to admit, and sometimes even to cherish as one of the fruits of protection. It is an undeniably real burden, and yet its measurement, no matter how approximate, appears an impossible task, since it involves a comparison of an existing situation with another hypothetical one. The levy by country A of duties which impinge upon country B's exports has, as its results a diversion by B of productive resources from producing the commodities formerly exported to B to producing the same commodities for home consumption or for export to other countries than B at reduced prices, or to producing different commodities for home consumption or for export to B or to third countries. The fact that this diversion results only from the imposition of duties by country A is sufficient to establish a presumption that it involves economic loss to B. But how measure the extent of this loss? If A's duties are low, the burden on B cannot be great, for B could maintain its exports without substantial reduction in volume by a moderate reduction in their price, and if it did not do so this would indicate that it had available alternative uses for its productive resources involving even less loss. But suppose some or all of A's duties were high? Without careful and comprehensive analysis of each case, it would be impossible to determine whether this meant a heavy burden for country B. High though the duties were, they might still be insufficient to induce domestic production in A of the commodities previously imported from A. If A's demand were inelastic, B might still be able to sell these commodities in A over the tariff wall without substantial reduction in either quantity of price; if A's demands were elastic, or if domestic production were established in A, the import from B might substantially cease. Whether this would involve B in heavy loss would depend on the available alternative uses to which it could put its released productive resources. If other markets were available for the same commodities on not much less favourable terms than those afforded by A's market before the imposition by the latter of its duties, or if the productive resources hitherto engaged in producing for export to B could be diverted without much loss to producing other commodities for domestic

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consumption, for export to A, or for export to third countries, the loss to B resulting from A's duties would again not be severe. Whether or not, therefore, even high duties by A on B's staple exports result in heavy loss to B cannot be determined merely by consideration of the height of A's duties, or their restrictive effect on B's export to A of the commodities subjected to these duties, but depends also on other factors extremely difficult of measurement.

II. *Quotas and Other Import Restrictions.*

(The use of import quotas in lieu of import duties as a means of restricting imports came into existence in modern times as the outcome of wartime conditions.) During the War there was almost world-wide resort to import and export restrictions essentially of the quota type. (These had as their objectives the conservation of productive resources, of gold and foreign funds, and of transportation facilities, for the essential national uses, rather than the protection of domestic industries against foreign competition, which was then a minor consideration if present at all. More stress, in fact, was laid on the conservation of supplies of essential commodities for national use than on exclusion of foreign supplies, and in international bargaining the exchange of concessions frequently took the form of the reciprocal reduction of barriers to *export* instead of the protectionist form of reciprocal reduction of barriers to *import*. After the termination of hostilities, these quantity restrictions disappeared only slowly, and there was, in fact, for a time a tendency to substitute quota restrictions on imports for the disappearing restrictions on exports. (During a period of marked currency disturbances, some governments sought means to protect domestic industries against the flood of abnormally cheap imports which they anticipated — usually mistakenly — would come from the countries with rapidly depreciating currencies, concluded that import duties, and especially specific duties, were too inflexible and too mild a restraint against exchange dumping, and therefore turned to import quotas as a more flexible and more exact instrument for limiting volume of imports to the desired level.) For some countries, moreover, as an added objective, for others the principal objective (of import quotas was the desire to protect their own currencies against exchange depreciation.) By 1928, however,

most countries had achieved what appeared to be definitive stabilization of their currencies, and with the disappearance of exchange fluctuations, came also the almost complete removal of quantitative restrictions on import.

(With the coming of the depression, (widespread resort was again had to the quota system, as a means of protection to currencies, as a means of maintaining employment in domestic countries subject to foreign competition, and also as an instrument of trade bargaining.) This wave of quota legislation had been foreshadowed even before the depression by the adoption in a number of countries of the quota method in dealing with imports of moving-picture films and of grain, and by the United States in dealing with immigration.

As instruments of commercial policy, quotas have, from the point of view of the officials in charge of executing commercial policy, certain distinct advantages over import duties. The fixing of quotas is almost invariably and of necessity an administrative responsibility, whereas legislatures have, for historical reasons, been jealous of their power over tariff rates and have been reluctant to surrender this power to administrative officials. (By the substitution of quotas for import duties, administrative authorities thus obtained a greater measure of power over commercial policy, and appreciated especially the greater flexibility and speed in adjustment to rapidly changing conditions which this made possible. They escaped also in large part the necessity of disclosing and defending their policies in detail before the legislative bodies.) The consuming public, moreover, were ordinarily even less conscious of the burdens resulting for them from import quotas than of the burdens resulting from formal import duties, and by the use of the import quota restrictions could be placed on imports without arousing the same degree of protest from consumers which would have followed the imposition of formal import duties sufficiently heavy to accomplish the same degree of import restriction. In tariff bargaining, also, quotas probably had an administrative advantage over import duties in that their greater effectiveness as restraints on trade made other countries more willing to make concessions to obtain an increase of a quota than they would be to obtain the reduction of a duty.) It was also probably regarded in many quarters as an "advantage" of quotas that since most-favored-nation pledges in commercial treaties made no provision for them, and there was no

satisfactory way in which the most-favoured-nation principle could be applied to them, they opened a path to almost unlimited discrimination between countries, without involving overt and unambiguous violations of at least the letter, if not the spirit, of existing most-favoured-nation obligations.

Quotas, however, were soon found to have offsetting disadvantages even for the administrative authorities. The same absence of an obvious rule for allotting quotas among different countries in accordance with treaty obligations or equity which facilitated discrimination between countries made it also impossible for countries to acquit themselves of charges of unfair discrimination no matter how guiltless they were of the intention unfairly to discriminate, and no matter what principle of allotment they adopted. (The task of allotment of the quotas among importers was also extremely difficult and burdensome, and made necessary continuous negotiation and controversy with importing interests, much more embarrassing in kind and more intensive in degree than the formalities involved in the routine administration of ordinary import duties)

From the point of view of the general public interest, the quota system has, as compared to ordinary import duties, some minor advantages, some of which, moreover, seem in practical experience to be more theoretical than actual, and has some major and certain disadvantages. (The advantages of the quota over the import duty are : the greater speed with which quotas can be varied conform to changed conditions; the greater precision with which quotas can be used to accomplish the objective of commercial policy, when that objective is the reservation for domestic production, regardless of cost, of a specified minimum proportion of the domestic market for particular commodities; the greater effectiveness of quota increases than of import duty reductions in trade bargaining.) (The disadvantages of the quota system, though less obvious, seem much more weighty. It involves the transfer of tremendous power to administrative officials, without effective safeguards against bureaucratic abuse and arbitrary execution, and with dangerous temptation to corruption. It destroys the effectiveness of the most-favoured-nation pledge as a guarantee against discrimination and a means of assuring that, as between foreign countries, the contribution to imports shall be allotted in accordance with the ability to supply them at the lowest money costs. It is free from the maximum

limit which a stable import duty imposes on the extent of sacrifice which a country shall assume to exclude importation, and it conceals from the public, and generally from everyone, the extent of the maximum sacrifice involved in such exclusion. The authority to change quotas without reference to the legislature tends to give assurance to domestic producers of commodities subject to quota that no matter how much they extend their production, a satisfactory market will be established for them through the progressive reduction of the import quotas, and thus tends to encourage the unlimited expansion of high-cost industries.) Whereas under import duties the excess of the price in the sheltered market over the world price, so far as the imports are concerned, goes to the Treasury in the form of customs revenue, under the quota system, unless complex and difficult administrative precautions are devised and successfully administered, this excess will go as a windfall profit to either the foreign exporters of the domestic importers who receive quota allotments. (When used as an instrument of tariff bargaining, the quota tends to discriminate against triangular trade — which is not inherently less advantageous than bilateral trade — and in general to foster an uneconomic allocation of production as between foreign countries.)

It should be noted also that countries may, and frequently do, impose obstacles to import trade in other ways than by levy of import duties or imposition of import quotas, and that these other methods are peculiarly uneconomic because they make imports more expensive not by adding a tax to them whose proceeds constitute revenue for the national treasury, but by making the process of importation itself more costly both for the importer and for the customs administration. Among such administrative barriers to import are : import restrictions and examination and other requirements in the guise of sanitary regulations; burdensome regulations with respect to the passing of goods through customs; marking of origin requirements; and provisions creating uncertainties and risks for the importer with respect to the amount of duty for which he is liable. The nature and purpose of such provisions is not often frankly conceded, but an enlightening exception is presented by the following passage in the decision of an American customs authority in a case involving the interpretation of the " marking of country of origin " provision in the American tariff :

The purpose of Congress in enacting this provision was to make competition with the domestic manufacturer more difficult and expensive, and if compliance with its requirements should render articles less desirable to purchasers, or should be more expensive and difficult, such fact could not defeat the intention of Congress, which was to reduce, if not prohibit, competition with American manufacturers. (T.D. 40,771 — G.A. 8961.)

The growth of direct participation by government in economic activities has also operated to increase the importance of barriers to trade which take other forms than import duties. Where a government is itself an important purchaser of commodities, it may operate to keep down the volume of imports by confining its purchases to domestic commodities even when there is a pronounced price advantage in favour of foreign commodities.

As the combined result of all of these factors, import duties have shrunk greatly in importance relative to other types of restrictions on imports, and in a number of countries the formal schedule of import duties in the tariff law has become a minor element in the general aggregate of restrictions on imports.

III. *Currency instability and trade barriers.*

Not only does currency instability constitute in itself a barrier to trade, but the existence of currency instability or of threats to currency stability leads in several ways to the deliberate establishment of restraints on imports, which, imposed though they are as emergency measures, tend to persist long after the situation which led to their establishment has passed away.

If the currency of a particular country is fluctuating in its exchange value in terms of the currency of another country and if the actual or anticipated fluctuations are substantial and irregular, this instability of exchange rates operates as a barrier to trade between these countries. If the exporter demands payment in his own currency, the foreign potential buyer may hesitate to take the risk that by the time payment is due, the cost to him of the merchandise in his own currency may be much higher than when the purchase was being negotiated, or the alternative risk that shortly after he made his payment the currency of the export-

ing country will depreciate sharply and the merchandise he bought will drop in market value in terms of his own currency. If the sales are made in terms of the importer's currency, the exporter may be reluctant to assume the risks and will therefore be restrained from pushing his export sales.) To some extent, protection against these risks can be obtained by hedging operations in the currencies involved. Aside, however, from the costs of the hedging transactions, this remedy is available only to a limited extent, since markets in forward exchanges are narrowly limited in the range of currencies dealt in, and for the less important currencies the markets are either non-existent or are "thin" and uncertain, so that it is difficult to obtain protection at moderate cost in the required amounts and for the required periods. (Foreign trade, moreover, is not merely a question of sales and purchases of commodities, but involves heavy long-term investments in sales agencies, assembly plants, transportation facilities, etc., and where such investments must be made in foreign currencies there is no available means of hedging against the risk of depreciation of those investments because of depreciation of the foreign currencies through which the investments were made.) It is to be noted, however, that the important instabilities from the point of view of foreign trade are instabilities in exchange rates, and instabilities in the gold values of currencies are important from this angle only as they involve, or are associated with, instability in exchange rates.

Countries whose currencies are under pressure, and which are determined not to permit them to depreciate, (have available only two methods of relieving themselves from such pressure, induced deflation at home, or restrictions on imports.) The former method is everywhere unpopular, and for governments which are not strong involve political dangers which few governments are willing to face, whereas restrictions on imports are more likely, at least initially, to increase than to decrease the popularity of the government. There is a natural tendency, therefore, for governments to resort to restrictions on imports as a means of coping with the emergency, rather than following other, politically more risky, expedients. The fact that increasing the barriers against imports is likely to prove a blind alley, since it relieves the country of deflationary pressure only if other countries do not, either in retaliation or in self defense, follow suit, is rarely given adequate consideration by the responsible authorities, and

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this procedure tends to result in a competitive race to raise the barriers on trade still higher, with damage to the *quality* of domestic employment and no increase, or even a decrease, in its quantity.

(A common expedient resorted to to protect a currency against depreciation, or to avoid forced resort to deflation, is to restrict the amount of exchange which importers may transmit abroad to the amount of the exchange proceeds from exports.) In this way, a balance is artificially maintained in the exchange market, but at great cost to the volume of foreign trade, and where by "compensation" agreements or unilaterally the balancing of payments against receipts is enforced by individual countries rather than for trade as a whole, the impact of the exchange restrictions falls with discriminatory severity on the trade with countries which are important sources of supply but are not important markets for your country's products, and, more generally, on triangular or multilateral trade.

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star (Exchange controls, however, are in some respects less injurious than import quotas involving the same degree of restriction of import, for whereas separate quotas are allotted as a rule for each important commodity, an exchange restriction is in effect a global quota for imports of all kinds from a particular country, and the apportionment of this quota among the different commodities is left to the determination of the ordinary forces of the market.)

It is, of course, possible to use depreciation of the currency as a deliberate substitute for increases in the tariff where the objective is to force a decrease of imports. Deliberate depreciations of the currency, as distinguished from mere surrender to pressure, have, however, been exceedingly rare in modern times, and when they were engaged in the major purpose seems to have been rather to escape from an internal deflation or from the unemployment resulting from rigid prices rather than to restrict imports. (Currency depreciation is commonly regarded as so much more serious a step than increase of tariff rates that to use it as a substitute for increased rates would to most persons — and rightly — seem like using a sledge-hammer to kill a fly.) When currency depreciation is in serious contemplation in any country, the additional protection against foreign competition which will — or may — result from it will often be advanced by its protagonists as an additional argument in its favor, but in general it

seems unlikely that it has ever been a major element in the decision to depreciate — or to permit depreciation to occur.

The existence of currency instability, or of the threat to currency stability, leads, however, in several ways to the deliberate establishment of barriers to trade. A country still adhering to the gold standard or to a currency pegged to gold or to another relatively stable currency, may find its currency under pressure because of competition in its own market or in its export markets from the abnormally cheap exports of other countries with recently depreciated currencies, or because of its inability to maintain its export sales in the accustomed volume, or at the accustomed prices in its own currency, in the markets of countries with recently depreciated currencies. (Even if it has abundant specie or valuta reserves, it may feel that the appreciation of its currency relative to other currencies is resulting in abnormal pressure of foreign competition on its domestic producers and in unemployment and budgetary deficits.) Countries finding themselves in this situation are under a strong temptation to seek at least partial relief from these pressures by imposing new restrictions on import trade, and because of the rapidly changing nature of the problem, they are likely to resort to the more flexible types of import restrictions such as "exchange-dumping" duties, import quotas, and changes of tariff rates by administrative action, rather than to the relatively inflexible method of legislative amendment of their tariff schedules. A country, moreover, whose duties are specific rather than *ad valorem* and whose currency, because of depreciation of foreign currencies, has a rising value in the exchange markets, is, in effect, undergoing an automatic rise in the level of its tariff, when calculated on an *ad valorem* basis, when prices in the countries with depreciating currencies are rising, if at all, in less proportion than the depreciation of the exchange value of their currencies. The depreciation of foreign currencies tends also to result indirectly in still another way in the raising of the tariffs of the countries with the relatively appreciating currencies. The relative appreciation of a currency tends to have deflationary consequences on prices and on the physical volume of business and employment, i.e., to cause "depression", and it is when bad business conditions are unfavorable that the pressure for tariff increases is most vigorous and the resistance to such pressure weakest, as a rule.

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IV. *Relation of Embargoes on Capital Exports and on Payments of Interest to Commercial Policy.*

In periods of acute depression, a debtor country with large fixed interest obligations on past obligations and with the previous inflow of new capital sharply cut down and perhaps even reversed through calls for amortization of old indebtedness, is likely to face serious difficulties in meeting its current foreign obligations. Increase in the value of its exports is likely to prove impossible, because in times of depression foreign demands will have fallen, and, in addition, the depression will probably have led to the introduction by foreign countries of added barriers to the entrance of foreign commodities into their markets. Even if money costs are sufficiently flexible in the debtor country to permit substantial reductions in export prices to be made, such reductions, while tending to result in an increase in the *physical volume* of exports, are by no means certain to result in an increase in the *monetary value* of the exports. In any case, any increase in the latter is certain to be substantially smaller, in percentage terms, than the increase in the former. To meet its external obligations, therefore, a debtor country in a period of world-depression must drastically reduce the value of its imports, and such reduction will not necessarily occur automatically with the speed and to the extent required if its external obligations are to be met. Under these conditions the government may judge it to be necessary either to impose new restrictions on imports or to default on its own external obligations, or — if the external obligations are mainly private and the debtors are still solvent — to prevent full payment of interest and amortization obligations due to foreign creditors by nationals.

The creditor country which during a depression imposes new restrictions on commodity imports (or on the export of capital) is therefore in effect by these measures operating to force the debtor country to default on its capital obligations, or to increase its own barriers on imports, or to do both. While debtor countries are sometimes only too ready to grasp any excuse for failure to carry out their financial obligations to the letter, the common behavior of creditor countries in the field of commercial

policy during a severe depression does provide their debtors with some measure of moral, if not legal, justification for refusing to make tremendous sacrifices in the attempt to fulfill the letter of their bonds.

Countries which deliberately assume the creditor rôle should either feel compelled to recognize that they thereby assume also an obligation to refrain from measures which make fulfilment of their contracts by the debtors actually or seemingly impossible or possible only at the cost of intolerable sacrifices, or else they should reconcile themselves to accepting with good grace failure by their debtors to meet their obligations on schedule during periods of stress. (One of the clearest lessons to be learnt from the experience of the past few years is that before resumption of international capital movements on anything like the pre-depression scale can safely be permitted, there must occur a substantial reduction of trade barriers, even compared to their 1929 levels, and that the creditor countries in particular must recognize the inconsistency — and the futility — of demanding full payment of what is owing to them if they are simultaneously following a trade policy which makes such payment unreasonably burdensome if not impossible.)

(Foreign trade, the free movement of capital, stable exchanges, were dominant factors in the economic progress of the world during the century before 1914, and their power to contribute to future prosperity, if given the opportunity, is undiminished.) But without substantial freedom of trade, exchange-rates stabilization will seem to many countries dangerous or inexpedient; without exchange-rate stabilization, few countries will be prepared to assume the risk involved in unilateral reduction of import restriction while their currencies are vulnerable and their labor still incompletely employed; without both a substantial measure of freedom of international trade from restrictions and of exchanges from wide fluctuations in value, international capital movements will not resume, and would involve serious risks if they did resume. (The multiplication of trade barriers, fluctuating exchanges, and restrictions on capital movements, are all closely interrelated manifestations of one general evil, namely, the disharmony between the economic interdependence of the nations of the world and the narrowly nationalistic orientation of their economic policies.) Movement

toward a greater measure of international economic cooperation, if it is to yield early and abundant results, must deal simultaneously with all three aspects.

February 1936.

(Signed): Jacob Viner.

**Comments
on the improvement
of commercial relations between nations**

by

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1. The permanence or impermanence of import quotas and of other devices for quantitative regulation of imports depends upon the character of the general economic structure of the nations employing such devices. (Generally speaking, control over the physical quantities of any particular commodity entering a country has a *raison d'être* under two sets of conditions: (1) when the production or marketing of the commodity in question is subjected to regulation within the country; and (2) when emergency circumstances render desirable a rapid and certain restriction of the volume of imports of that particular commodity. Quotas which represent an accompaniment of internal regulation are not likely to be abolished, unless the system of regulation is itself abandoned. On the other hand, quotas which operate in the absence of such regulation are not likely to be long-lived.)

(Most of the quota systems in existence today belong to the second category. They were introduced for emergency reasons or as a means of retaliation, and logically ought to disappear when the conditions which brought them into being cease to exist.) However, like all strong protectionist measures, they tend to create vested interests, which are frequently responsible for their continuation long after the original difficulties which they were designed to correct become capable of adjustment by other and less drastic means.)

At the same time, quotas are in no way different from other emergency measures, which, if continued in operation too long,

tend to set into motion forces that bring about their own destruction. Quota systems are administratively irksome and expensive. Because of their drastic nature, they create violent alterations in movements of trade and wide disparities between national price levels. They are difficult to apply in a non-discriminatory manner and, therefore, introduce an element of hostility into international commercial relations. By impairing foreign markets, they arouse the opposition of the exporting industries. By raising prices, they become anathema to the consumers.

All these elements combined have, no doubt, been responsible for the fact that during the past two years there has been a noticeable slowing down in the extension of the quota idea. In fact, in most of the quota countries the tide is visibly beginning to set in the opposite direction.

It is scarcely to be anticipated that quotas and other quantitative controls can be abolished with anything like the same swiftness with which they were introduced. But there are many ways in which their demobilization can proceed. There are to-day numerous individual quotas which have long ceased to serve any useful purpose and which can be weeded out without in any way impairing the particular interests for the defense of which they were originally set up. There are numerous other individual quotas which, because of changed conditions, can be gradually enlarged, until they become means of safeguard rather than of direct restriction. There are still others which can be superseded by more normal and less drastic and disturbing devices.

Finally, the customs quota, under which there is no limitation on the total physical volume of imports, but only a limitation on the quantity that may be brought in at relatively favourable rate of duty, may provide, in some cases, a feasible method of transition away from quantitative regulation.

II. — IV. — VII. These three points can be more conveniently discussed together than separately. I shall touch upon the following aspects: (1) relative efficacy of bilateral and multilateral agreements as instruments for the reduction of trade barriers; (2) bilateral agreements without the use of the most-favoured-nation clause; (3) bilateral agreements with the conditional most-favoured-nation clause; (4) bilateral agreements

with the unconditional most-favoured-nation clause; and (5) criteria for the generalization of concessions under the unconditional most-favoured-nation principle.

(1) (In my opinion, bilateral agreements are more effective than multilateral arrangements as instruments for the reduction of trade barriers. It is difficult to imagine a multilateral agreement that would do more than provide for a horizontal cut in the general level of customs duties in the participating countries.) Such a cut, because of its general nature and because of the differences in the economic position of the countries concerned, is not likely to be extensive. Most of the recent discussions with reference to possible multilateral commercial arrangements have run in terms of cuts of the order of magnitude of 10 per cent. Bilateral agreements, on the other hand, permit much larger reduction with respect to selected commodities. Each of the signatories can concentrate its attention upon those trade barriers which hurt the most and can seek concessions with regard to those of its exports the sale of which in the market of the other signatory is especially restricted. While the bilateral method is slower and more cumbersome than the multilateral method, it is more likely to result in an increase in the volume of trade, provided, however, it is accompanied by appropriate action in the field of the application of the most-favoured-nation principle.

While less effective than bilateral agreements for purposes of direct demobilization of trade barriers, multilateral agreements have great usefulness from another viewpoint. They can be utilized to advantage in securing uniformity of general principles and practices, and in this manner provide an important foundation for, and facilitate the conclusion of, bilateral agreements.

(2) (The omission of the most-favoured-nation clause from a bilateral agreement is usually for the purpose of giving such an agreement an exclusive of preferential character. Agreements and arrangements of this sort are, in my opinion, highly detrimental to an effective functioning and satisfactory development of international trade. They inevitably cause diversions of trade from its accustomed channels. They create a tendency toward bilateral balancing, which serves to intensify trade diversion. They set up a vicious cycle of discrimination and retaliation.) As a result, while they may, in some cases, facilitate the solution of immediate

difficulties arising between the two nations concerned, their general effect is to cause a reduction in the general volume of world trade and frequently also in the volume of trade between the two nations themselves.

(3) (The same objections apply fundamentally to bilateral agreements based on the conditional most-favoured-nation principle. Under that principle, the concessions which one country grants to another apply initially exclusively to that other country, although their benefit may be extended to any other country which is willing to offer equivalent concessions.) By the same token, the country with which the particular treaty or agreement is concluded, does not receive automatically the benefits of concessions accorded in the next treaty or agreement, but must bargain for them additionally. The result is that discriminations are constantly set up — initially, in favour of one country and against all others, and gradually in favour of some and against other countries. These discriminations can be removed only through a long and confused process of continuous negotiation. In the meantime, trade currents are caused constantly to shift, in smaller or greater degree.

Moreover, when a country concludes with another country a bilateral agreement based on the conditional form of the most-favoured-nation-principle, it does so with a full realization that later on it will be called upon to offer additional concessions in order to secure additional benefits. Hence, it will naturally tend to hold possible concessions in reserve. Initially, therefore, such agreements are likely to be not nearly as far-reaching as they could be if it were not necessary to hold something in reserve for future use.

(4) In my view, only bilateral treaties and agreements based on the unconditional most-favoured-nation principle can be really effective in bringing down trade barriers and in supplying a satisfactory basis for the development of international trade. This principle was one of the important bases upon which commerce achieved its development during the half-century preceding the world war and upon which it was reestablished during the post-war years. It renders possible equality of treatment and thereby lends flexibility to international commercial competition.

The inclusion of an unconditional most-favoured-nation clause in a bilateral agreement requires, as a necessary corollary, a

generalization of the bilaterally granted concession to all or most of the other countries. The clause means a mutual pledge on the part of the two signatories to extend to each other, automatically and without any further compensations, the benefit of any concessions granted by each of them to a third country. The pledge can clearly be fulfilled only if such automatic generalization of concessions is practiced, as a matter of policy, by each of the signatories.

The usefulness of the unconditional most-favoured-nation principle may be substantially impaired if that principle is applied in a limited, rather than unlimited, form. In the latter case, most-favoured-nation treatment extends to all commodities; in the former, certain commodities may be exempted from its application. Under present-day conditions, the principle is usually applied in its unlimited form, although some countries retain, as a matter of policy, a system of exempting specified commodities.

(5) In the application of the unconditional most-favoured-nation principle, a substantial importance attaches to the criteria used for establishing the basis of generalization. The customary and, in my opinion, the most acceptable test is that of non-discrimination. A country may generalize bilaterally granted concessions to all countries without exception. Alternatively, it may generalize only to countries which in fact accord its commerce non-discriminatory treatment. Or it may limit generalization only to those countries with which it has a treaty or agreement providing for a contractual most-favoured-nation obligation. (Of the three forms, I consider the second the most effective. The third is too limited in scope, while the first provides no basis for exerting an influence upon discriminating countries to cease discriminatory practices.)

Some students of commercial policy believe that generalization of concessions under the unconditional most-favoured-nation principle should be denied to countries which maintain a relatively high level of protection or which pursue in other ways commercial policies which may be regarded as relatively illiberal. In my opinion, the use of the principle for this purpose is likely to impair rather than strengthen its efficacy. The principle is admirably suited as an instrument for establishing a regime of equality of treatment, but its effectiveness for this purpose will

clearly be impaired if it is also used as a means of reduction of trade barriers. Other and more powerful means exist for accomplishing this latter result.

For example, there is a sufficient degree of national specialization for the rule of the principal supplier to be employed very effectively. A country concluding commercial treaties or agreements with other countries can restrict the granting of concessions to each of the latter only to those commodities of which it is the principal supplier. Unless too closely restricted by minute sub-classification of tariff items, such concessions are, under the unconditional most-favoured-nation principle, of value to many countries in addition to the principal supplier. On the other hand, there are few countries at all important commercially which can secure full benefit for their export trade merely through generalization, unless trade barriers are reduced on those commodities of which they are the principal suppliers. The withholding of such concessions from recalcitrant countries by refusing to negotiate with them constitutes a powerful weapon for securing liberalization of commercial policies on the part of such countries.

III. (The absence of currency stability has an extremely detrimental effect upon the process of reduction of trade barriers.) So long as no assurance exists as to the relative values of the national currency units, nations will hesitate to assume definite and far-reaching commitments with respect to the devices which they employ for the protection of their national economies from foreign competition. The degree of reduction of customs duties will inevitably be such as to take into account the possibility of a sudden and substantial alteration in the terms of trade resulting from changes in the exchange rates. While such danger exists, there is little likelihood that the machinery of quantitative control will be scrapped, since its operation might have to be invoked on short notice to meet emergency conditions. For the same reasons, commercial treaties and agreements are likely to be of short duration or be made subject to denunciation on short notice. Alternatively, reservations with respect to change in the exchange rates are likely to be written into commercial treaties and agreements. Such reservations are included, for example, in the trade agreements which are being negotiated by the United States, in the following form :

In the event that a wide variation occurs in the rate of exchange between the currencies of the United States of America and, the government of either country, if it considers the variation so substantial as to prejudice the industries or commerce of the country, shall be free to propose negotiations for the modification of this Agreement; and if agreement with respect thereto is not reached within thirty days following receipt of such proposal, the government making such proposal shall be free to terminate this Agreement in its entirety on thirty day's written notice.

The writing into commercial treaties and agreements of reservations of this type was recommended in the resolution on commercial policy adopted last September by the Assembly of the League of Nations.

Such reservations represent an attempt to reconcile the process of demobilization of trade barriers with an absence of definite currency stabilization, but their use serves to emphasize the fact that at least *de facto* stability must underly any contractual agreements or arrangements for a reduction of trade barriers. It is clear, however, that the very need of incorporating such provisions in commercial treaties and agreements renders the operation of these instruments precarious and uncertain.

VII. (Past experience with a tariff truce has shown clearly both the usefulness and the limitation of this device. The creation of a ceiling to trade barriers is indispensable to any general and widespread movement toward a demobilization of trade barriers.) But unless it is followed by such a movement and serves merely as a starting point for it, a customs truce is not likely to be maintained. These two propositions were demonstrated with great clarity by the experiment with a customs truce during and after the London Monetary and Economic Conference, of 1933. In other words, a tariff truce must inevitably be precisely what the phrase itself implies : an interval which cannot last, but which must lead either to a treaty of peace or to renewed hostilities.

February 1936.

(Signed): LEO PASVOLSKY.

Comments on the Improvement of Commercial Relations between Nations

by

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I. *The Possibility of Abolishing of Mitigating the Use of the Tariff Quota.*

(Because the quota is a more effective means than the import duty of restricting imports, its disappearance cannot be expected unless protectionist sentiment subsides.) But a number of factors will, or may, work toward a decline in the extent of the resort to it.

(a) The duties and responsibilities it imposes on administrative authorities will tend to become burdensome to them, especially as the struggle by interested importers to gain larger fractions for themselves of given quotas becomes more intense, and as the importers become more efficient, or more insistent, in applying political and other pressures.) It may reasonably be predicted also that corruption and favoritism will invade this fertile field, and general discredit for the quota system may thereby result, with a consequent revulsion of opinion against it.

(b) The countries which do not themselves practice the quota system could check its growth by pressing in their trade bargaining for quotas so large as to cease to be restrictions on imports, by protesting vigorously when reasonable grounds exist for holding that the quotas assigned to them violate the spirit if not the letter of their claims to most-favoured-nation treatment, and in general by resisting as far as possible the application of quotas to their exports.

(c) The fact that there is no simple rule or formula for apportionment of quotas between different countries which is demonstrably equitable to all tends to make each quota a basis for

recriminations and for claims of unfair discrimination by foreign countries, and thus tends to make the application of quotas a nuisance for at least the diplomatic branch of the government applying them.

(d) (One of the main arguments for quotas is that they are a more flexible instrument than import duties for dealing with abnormal trade conditions resulting from disordered exchanges and acute depression. Currency stabilization and economic recovery will operate to deprive this argument of force and to weaken the attachment of economic groups to the quota system.)

(e) (Countries which would not think of abandoning the quota system unilaterally might be willing to contemplate such abandonment if it were part of an international movement in this direction.) Multilateral agreement seems a much more promising avenue to mitigation of the quota nuisance than either unilateral or bilateral action, especially as in any international conference there would be important participants who were definitely hostile to the quota system, or who had adopted it only or mainly as a means of coping in trade bargaining with other countries who adhere to it. Except, however, on the ground that past experience indicates that protectionism has tended to wax in periods of depression and to wane in periods of prosperity, there is not much in the present situation to give hope of an early demise of the quota system. One can resort to wishful thinking about the irresistible influence in time of education and the spread of enlightenment, but the educational process works slowly and uncertainly, and its product is not invariably good to look upon.

II. *The Past and the Future of the Most-Favoured-Nation Practice*

(a) *The Unconditional Form*

Certain important advantages flow from the unconditional most-favoured-nation practice.

(1) Given the extent to which a country desires to permit imports, the application of uniform rates to imports of similar commodities, regardless of their country of origin, leads to the imports being made from the countries which are willing to provide them at the lowest prices. It especially safeguards the importing country from the danger that the country (or countries) receiving preferential treatment will be unable or unwilling

to provide the full quantity which the importing country demands, so that the importers in the latter country must resort to countries subject to the full duty for portions of their supplies; that the price level prevailing in the importing country is therefore the world-price *plus the full duty*; that exporters in the favoured country, for the portion of the trade which they supply, therefore obtain the world-price *plus the amount of preference in duty enjoyed by them*; and that the amount of the preference thus, in effect, constitutes a subsidy to exporters in the favoured country at the expense of the customs revenue of the importing country.) When a reduction of duty is extended to all countries, the Treasury's loss of customs revenue is offset by the consumers' gain in the form of lower prices; when the reduction of duty is granted only to a country, or countries, providing only a fraction of the imports, the loss to the Treasury is not offset by a corresponding gain to the consumers.

(2) Uniform tariffs, regardless of origin of imports, avoid giving rise to the irritation, controversy, an international ill-feeling which results when countries find that their exports are being subjected to discriminatory treatment.) There is no case on record where a country whose exports have been subjected to higher duties than exports from another country has acknowledged that such discrimination was justified.

(The most weighty arguments against unconditional most-favoured-nation practice will next be commented on :

(1) It is claimed that the increasing specialization of tariff rates, and the use of administrative regulations and quotas in lieu of import duties, make possible almost unlimited discrimination between countries without overt violation of the letter of the most-favoured-nation pledge, and that the pledge is thus losing its significance.) There is much force to this objection, but it is to be noted that it is equally valid against the conditional form of the pledge, that something — though not much — can be done, through additions to the usual wording of the pledge, to provide protection against discriminatory administration and discriminatory quotas, and that in any case whatever protection against discrimination the most-favoured-nation pledge still provides is so much to the good. It must be admitted, however, that both tariff specialization and the substitution of other devices for

import duties have lessened the effectiveness of the pledge, and that there is no reason for supposing that it will regain its former importance if these practices continue to prevail. Even more serious perhaps is an apparent tendency of countries bound by such pledges to disregard them whenever inconvenient, and of countries holding such pledges to refrain from vigorous protest when they are violated.

(2) (It is claimed that unconditional most-favoured-nation practice, instead of promoting tariff reduction, operates as a barrier to such reduction through tariff bargaining.) Country A, it is held, will be reluctant to grant concessions to country B, if it knows that it must immediately extend them gratuitously to all countries entitled to receive most-favoured-nation treatment from it, and country B, moreover, will be less tempted to offer return concessions to A if it knows that it must share A's concessions with all the rest of the world.

Granting for the moment that concessions which must be generalized will not be valued as highly by the other parties to tariff negotiations as would exclusive concessions, it should be remembered also that exclusive concessions are much more likely than generalized ones to be economically costly to the grantor country. (See *supra*.) If concessions are made exclusive, moreover, this restricts the number of concessions which can be made, and therefore the number of countries to whom attractive offers of concessions can be made. If the concessions, instead of being made exclusive, i.e., confined by agreement to a single country, are simply not generalized, and the country receiving the concession does not also receive a pledge of most-favoured-nation treatment, it is not likely to place a high value on the concession, since not only may it later be extended to other countries, but in subsequent negotiations other countries may be given even greater concessions on the same items, with the result that the original concession becomes totally valueless. Even countries that are reluctant to give the most-favoured-nation pledge are insistent, therefore, upon obtaining it, and while the unconditional pledge does, in some ways, act as a barrier to negotiation of tariff treaties, refusal to grant it would also act such a barrier, and, if we may judge from past experience, to even a greater degree.

In modern times there have been three important instances of attempts to carry on tariff bargaining on other than the un-

conditional most-favoured-nation principle, and in each case the attempts were either failures or return to the unconditional principle became necessary before the negotiations had been completed.

Sardinia, in the 1850's, initiated a series of tariff negotiations in which she planned, in addition to the specific tariff concessions to be made by her, to grant only a pledge of conditional most-favoured-nation treatment. But Austria, through fear that any concessions granted to her by Sardinia would be rendered nugatory by subsequent greater concessions on the same items, and also with the objective of gaining protection against discrimination by Sardinia on items not included in the Austro-Sardinian treaty, would negotiate with Sardinia only if Sardinia agreed to include an unconditional most-favoured-nation pledge in the treaty. Sardinia was forced to yield, and her grant to Austria of an unconditional pledge had the effect of making all her formally conditional pledges also unconditional in their mode of operation.

The United States, from 1890 to 1913, carried on tariff bargaining on the basis of the conditional principle, but only with mediocre and diminishing results. At the beginning of the period, there was not general understanding of the differences between the conditional and the unconditional pledge, and, moreover, the statutory limitations on the concessions which the United States could make by treaty or agreement gave assurance to negotiating countries that once they had received the minimum rates permitted by the statutes no countries could be given lower rates without new legislation. At the beginning of the period, moreover, the United States were in a peculiarly strong bargaining position. The principal item they used for bargaining purposes was the sugar duty, and the competition between the sugar-producing countries to find a market for their subsidized sugar crops was so intense that an important importer of sugar was in a strong bargaining position. The United States, moreover, were at the beginning of the period, still predominantly an exporter of raw materials and foodstuffs and an importer of manufactured products, and at that time the countries of western Europe were much more concerned with finding markets for their manufactures than with protecting their food and raw-material producing industries against foreign competition. In spite of their advantageous position, the United States nevertheless obtained only meagre results from their bargaining. Many of the

concessions they received were merely nominal, or consisted of the removal of discriminations to which they would not have been subject in any case if they had been following the unconditional practice themselves. With the exception of some exclusive concessions extracted from Brazil by strong-arm diplomacy, for which episode two later presidents of the United States offered apologies, none of the concessions received by them from any country were exclusive or even special in character. The discriminations in their treatment of imports coming from different countries led also to repeated and acrimonious diplomatic protests, and were in part responsible for the fact that the export trade of the United States was, before the war, subjected to more open discriminations in foreign tariffs than the exports of any other important country. In 1923, after an exhaustive study of its own experience under the conditional practice, and the experience of other countries under both practices, the United States Government abandoned the conditional practice which it had hitherto followed from the beginning of the republic, and adopted the unconditional most-favoured-nation practice.

The third instance is provided by the experience of France in the post-war period. France emerged from the war determined to abandon the unconditional practice, against which she was prejudiced because it had been imposed on her by Germany in the treaty ending Franco-Prussian War. She promptly entered into a series of tariff negotiations, with the determination not to grant any unconditional pledges, but soon found that she could not obtain significant concessions from other countries unless she gave them guarantees that her own concessions would not be nugatory by still greater concessions to third countries on the same commodities, and, as the negotiations worked out, the countries negotiating with her obtained pledges of unconditional most-favoured-nation treatment sufficiently extensive to cover all the trade possibilities in which they had a substantial interest.

There is, however, one aspect of unconditional most-favoured-nation practice which, it must be conceded, does operate both as a check to tariff bargaining and as an obstacle to tariff reduction. Where the unconditional most-favoured-nation pledge is granted as a routine matter, or unconditional most-favoured-nation treatment is granted without bargaining even in the absence of a pledge, a country with a prohibitively high but uniform tariff may refuse to enter into tariff negotiations at a time when they are

prevalent, content to wait for the flow of concessions which other countries grant to each other for compensation to accrue to her without involving her in the necessity of making compensatory concessions. The existence of countries which follow this practice has a natural tendency to make other less intransigent countries reluctant to enter into tariff-reducing agreements among themselves whose benefits they will have to extend to the non-bargaining countries.

There is a solution for this problem which is consistent with adherence to the unconditional principle. The most-favoured-nation pledge should not, or need not, be granted as a routine matter, and as merely an incidental provision in stereotyped treaties of commerce and navigation. It should, instead, be made an integral part of *tariff* treaties, and accorded, reciprocally, as one of the significant items in the mutual exchange of considerations. The life of the pledge, moreover, should be made coterminous with the life of the other provisions in the tariff treaty. To countries with low-tariff and non-bargaining policies most-favoured-nation treatment should be extended without a pledge, or if with a pledge the pledge should be subject to termination in case of departure from the low-tariff policy by the country receiving the pledge. High tariff countries which refuse to engage in tariff-reducing negotiations should not be given a pledge of unconditional most-favoured-nation treatment, and whether in practice such treatment should be extended to any of these countries or withheld from them should be determined as expediency may dictate. Even if only a handful of countries were to adopt the policy here recommended, it would suffice to remove in large part whatever validity there is in the objection to the unconditional principle that it operates as an obstacle to tariff reduction, and would make it more unquestionably than it has been in the past an instrument toward the reduction of tariffs as well as an instrument toward uniform treatment of all countries in good standing in tariff matters. It should be noted, however, that the policy advocated could be followed in better grace by a country with a low tariff than by a country whose own tariff seems unreasonably high to other countries, and low tariffs are at the moment very nearly non-existent.

(3) The objection so frequently made against the unconditional most-favoured-nation principle that it involves the grant by country A to country B for nothing of concessions for which

country C had been required to give compensation, and is therefore unfair both to country A and to country C, would be without force if unconditional most-favoured-nation pledges were not granted promiscuously to all countries that asked for them, but were granted only to countries following a tolerable tariff policy. The most-favored-nation pledge would then be a mutual guarantee against discrimination, and the flow of advantage from the pledges would ordinarily be in both directions as between any pair of countries tied to each other by such pledges.

(b) *The Conditional Form*

The conditional form of the pledge is, in practice, either interpreted and applied as if it were unconditional, or is a meaningless pledge, imposing no real obligations on the country granting it, and conferring no genuine protection on the country receiving it. In the conditional form of the pledge, country A pledges to extend to country B : (1) freely, any concessions which it may make to a third country freely, and (2) for equal compensation, any concessions which it may make to a third country for compensation. But when concessions are made freely, they are almost invariably made general in any case, and if country A makes a concession to country C for compensation, country B would find that its pledge of conditional most-favoured-nation treatment would be of no service to it in obtaining the extension of such concession to itself. Country B can, it is true, offer compensation to A in return for the extension to it of the concession made at country C. But it does not need a treaty in order to be free to make offers. Country A, it is true, is legally bound to extend to B the concession it has made to C if B offers equivalent compensation, but country A will be the sole judge as to the "equivalence" of the compensation. There have been several instances in the past when a country in the position of country A has gone to the extent of informing a country in the position of country B that the economic relations between A and C were such that no concessions which B could offer would be equivalent to those received from C.

In the past the United States was the only country which for any time followed consistently the conditional practice, and while its holding of conditional pledges by other countries which followed the unconditional practice generally enabled the United States to claim the extension to herself gratuitously of concessions

which other countries had granted originally for compensation but had immediately extended to third countries gratuitously, the United States, themselves, had refrained from making any gratuitous concessions, and by virtue of the conditional nature of all their pledges, at least as they interpreted them, were able to refuse to extend gratuitously to third countries any of the concessions which they had originally granted for compensation. No country ever derived any advantage from a conditional pledge by the United States, except in a few minor instances as the result of inadvertence on the part of the drafters of the pledge. The conditional pledge is to all intents and purposes equivalent to no pledge at all when it is received from a country all of whose pledges and whose practice is conditional, and is in its mode of operation identical with the unconditional pledge when it is received from a country any of whose pledges or whose practice is unconditional. The substitution of the conditional for the unconditional most-favoured-nation principle and the total abandonment of the most-favoured-nation principle would, in practice, have virtually identical significance.

III. Currency Stabilization and Reduction of Trade Barriers.

I have dealt with this in my memorandum on Part C. I wish here only to emphasize that currency instability and trade barriers are mutually supporting, that each provides a pretext for the continuation of the other, and that it is unlikely that either problem will soon obtain even a partial solution unless they are both attacked simultaneously as interrelated aspects of a general situation.

IV. Bilateral Treaties.

The history of tariff-bargaining is long and complex. In the period, 1860 to 1880 or so, tariff-bargaining on a bilateral basis, with generalization of the concessions by virtue of most-favoured-nation provisions, was an important contributing factor to the only major movement of modern times in the direction of reducing trade barriers. In the period after 1880, the practice of padding tariffs for bargaining purposes and of failing to remove all the padding in the subsequent negotiations made it a question

whether the bargaining had as a net result the raising of the lowering of tariffs, and in any case the favourable results were disappointingly small. Unfavourable results, however, are not inherent in the tariff-bargaining process; during a period of depression and unemployment the case from the national point of view against unilateral tariff reduction is a strong one; the popular prejudice against tariff reduction is not nearly so strong when the reduction is brought about simultaneously at home and abroad, and when the concessions obtained from foreign countries can be set off against the "sacrifices" made by one's own country; if tariff-bargaining were conducted with a genuine will to obtain reduction of tariffs, and not merely to squeeze concessions out of foreign countries, if there is a fair measure of popular support at home for tariff reduction by agreement, and if the negotiators are not merely skilled traders but realize that in the long run the advantages from what is "surrendered" are likely to be at least as great as the advantages from what is "won", the results of tariff-bargaining would be surprisingly and gratifyingly abundant.

VI and VII. *Multilateral Agreements.*

The recent history of multilateral negotiations is not such as to warrant optimism as to a successful outcome from further attempts in this direction. The more countries there are participating, the smaller is the pressure on any one country to make concessions, the smaller is the responsibility or credit attaching to any one country or its representatives for the failure or success of the negotiations, the greater is the probability, if the scope of the conference is limited, that for some of the participants the product of the negotiations will appear to be concessions without compensation in return, and the greater will be the opportunity to make empty but generous sounding speeches in the more public meetings while pursuing wholly obstructionist tactics in the business meetings. In any case, the failure of past conferences has, for the time being at least, put a curse on such conferences in the public mind, and bilateral negotiations, or perhaps better, negotiations between small groups of important countries, would seem to offer more prospects of success in the near future than ambitious multilateral conferences.

The narrower the range of matters with which an inter-

national conference has to deal, the greater the probability that, in appearance or in fact, the participants will belong to three groups, of which one has no substantial interest one way or the other in the outcome of the conference, another has everything to gain and nothing to lose, and the third has — or believes it has — nothing to gain and everything to lose. From such a conference no valuable results can be expected. If, however, the range of matters dealt with is broadened, the chances that every participant has something specific to gain from it and that every national representative can return boasting of what he has won for his country, and therefore the chances of a successful outcome of the conference, will be much greater. It is significant that the only genuine product of the Geneva Economic Conference was the hides and bones agreement, every signatory to which was in the position of winning an apparent advantage as well as of making a concession, and that this perhaps was also true of the only genuine outcome of the London Economic Conference, the silver agreement. If conferences are planned to deal only with particular groups of commodities, the countries will ordinarily be either exporting or importing countries, and will divide accordingly, or they will be exporting countries, when any agreements they reach are not likely to be received with enthusiasm by the importing countries. If the commodities to be dealt with cover a wide enough range so that each participating country finds that the concessions it is asked to make as an importing country are offset partially at least by concessions offered to it as an exporting country with respect to some other commodities, the conference would appear to have better prospects of a successful outcome.

VIII. *Tariff Truce.*

A record of previous failure in one or two previous efforts is not of course to be accepted as a decisive demonstration that a further effort would be equally unsuccessful. It seems obvious, however, that none of the important participants at the Geneva Economic Conference participated in it with a genuine determination that something substantial should emerge from it, that what enthusiasm there was behind it was the enthusiasm of the League Secretariat unbacked by power and that the national representatives who had the power lacked the enthusiasm. That

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a conference should have prospects of success, it seems necessary that it should have some vigorous *national* sponsorship; that it should not appeal merely to the inadequate quantity of good sense and good will of world public opinion but should represent also the specific and firm objectives of at least a few national governments.

But the need now is for much more than a "tariff truce", which might indeed be an evil rather than a good, if it had the psychological effect of freezing the status quo and of permitting governments to experience the warm glow of moral achievement merely because they had promised not, for a time, to make a bad situation still worse. It seems to me it would certainly be ill-advised to promote an elaborate and pretentious world conference unless the objectives of the planners of the conference were splendid enough to capture the imagination and enlist the hopes and the sympathies of statesmen and leaders of public opinion.

February 1936.

(Signed): JACOB VINER.

Comments on the Improvement of Commercial Relations between Nations

by

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Of the various suggestions one hears for the restoration of order in international economic relations, only such as are based on recognition of the real, operative forces and facts of the position, as opposed to insubstantial ideals and political postulates, can give promise of success. Thus, it may be put forward for free trade and international division of labour that they, and only they, can guarantee the maximum economic return; but that is no argument for their future revival, certainly not for an extensive revival. National economic policy, in its real sense, does not run on the lines calculated to lead to attainment of an economic maximum. And particularly is that true of the economic policy of to-day, which does not hesitate to bring purely economic sacrifices where these may serve to the advancement of other aims of national policy, in respect of population or defensive efficiency or general progress. It is not implied that economic policy must necessarily see its goal in the state of economic minimum consonant with a more or less advanced autarky. That would entail not only the imposition of heavy economic sacrifices on the nation, but, on the other hand, prejudice to all those other aspirations, which can only be fulfilled if the economic ground-work remains stable. No, actual economic policy diverges from maximum-policy only in so far as such divergence is necessary to harmony with other aspects of general policy. But the resulting equilibrium, in view of the dissimilar economic equipment of the various nations, is inseparably dependent on a relatively high degree of international economic correlation. This, in spite of all autonomic reservations.

We must make recognition of this fact, the starting point

for our inquiry into ways and means of overcoming the obstructions to trade, if we are to arrive at worth-while conclusions. We must distinguish between such obstacles to trade as appear, in the long view, necessary concurrents of the various national aims and such as result from more or less casual and isolated occurrences. It is the demolition of this latter type of obstacle that calls for our attention : for, seen in its proper light, it must appear as ultimately irreconcilable with the national interests of the countries concerned. The obstacles in question consist pre-eminently in defensive and emergency measures introduced under the influence of, and with direct reference to, the world economic crisis and the consequent derangement of monetary systems. If and when these measures are withdrawn, the essential opposition to a levelling of those obstacles to trade for which the crisis was responsible, will be already overcome.

For a more detailed development of this standpoint, I refer the reader to my *Memorandum to the Currency-Report* : " the Relations between Currency and Trade-policy ". The attitude I shall adopt in this paper to the various points in Part D follows logically from the basic principles which I derived in my memorandum and have shortly resumed above. As the space at my disposal is limited, I shall confine myself here to the most essential facts and aspects, beginning with the questions that demand a negative answer :

VIII. How far has past experience with a tariff truce been conclusive?

VII. The possibility of multilateral agreements.

VI. The problem of reducing the level of tariff-rates by means of international agreements covering particular groups of articles.

National economic policy and the international market-system may only in rare cases be brought into harmony by means of multilateral agreements. The strong divergence of interests in the various countries is against this solution, as is brought out in all clearness in the case of the mooted general tariff-truce. Not the avoidance of a general raising, nor the achievement of an all-round lowering of tariffs is the point at issue : instead, steep tariff reductions on certain fronts must be combined with recognition and admission of prohibitive tariffs on others. And in

both cases, allowance must be made for the particular needs of the various countries. For our purpose, a general tariff-truce is an unsuitable instrument, yet it need not be rejected as a supplementary expedient. And almost the same can be said of all kinds of multilateral agreements, for they become progressively incapable of accomodating the individual requirements of the various countries as the number of contracting parties grows. Multilateral agreements lowering the tariff-rates on specified articles may carry a certain promise in some cases (cf. the Brussels Sugar Convention). But they, too, offer no generally applicable solution.

Previous experience fully confirms this verdict. The Geneva tariff-truce of March 24th 1930, and other similar efforts may be said to have come to grief. Alone the Oslo agreement of December 22nd 1930 (the Scandinavian countries, Belgium-Luxemburg and Holland) has so far realised the idea that lay at bottom of the Geneva agreement, that the contracting states inform their partners in due time, and take up negotiations with them, before raising existing import-duties or introducing new ones. But all in all, the obligation extends merely to an exchange of views. And other cases of multilateral agreements, as many of them as throve to the point of being signed, have been equally unsuccessful : we may instance the attempts made to get rid of import- and export-prohibitions, and the Belgian-Luxemburg-Dutch Ouchy agreement. Agreements come to for an all-round lowering of tariffs on specified articles have, in the main, met similar shipwreck. ^{ferrous} (The Geneva tariff-conferences of 1930 fought in vain for a general reduction of tariff-rates on aluminium and cement; they got no farther than to fix minimum-limits for tariffs on bone and skins.) Plans for an all-round uniformity of tariffs on copper, cellulose, paper and vegetables have also been variously and vainly mooted. The World Economic Conference in London tried unsuccessfully to call into existence similar provisions in respect of wool, cotton, tobacco and dates. Likewise unsuccessful have been all efforts to reach an understanding on wheat, coffee, cocoa and wine. The real centre of gravity in such questions lies with the international cartels, which are in a better position to contribute to a defeat of tariffs, or their levelling, since their policy may affect at once international market regulations and the necessary compromise between conflicting national

interests. International cartels have had very considerable success in this sphere.

To avoid misunderstandings it may be added that currency-stabilization itself, being multilateral by nature, ought to be based on multilateral treaties or may be a unified international complex of several treaties. To be sure, the way of gradual stabilization by entry into bilateral or three-party treaties, in each case for the benefits that it separately offers, is more seductively accessible. But its attractiveness is no greater than the danger to which this type of stabilization is exposed; the possibility of new autonomous currency-movements on the part of any non-participating country is a permanent threat. At the least, all important countries must unite: otherwise the risk is inevitable present that the lingering uncertainty may prevent the withdrawal of those measures of economic autonomy which belong properly to the crisis and stand in the way of stabilization.

III. The influence of currency-stabilization and the reduction of trade-barriers;

I. Is it possible to abolish or to mitigate the use of the tariff quota?

In so far as the causes of crisis are eradicated — that is, the debt-problem solved — currency stabilization offers us a very fine chance to get rid of those obstacles to trade which were originally phenomena of the crisis. For a detailed treatment of this question, I refer the reader to my memorandum to *Part I of the Currency-Report*. However, I may add here in the same connection that any trade policy that takes a step towards overcoming the obstacles to trade implicit in the crisis-created features of autonomous policy, is a policy that we should not merely approve but that we should cry for. It is certain that abolition of the causes of crisis, followed by currency-stabilization, will lead automatically and on a wide scale to the disappearance of trade-restrictions of this kind. But it is equally certain that the forces of automatic reaction alone are insufficient. The unflagging co-operation of trade-policy will be required to wipe this particular slate clean: otherwise the currency-stability attained will be continually imperilled by the dangerous, reactionary tendencies that may still be present, though now bereft of all rhyme and reason in the general economic policy.

Future of Tariff quotas.

I may further add that the stabilization should aim at as high a degree of permanence as possible. Every lingering element of uncertainty only helps to prolong the existence of the autonomous measures due to the crisis, and is a menace to the maintenance of stability. But one cannot blink the fact that the forces of autonomy are strong and reluctant to any stabilization. So that even a "permanent" stabilization will be at bottom no more than a provisory measure, liable to necessary adjustment, to meet the fundamental discrepancies that will later appear. The chief business of monetary policy in the future will be the smoothing away, so far as is possible, of these difficulties. But to think in terms of "provisional" stabilization would be, by the very name, an invocation to those dangers which it is our task to exclude. No-one can expect of a "provisional" stabilization that it will be followed by disappearance of the autonomous obstacles to trade of the post-crisis and anti-stabilization order.

The question of a mitigated use of the tariff quota is closely bound up with that of the relation between currency-stabilization and trade-restrictions. Both depend on the realization of monetary stability, and the eradication of causes of crisis. So long as this conditions remains unfulfilled, so long will tariff quotas remain indispensable means to equilibrium in the Balance of Trade and Balance of Payments. Indeed, in many cases even exchange control has to be resorted to, and exchange control is a far worse enemy to foreign trade than even tariff quotas. The idea that one day, after the crisis is past and done with and currencies are stabilized, tariff quotas may be generally abolished, is an idea fit for a better world than ours. So long as the interests of the various countries lie in different directions, and the interest of each separate country lies in a certain distribution of its total import-trade amongst the various branches, so long will the tariff quota remain a necessary economic conception. The same can be said of the tariff quota as of the mass of trade-restrictions : autonomous policy is assailable and worthy of attack only in so far as it is a product of crisis, not in so far as it is part of a process of evolution.

The question of tariff quotas, in particular, is made the more complicated by a certain change that has been brought about in their general significance. They appeared originally as an essentially more formidable check than tariffs to the international exchange of goods. Tariffs represent computable sums and fit in

with the market-system : tariff-quotas run counter to the market system and hinder or prevent the equilibrium of home-markets with markets abroad. The tariff quota is accordingly the typical instrument of autonomy. However, where the small importer has been superseded by monopolistic overseas trading groups, the importance that once attached to the tariff quota itself has now been transferred to these organizations and their effect on the markets. The tariff quota is really becoming a means of insuring the foreign supplier of access to our home-market. These facts do not speak *in favour of* the tariff quota but *against* the market-demeanour of the monopolist organizations, or even against these organizations themselves. So far as they belong to the non-evolutionary features of autonomous policy, such organizations must be abolished and tariff quotas themselves thinned down. Nevertheless, it should be observed that such market-organizations are much more typical of naturally evolved autonomy than of the other kind.

I. The past and the future of the most-favoured-nation clause in its limited and unlimited forms.

IV. Experiences with bilateral treaties, both with and without the most-favoured-nation clause, a study of actual experience.

Bilateral treaties illustrate most clearly the main themes of my argument for Part I, 1 of the Currency-report; I have already gone over these themes in my introductory remarks here. Bilateral treaties were recommended as early as 1927, by the World Economic Conference, as the best way to an ordering of trade-relations. Since then they have steadily increased in number, particularly during the crisis. Together with the trade-treaty negotiations of the mixed government-committees, which have become a permanency, they remain today the most thoroughly proved instrument of trade-policy.

At first sight, the wedding to bilateral treaties of the most-favoured-nation clause — indeed, the whole most-favoured-nation principle — is much open to doubt. According to a view that finds wide representation in these days, the most-favoured-nation clause is worn-out as an instrument of trade-policy and no longer suited to the modern international economic structure. This is an erroneous conception. It is true in so far as one regards the

most-favoured-nation clause in the pedantical sense that it stands or falls as an instrument, according to its capacity or incapacity for unlimited employment. But such a view is unrealistic : it fails to take account of the transformations that the most-favoured-nation-principle has undergone in course of the change that has come over international economic relations. Liberalist economic internationalism or nationalist autarky, unlimited employment of the most-favoured-nation principle or its absolute renunciation : the one ultimatum is as uncalled for as the other. The most-favoured-nation system and the preference-system are not contraries but complementaries : as employed together, they are the typical instrument of an international economic order that combines national, autonomous reservations with intensive international exchange; indeed, to some extent, they make that new order possible. "Exceptions", and "suspensions" of the most-favoured-nation clause, are quite another thing. The international market-system is only compatible with economic nationalism in so far as each accomodates itself to the nature of the other; and, in the same way, the most-favoured-nation clause is only compatible with such other measures as are not in direct contradiction to it. All the parts of a policy should interlock harmoniously, and that is the secret we must learn.

V. The position as regards regional pacts.

In the case of the regional pacts too, I shall confine myself to the fundamental facts. In the first place, because any sketch of the problem of Ottawa and Central Europe, to be even reasonably thorough, would go far beyond my available space. But chiefly, because a careful study of the question has shown me that it will be difficult, and may be impossible, even for objectively-minded experts, to come to a unity of opinion over concrete measures for the solution of the Central European problem, especially. I read the question set by the Committee as meaning that it is to be demonstrated in a general fashion whether and in what way regional pacts appear suitable as means to the re-animation of international economic relations : and I think that that is how the Committee would wish it to be read. I shall refrain from taking a concrete attitude to the problem of regional pacts, unless this reading of the question is generally held to be impertinent.

The problem would be all too simple and too simply answered, if we tried to reduce regional pacts and tariff unions to one and the same thing. Tariff unions amount to a return to free-trade between the contracting states. And thus, over a limited area, they lead to all the consequences which forced autonomous policy into divergence from free trade. They are practicable only for states that are conscious of a natural political unity or are yoked together in service to a common political purpose; in which cases the clash of differing autonomous aspirations is avoided. This view is confirmed by the fact that every historical precedent for these unions shows accompanying political union or efforts towards political union; or sometimes the tacking on of a very small customs area to an extensive one.

Our inquiry here is concerned not with tariff unions, but with regional preference-systems. Such preference-systems are more capable than tariff unions of leaving the participating countries unhampered in pursuit of their autonomous aims, yet in enjoyment and respect of their closer economic ties with the preference-countries. They are thus fundamentally compatible with an autonomous policy. Quite the contrary is the difficulty, — the question is whether they permit the participating countries to maintain close economic ties with the countries without the preference-group. In other words, are they capable of conciliation with the most-favoured-nation clause? For, to the industrial countries at least, the most-favoured-nation clause is the indispensable instrument of trade-policy for the maintenance of the international marketing-system.

It become clear that the question at issue here is not the purely juridical one, which preference clauses are compatible with the most-favoured-nation clause. The economical question is the one that matters: to what extent are the countries that conclude most-favoured-nation treaties prepared to admit exceptions to the most-favoured clause? For the resuscitation of international economic relations, it is of decisive importance that the two principles should be brought into line with one another. The most-favoured-nation principle must not be carried so far as to extinguish all possibility of satisfaction for the particular requirements of the various countries. And preferences must not so expand as to squeeze the most-favoured-nation principle out of existence. Regional pacts, then, can never play more than a com-

plementary rôle, never take the place of international trade-relations of a general nature.

Actual experiences are thoroughly in support of this view. It is true that regional pacts have been signed and been successful : and if they have never advanced beyond the stage of assays in Central Europe, that is to be attributed rather to the complications of the political situation than to economic draw-backs. But these regional pacts were shaped largely by and for the crisis and their successes are to be explained with reference to the world economic crisis. In the case of Ottawa, the favourable effect of the devaluation must also be taken into account. One thing is sure : the fact that previous successes can be statistically proved gives us no ground for the assumption of future successes, unless we first assign these previous successes very carefully and exactly to the circumstances which lay behind them. However useful regional preference-systems may be and however well adapted they may have proved for use in times of crisis, they have not yet proved their aptness for general use.

February 1936

(Signed): ANDREAS PREDÖHL.

**Comments on the Past and Future
of the Most Nation Favoured Clause in its Limited
and Unlimited Forms**

by

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In studying the M.F.N.C., the first point that should be noted is that it is at once a principle of international public law and an economic instrument for the organization of trade.

As principle of international public law, it confirms the equality of the different States in their relations with a given State. As instrument for the organization of trade, it provides for competition on an equal footing between all countries in the territory of the country agreeing to the clause, and it is to be hoped that this may lead to a better distribution of production and trade.

The clause may be compared with the abolition of internal customs barriers in a given State. Such abolition constitutes a principle of public law providing for the juridical equality of all citizens in their transactions with whatever part of the territory. At the same time, it constitutes a principle of economic organization, in so far as it determines a distribution of production and trade different from that entailed by the existence of internal customs barriers.

As principle of international public law, the M.F.N.C. safeguards the interests of all States, in so far as it enables them to compete on an equal footing in commercial transactions with a given country.

But *de jure* equality is not necessarily *de facto* equality. Just as certain citizens benefit more than others, owing to differences of economic position, by the abolition of internal barriers, dif-

ferent States derive greater or less advantage from the principle of public law embodied in the M.F.N.C. Such advantages vary according to the distance of States from the markets thus opened to them, according to conditions of production, technical capacity, wage-rates and capital strength. Thus, it may be possible for B, beneficiary of the clause, to derive immediate benefit from further tariff reduction granted by A to C, while D, more distant or not manufacturing the article concerned, may be unable in any way to profit by this new concessions. It may even work out to D's disadvantage, in so far as B, beneficiary of the clause, will henceforth be able to import into A wares which take the place of those hitherto imported by D.

Similarly, the suppression of internal customs barriers may prove of benefit to regions hitherto cut off by such obstacles from a sea-port and at the same time divert from the markets of other regions the trade hitherto passing through these channels.

All the controversies which have arisen in connection with the clause are based on its dual character; on the one hand, States cannot, for political reasons, countenance less favourable treatment than their competitors on a given market. Refusal of the clause may be contemplated in certain cases; but no State will renounce claiming its benefits. On the other hand, the State granting the benefit of the M.F.N.C. thereby exposes its own industries to competition the consequences of which it is impossible to foresee. Although the *States as such* may derive an advantage from the promotion of international division of labour and the multiplication of commercial exchanges, each of its individual industries is thereby faced with the extension and multiplication of the various kinds of competition with which it has to cope and, accordingly, of the efforts which it will have to make to surmount them.

Hence, a permanent conflict between the efforts of each country to obtain from others the benefit of the clause and its endeavour to mitigate the working of the clause in its own territory, consisting in indirect attempts to re-introduce discrimination between beneficiaries.

History of the clause

Despite unceasing criticism of the clause, there can be no doubt that its domain has constantly been extended in the course

of the past years. The very attempts made to eliminate it, during the past fifteen years, have but served to demonstrate its vitality.

As will be remembered, the development of the M.F.N.C. dates from the xvii. and xviii. centuries, culminating in the xix. century with the Cobden-Chevalier treaties of 1860, by which it was made the common commercial law of the Great European Powers. It was inserted in the Treaty of Frankfort, which terminated the war of 1870-1871, not, as often believed, at the request of Germany, but at the urgent request of the French negotiator, Pouyer-Quartier. This insertion marked, as it were, the definite victory of the clause, in that it confirmed the triumph, over the prejudices and bitterness borne of the war, of the desire of two recent enemies to restore complete commercial equality.

Since that date, various endeavours have been made to elude its consequences; each of them has, however, resulted in a further triumph of the clause. Of these attempts, three are particularly significant, namely two belonging to the customs history of France, the third to that of the United States.

France reverted to protectionism in 1892, after thirty years of liberal trade policy. Among the objections called forth by the liberal policy initiated in 1860, one of the most serious concerned the increased competition with which the French producer was faced on the application of the clause to each new commercial treaty. The French Parliament sought a remedy in the form of the so-called "Double Tariff" system (maximum and minimum), the minimum tariff constituting a limit below which French negotiators were not allowed to descend. The law further provided for the application of intermediate tariffs, lying between the maxima and minima tariffs, the idea of the legislator being that these intermediate tariffs should vary according of the different treaties. What actually happened? The negotiators were from the outset obliged to grant certain countries the minimum tariff, together with the M.F.N.C., refusal of which by France would in return have deprived the latter of equality of duty in the country with which it concluded the treaty. The natural consequence was that, in a relatively short time, the majority of States finally obtained the benefit of the minimum tariff, and the intermediate tariff envisaged in the customs law of 1892 remained a dead letter. What is more, France was in certain cases obliged to descend below the minimum tariff in virtue of the so-called

" consolidated duties " and all countries to which the M.F.N.C. had been conceded, likewise claimed the benefit of such consolidation.

The second attempt made by France to elude the consequences of the M.F.N.C. took place immediately after the war. At that moment, France had denounced all commercial treaties. It was accordingly faced with the necessity of negotiating new agreements with all countries.

A law dated July 29, 1919, re-instated the notion of intermediate tariffs, already contained in the tariff issued in 1892. The question was to place the French trade relations with the different countries on a footing which varied according to their economic position. The same law re-embodied a formula borrowed from the American system and contained in the 1892 law, which provided that concessions as regards the maximum tariff could only be granted in exchange for " correlative advantages ". This was the basis on which the first French negotiations were conducted. But if we examine the formulae applied to the various agreements actually concluded, we find that they tend, directly or indirectly, towards the re-establishment of the M.F.N.C., and that, in the case of the 1927 agreements defining the commercial relations between France and Germany, the treatment of the M.F.N.C. " is formally applied to Germany under Article VI ". As a matter of fact, the M.F.N.C. is at present applied to almost all agreements. " Ever since the initial negotiations ", writes Mr. Nogaro, " it was realized that, to obtain the benefit of the M.F.N.C., it was necessary to agree to this clause in regard to all products of real interest to the other party. It was subsequently granted in a general way by means of reference to a given article of an earlier-agreement. In the long run, the very French negotiators for whom the primary consideration had been to free French trade from the servitude of the M.F.N.C. were precisely those who contributed to its most explicit, fullest and most liberal definition in the recent conventions... As for the intermediate tariffs, they were gradually eliminated by the implacable functioning of the M.F.N.C. (Nogaro : *Régime douanier de la France*, p. 143.)

The third — and particularly significant — example of a return to the M.F.N.C. is the well known case of the United States of America. It will be remembered that this country, up to 1922, had adopted the system of the so-called " correlative advantages ".

From the xviii. century onwards, the United States had granted the M.F.N.C. only in the following conditions : to benefit by the advantages previously conceded to A, B must grant the United States further concessions corresponding to those made by A. This is what is currently known as the *conditional clause*. As a matter of fact, the United States, in view of their special circumstances, have but on rare occasions agreed to concessions in regard to their tariff — which is a single tariff. It is all the more remarkable that the United States should, in 1922, have renounced the formula hitherto applied and, during the past few years, have reverted to the unconditional M.F.N.C., which has been included in the commercial treaties contracted by M. Cordell Hull with a series of States. It would seem that the principal reasons for this change lie in the disadvantages of the conditional clause for a country which mainly exports manufactured products, following a period in which its principal exports were raw materials and agricultural products.

At all events, these three examples are striking illustration of the difficulty, not to say impossibility, of not applying the M.F.N.C. in a system of public law confirming the equality of States.

The adhesion of the United States to the M.F.N.C. is in so far of primary importance : it may be said that, henceforth, two of the greatest trading powers of the world, the British Empire and the United States, consider the M.F.N.C. as an essential element of their commercial agreements with other powers. It is impossible to under-estimate the importance of this fact. The vast trade carried on by these two great communities, their rôle as producers of raw materials and agriculture produce invest them with a situation which may be described as preponderant in international commercial relations as a whole. Their manufacturing capacity, the facilities provided by their vast home markets as regards the possibility of reducing cost prices are also factors which weigh heavily in the balance of commercial negotiations.

Means of eluding the effects of the clause

Let us now consider the other aspect of the M.F.N.C. On the one hand, the quest for political equality as between States has resulted in the continued extension of the clause; on the other, the inequality of the economic effects entailed by the clause for

various nations has given rise to attempts on the part of the latter to elude some of its most irksome consequences. This is the aspect of the M.F.N.C. which we must now consider.

The methods by which States have, from the outset, endeavoured to escape from these consequences are a matter of common knowledge. We shall confine ourselves to mentioning the two most important :

A. The first is the system of *Discrimination*. We know in what it consists. The nomenclature adopted in the customs tariff is so precise and in such minute detail that, in practice, the advantages conferred are restricted to the wares of the country party to the actual negotiations. This is the method frequently applied by Germany since 1892, which has enabled that country to elude the consequences of the general clause inserted in the Treaty of Frankfort.

B. Another method consists in maintaining such a high tariff that the reduction resulting from concessions granted to this or that State is extremely small — so small that the State granting the concessions runs but slight risk of competition. This method is not without its disadvantages for the State resorting to it -- for it encourages other States to raise their own tariffs on the eve of negotiations.

But such methods, however perfect, have not been sufficient to silence the critics of the M.F.N.C., the reason being that, in reality, the object of criticism is not so much the clause itself as the existence of foreign competition which the clause naturally cannot prevent. As a matter of fact, *the severity of such criticism is in direct ratio to the inequality of the conditions of production of the various States.*

During prolonged periods of peace, when the different price-levels have had time to adjust themselves, when differences between cost prices tend to weaken, while international division of labour improves, the disadvantages of the clause are less acutely felt. But, during vast political and monetary upheavals, when economic nationalism tends in the direction of "autarky", the clause appears as a serious obstacle.

This is precisely what is taking place at the moment of writing. On the one hand, all the nations of the world, both small and great, express the intention of creating within their territories every type of industry that they may one day require; on the other hand, currency devaluation has enabled certain

countries, although not regarded in the light of potential competitors when granted the benefit of the clause, to compete on certain markets closed to them at that moment. In this respect, unequal conditions of production may be classified under the three following main headings :

- A. Unequal conditions due to currency devaluation;
- B. Unequal conditions due to differences of home markets (e.g. superiority of U.S.A., owing to mass and serial production);
- C. Unequal conditions due to social conditions and the standard of living in recently industrialized countries.

This transformation of competitive conditions would in any case have entailed certain consequences, with or without the M.F.N.C. But the existence of the clause appeared to facilitate this process and to increase the difficulties to which the post-war economic transformations would in any case have given rise, even without the M.F.N.C.

When the effort of reconstruction and adjustment demanded of the businessmen and farmers of each country is too intensive and too prolonged; when the results due to their energy and labour are constantly reduced to naught not only by the application of new inventions and methods in other countries but also by sudden price fluctuations and industrial concentrations against which they are powerless to defend themselves, it is but natural that they should seek protection against such incidents in the mitigation of that principle of the equality of States of which the M.F.N.C. is only one of the aspects.

Methods proposed in lieu of the M.F.N.C.

This then is the state of mind, which, during the past ten years, has given birth to a series of propositions with a view to replacing the unconditional M.F.N.C. by various systems, the most important of which are the following :

1. *The system of preferential tariffs* as between certain States.
2. *Customs Unions.*
3. *The quota system.*
4. Substitution of a *conditional M.F.N.C.* for the unconditional clause.

1. *Preferential tariffs.*

(The idea of preferential tariffs for certain countries first arose in connection with the relations between a mother-country and its dependencies. No one has ever dreamed of challenging the right of a mother-country and its colonies to institute a special trade system as between themselves.) On the other hand, the *economic advantages* of such a regime are open to discussion. It is enough to recall the case of Canada, which is much nearer to the United States than to the mother-country, and also that of France and Indo-China.

On the other hand, in the case of entirely independent countries, the question of preferential tariffs raises a twofold legal and economic problem. Hitherto the right of independent States to grant reciprocal preferential tariffs has invariably been challenged in countries benefiting by the M.F.N.C. The 1922 draft agreement between the Netherlands and Belgium is an excellent example of the case in point. It will be remembered that this agreement succumbed to the opposition of Great Britain. This is, in fact, one of the reasons for considering the M.F.N.C. as an obstacle to a possible and desirable extension of economic relations. Our own opinion is that, in an age dominated by nationalistic tendencies, the formation of preferential groups should effectively be tolerated, above all when the community of the interests of the countries in question is based on such close neighbouring relations as in the case of Holland and Belgium. As a matter of fact, those very countries which oppose preferential tariffs on the grounds of the M.F.N.C., do not place obstacles in the way of the formation of customs unions in the strict sense of the word, and consider that the objection of the clause does not apply to this case. This distinction does not appear to us of a really fundamental character, in particular, if the countries bound by preferential tariffs undertake not to raise their tariffs for other countries and are prepared to receive the adhesion of other countries subject to similar conditions. Obviously, a reduction of tariffs for all countries would in any case, be infinitely preferable, and it may be submitted that geographical neighbourhood, owing to the low carriage costs, is in itself a sufficient natural advantage to make it possible to dispense with that of preferential tariffs. It might also be argued that an agreement of this kind is in reality tantamount to the application of the American

reciprocity clause, in virtue of which A undertakes to grant C the same advantages as B, provided C grants A facilities similar to those already granted the latter by B; needless to say, it is difficult for one and the same country to apply simultaneously the M.F.N.C. and the reciprocity clause.

But an effort should nevertheless be made to reconcile the two systems.

2. *Customs Unions.*

Customs Unions have never called forth opposition on the part of nations benefiting by the M.F.N.C. directed against the prospective partners to such unions. The general view is that, once the union has been established, the States in question constitute a single entity from the point of view of commerce. But there is no example of a complete customs union having been established between States other than those aspiring to form, and indeed already forming a veritable political unit, and this is why customs unions will invariably prove an exception to the rule.

3. *Quotas.*

The more general application of the quota system is a recent phenomenon of extremely rapid growth. This system is not incompatible with the clause, provided the quotas allocated to the different States are proportionate to their share of the imports concerned during preceding years. But this principle has been sharply opposed. The quota is a matter of concern for certain importing countries only. Mathematical allocation is therefore purposeless, and most States claim the right to allocate quotas without reference to the M.F.N.C. The quotas are determined on the basis of separate negotiations with each State, and as it is extremely difficult to establish a comparison between the advantages thus conceded to different States, it may be said that this system constitutes the simplest method of eluding the consequences of the M.F.N.C. And this is why the application of the quota system regardless of obligations under the M.F.N.C. threatens to create the greatest possible difficulties between States. In the absence of any criterion for the preferential character or the severity of the treatment meted out to them, all States are likely to consider that they are unfairly treated, without disposing of any means of estimating the more or less arbitrary character of

such treatment. Reprisals are a foregone conclusion, and a country which adopts the quota system as the normal basis of its commercial policy will, in a certain time, be confronted with measures taken by its competitors to apply this system to its own wares. For this reason, it is impossible to regard the quota system otherwise than as an exceptional measure, born of exceptional circumstances and destined to disappear with the circumstances to which it owes its inception.

4. *Conditional M.F.N.C.*

A final means of eluding the unconditional M.F.N.C. has been sought in the introduction of a so-called conditional clause. This term often serves to designate the American system, which we have already mentioned under the title of "reciprocity system". This is not the sense in which it is used here. By conditional clause, we mean that, instead of it being taken for granted, at the beginning of negotiations, that the unconditional clause will form part and parcel of the future treaty, it is decided that its benefits shall be accorded only at the end of the negotiations and in some respects as their corollary. Moreover, the application of the clause is restricted to a certain number of products, namely the principal commodities handled in the reciprocal trade of both parties, to the exclusion of other wares. Thus interpreted, the conditional clause has for many years formed part of the current practice of German negotiators. It has now entered into that of French negotiators.

As a matter of fact, the limitation implicit in the conditional clause is apparent rather than real. In the Treaties signed during the past few years by France, in which the application of the unconditional clause was thus restricted, the number of items excluded from negotiation was extremely small and their importance negligible.

As a general rule, the popularity or unpopularity of the M.F.N.C. and the attempts made to elude its consequences vary considerably accordingly to the stability or instability of commercial relations and the more or less intensive character of economic nationalism at a given moment. As a matter of fact, although the M.N.F.C. is primarily an instrument for the maintenance of inter-States equality, it inevitably results, in the case of tariff reduction, in a certain increase of foreign competition, not only on the

part of the negotiating States, but also on the part of those destined to benefit by the clause. National industries have invariably considered a reduction of duties as an encroachment on their situation. It is therefore inevitable that the effects of such reduction should vary in intensity according to the number of countries affected by this measure. Although an industry may perhaps admit the necessity of tariff reduction affecting other branches of national industry, it is extremely difficult for it to realize the absolute necessity of the equal treatment of all States in regard to matters affecting its own interests. Objections to the M.F.N.C. are therefore nothing more than objections to increased facilities for the importation of foreign wares. Hence the unceasing and constantly renewed efforts on the part of national industries to limit the application of the clause.

It is certain that similar efforts would be made in regard to home competition, if this were not prohibited by the existing public law of the more important powers. At the present moment, no one would dream of suggesting that inland customs barriers be re-established. And yet, it is certain that attempts are constantly being made to prevent the extension or establishment in certain regions of new industries or undertakings which might be detrimental to the interests of those already existing in the regions in question. At a comparatively recent date, the Swiss Federal Government proposed the prohibition of motor traffic on certain routes with a view to protecting its railways from the competition of the motor vehicle. The existence of similar tendencies is therefore hardly surprising in regard to foreign trade. Such tendencies are, however, counteracted by the profound recognition of each State of its responsibility to its citizens and of the obligation devolving upon it to maintain their rights abroad. Of these, one to which all citizens attach considerable importance is that of trading in foreign countries on an equal footing with nationals of the latter. Thus, the conflict between these two tendencies, mentioned at the beginning of this report, would appear likely to play in the future, as it has played in the past, a decisive part in the question of the M.F.N.C. No State can renounce claiming its benefits. But the States granting these benefits are constantly adjured by their own nationals to limit the application of the clause. The divergence of views with which we are faced is therefore in the nature of things. Only when the existing opposition to the importation of foreign wares and the

current of opinion in favour of impracticable autarky yield to a wider comprehension of the indispensable conditions of foreign trade, will this contradiction tend to disappear. In our opinion, such comprehension can but depend upon the energy with which the Governments of the various States succeed in bringing home to their nationals that exportation and importation are two aspects of the same medal, that it is impossible to reduce the one without at the same time reducing the other, and that the final result of such an operation is to reduce the very medal it had been hoped to preserve.

February 1936.

(Signed): Charles RIST.

John H. HERBERTS.

Comments on the Trade between the Industrial and the Agricultural Exporting Countries of the World

by

* * *

Introduction.

The purpose of this memorandum is to put forward certain proposals as a contribution towards the discussion of methods of reviving the flow of world trade.

The fall in world prices that began in the United States about 1929 and rapidly communicated itself to all countries was enough in itself to cause profound maladjustments and slow down world trade, but throughout the crisis, nationalistic policies have been adopted to deal with problems that are essentially international. Economic policies framed for narrow national ends have added a maze of barriers to international exchanges through which a diminished flow of trade finds its way difficultly. Tariffs and quotas were imposed in the first place to stimulate employment by cutting down competing imports, and then to protect currencies.

Superimposed upon these causes of tariffs and quotas there was (the problem of the low prices of agricultural products.) (These low prices had two kinds of effects upon the principal countries engaging in foreign trade. The industrial countries, faced with abnormally low agricultural prices, felt compelled to protect their own producers, and did so frequently with measures that had the most drastic effects upon the volume of agricultural imports. In agricultural exporting countries income contracted sharply, while they still had rigid money obligations overseas, leaving much smaller balances for purchasing imported manufactures.)Moreover the cost of manufactures increased in terms of the agricultural goods exported.

The well recognised disparity between the fall in agricultural

and industrial prices has been an important factor in the depression. In the United States a prominent part of recovery measures (A.A.A.) has been directed towards removing the disparity within that country. So far as international trade is concerned, the removal of the disparity would go far towards re-activating trade between the agricultural exporting and the industrial countries.

The conclusion to which this memorandum leads is that action taken to increase consumption of foodstuffs would tend towards a solution of this problem.

It is recognized that the question of exchange stabilization, leading towards a return of confidence, and to greater stability in the conditions in which international trade is carried on is of the utmost importance in international policy for recovery. Monetary questions, however, are dealt with by other writers and this memorandum is devoted wholly to policy outside the monetary field.

The direction of world trade.

In 1934, 26 % of world trade was in foodstuffs, 37 % in raw materials and semi-manufactures, and 37 % in manufactures.

There are some ten countries whose exports are made up largely of industrial products, and of these all but two (U.S.A. and Japan) are European countries.

To a certain extent, world trade is an interchange between industrial countries, but the main stream of commerce, taking the world as a whole, is between the industrial and the agricultural exporters. 76 % of the imports of the group comprising the United Kingdom, the United States of America, Germany, France and Italy consisted (1929) of foodstuffs and raw materials.

Rather more than half the countries appearing in international trade statistics are agricultural producing countries exporting foodstuffs and raw materials, and moreover, basing their prosperity very largely upon the income received from such exports. (China and India are excluded, since they consume internally an overwhelming proportion of their agricultural production, although deriving their purchasing power for imports from exports of primary products.)

The fall in agricultural prices.

As already recognized, the greater fall in the prices of agricultural products entering into world trade than of industrial products was the cause of one of the fundamental maladjustments of the depression.

The price disparity may be illustrated from movements of the "terms of trade" of an industrial and an agricultural country.

Taking 1927 as a base year, the average prices of goods imported into the United Kingdom (mainly foodstuffs and raw materials) fell from 100 to 62 in 1933, while average export prices fell to only 76. Thus a quantity of industrial exports, purchasing 100 units of foodstuffs and raw materials in the earlier year, bought 123 units in 1933. In New Zealand the relative price fall was from 100 to 85 for imports and from 100 to 59 for exports in the same period; thus depressing the "terms of trade" from 100 to 69.

There is some indication that the price disparity was narrowed in 1934, as shown by the following table of price movements of articles entering into international trade :

	1929	1932	1933	1934
Foodstuffs	100	52.5	46.0	42.0
Raw materials	100	44.5	40.5	40.0
Manufactures	100	64.0	55.5	50.0

(From : League of Nations' Review of World Trade, 1934.)

Nevertheless, the disparity remains, and, this apart, foodstuffs prices are only 42% and raw material prices 40% of the 1929 gold prices.

The explanation of the greater fall of agricultural prices is that industry reacts to lower prices by reducing production, either deliberately where cartels and monopolies exist, or through the general reduction of profits which leads to a shutting down of the least profitable concerns or parts of a business. In agriculture, however, any contraction in output must be slower, since the time that elapses before a decision about future production can take effect may be anything from one year for cereal crops to three years or more for cattle and dairy products. Whereas, too, industry throws its surplus workers out of employment, agriculture, especially where run largely on a

family basis is more likely to demand increased work in the effort to maintain the money return by means of increased production. The farmer's indebtedness usually renders this course essential; and there is also the psychological factor of the farmer's reluctance to abandon land (in the countries of extensive production) that has been now with difficulty from nature. There is a sound biological basis for this reluctance since land left idle for a considerable period tends to revert to its natural state. This is evident even after centuries of cultivation. (Agricultural reaction to lower prices has been described in the League of Nations "Survey of World Trade" as "perverse elasticity". From a broad human standpoint, the perversity may be in the economic system rather than in the farmers reactions to it.)

Trade of agricultural exporting countries in the depression.

The table which follows shows the decline in the gold value of imports and exports of nine agricultural exporting countries between 1929 and 1934.

Imports and exports of certain agricultural exporting countries
\$ millions (gold)

	1929		1934			
	Imports	Exports	Imports	Percentage decline	Exports	Percentage decline
Argentina	820	908	222	73	288	68
Australia	706	590	198	72	238	60
Spain	528	407	166	69	118	71
Denmark	460	433	173	62	157	63
Dutch E. Indies	446	581	118	74	212	63
Poland	349	316	90	74	109	66
Cuba	216	272	45	79	50	81
Hungary	186	181	60	68	70	61
Ceylon	130	137	44	66	55	60

The fact that in most of these countries imports have fallen off more than exports is related to the necessity most agricultural countries were under of adjusting their balance of trade in commodities in order to meet relatively inelastic external obligations. (Since prices of manufactures have fallen on the whole less than agricultural prices, the fall in the quantity of imports (largely

manufactured goods) into the agricultural countries, has been relatively greater than the table indicates.)

While the exports of some agricultural staples increased in quantity, such increases were offset by falls in price greater than the general fall. In 1934 the average values of world exports and imports were at 44 % of the 1929 level. The export value of wheat was only 30 % of the 1929 gold value; of maize 34 %; of sugar 37 %; of butter 27 %; of coffee 32 %; of chilled and frozen meat 40 %. The export values of cheese (56 %) and tea (50 %) were above the general level. (Based on figures in "Review of World Trade", 1934.)

Tariff and quota policy.

In the post-war years attention was frequently called to the new tariffs imposed by the agricultural countries in order to stimulate their infant industries which had arisen during the war. The older industrial countries looked to a mitigation of this protectionism, which they rightly said often fostered industries inappropriate to the size of local markets, the availability of semi-manufactured goods and the availability of technical skill.

At the World Economic Conference of 1927 and at a series of other meetings at Geneva between 1927 and 1930, proposals were made for reduction of these post-war industrial protectionist measures. No effective progress was made but these measures were mild in comparison with the restrictions which the industrial countries have since 1929 imposed on agricultural imports. Extreme agrarian protectionism has been a feature of the years since 1929. The trend of the industrial countries towards agricultural self-sufficiency has greatly alarmed the agricultural exporting countries. It is now certain that most of the agricultural countries would, at the present time, be prepared to take a very reasonable line over their industrial tariffs if thereby they could in any way bring about a general lowering of trade barriers against agricultural exports.

(In the years following 1929, European countries were constrained to impose tariffs and quotas to keep their agricultural populations comparatively satisfied.) Any survey of the position, such as the League of Nations Report on Agricultural Protectionism in Europe, reveals the extreme height to which these barriers have risen.

The following table, showing European duties on butter, is quoted from "Butter as on World Staple" (Index, Stockholm, Nov. 1935):

Import duties on butter

Country	As on June 1st 1929		As on June 1st 1935	
	Tariff in Swiss fr. per 100 kg	Tariff as a percentage of the butter price	Tariff in Swiss fr. per 100 kg	Tariff as a percentage of the butter price
Germany	35.0	9.0	208.5	187.0
France	20.3	5.0	182.5	163.0
Italy	18.1	5.0	153.0	138.0
Switzerland	20.0	5.0	120.0	108.0
Belgium	2.9	1.0	88.0	79.0
United Kingdom :				
1) from Irish Free State:				
	—	—	40.0	40.0
2) from Foreign Countries :				
	—	—	25.0	22.0
3) from Dominions :—				
	—	—	—	—

The World-Monetary and Economic Conference of 1933 proved quite ineffective to bring about any measures either of currency stabilization or of the reduction of trade barriers and its only effective proposals were those for the temporary restriction of production of raw materials. The reason for restrictions was the belief that economic recovery could not come about unless prices of raw materials could be raised substantially above their then levels. Now, however, that internal recovery is showing itself in a considerable number of countries; that there has been a certain measure of price recovery in some important staples and that producers in some of the overseas exporting countries have adjusted themselves to lower prices than obtained in 1929, it may be asked whether measures to increase consumption are not the most direct way of bringing an end to the present impasse. If this contention is sound, then probably the best starting point is to be found in efforts to increase the consumption of food since it is now clear that great improvements in public health can be brought about through the greater use of what are known as the "protective foods". It is recognized that industrial countries are not prepared to face violent disturbances to their own agricultural production. The fear of this has hitherto rendered ineffective attempts at all-round tariff and quota reduction, and even at a

" tariff truce ". But import restrictions in the industrial countries have had the result of keeping foodstuff prices much above the levels at which these foodstuffs might have been available to their populations. Moreover, adjustment of costs to lower levels of prices have not been made as they have in many cases in overseas agriculture.

The opportunity therefore arises for a new approach to the question of the relations between industrial countries and the agricultural producers (domestic and foreign) that supply their primary needs for nourishment and health.

Possible methods of adjusting supply and demand in agricultural export products

Although the United Kingdom is the principal market for meat, butter and indeed nearly all foodstuffs, Continental European countries are also markets of the greatest importance to the exporting countries, both in Europe and overseas. In 1934, Argentine exported 44 % of its total exports to Europe (excluding United Kingdom); Denmark 33 %; Australia 24 %; Canada 8 %; South Africa 14 %.

The decline in the quantities of certain foodstuffs imported by some of the principal European importing countries has been very marked, as is illustrated by the following table

	1920	1931	1933	1934
	Import balances of butter (000 quintals)			
Germany	1,354	1,001	591	617
Belgium	30	176	121	93
France	¹	135	61	11
Switzerland	75	106	5	3
	Import balances of cheese (000 quintals)			
Germany	643	513	395	340
	Import balances of beef (frozen, chilled and fresh) (000 quintals)			
	1925-29 av.	1930	1932	1934
Germany	1,215	577	29	28
Italy	702	606	334	330
France	480	381	289	153
Belgium	516	364	208	188
	2,913	1,928	860	697

¹ Net exports.

	Import balances of wheat (million quintals)			
	1925-29 av.	1930	1932	1934-35 (season)
Germany	19.8	11.75	5.5	3.2
France	12.6	6.0	21.2	'
Italy	22.4	19.4	10.6	5.0
Europe (excl. U. Kingdom)	98	81	86	50

Mounting tariffs and quotas in most of these countries have deflected greater quantities of foods to the United Kingdom market, and this in itself has perpetuated the low-price situation against which tariffs and quotas have been raised in protection. Thus abnormal tariffs and quotas owe their origin to low "world" prices; and prices remain depressed while markets that formally imported foodstuffs and raw materials on a substantial scale remain very largely closed to such imports.

As mentioned above, efforts were made at the World Monetary and Economic Conference of 1933 to approach the problem from the angle of direct measures to raise prices by restricting supplies. It may be recalled that the International Wheat Agreement of 1933 contained an interesting provision that European countries would reduce tariffs and other restrictions *pari passu* with a rise in the world wheat price, as defined, above 63 gold cents per bushel. Neither for this nor other commodities have restriction schemes achieved market success, and the downward revision of import restrictions has so far been negligible. The study of almost any international staple commodity in detail reveals the influence that shrinking markets in Europe have had upon prices.

Low prices themselves have brought about some readjustment of supplies to available demand; but as many of the exporting countries have taken steps to afford some form of subsidy to producers in their export agricultural industries, there is no possibility of the smooth and rapid adjustment of supply to demand.

The industrial countries of Europe.

There is general agreement as to the need for the restoration of world trade and it is clear that the most important step which can be taken in the economic field is to secure the reactivation of

¹ Net exports.

Europe both as a market for food and raw materials and as a supplier of manufactured exports. The analysis made in the first section of this memorandum showed that the main stream of world trade was between the agricultural exporting countries and the industrial countries. The United States and Japan are important members of the second category, but it is not proposed here to go into the question of the foreign trade and economic policies of either of these countries, which have problems largely special to themselves.

It is, therefore, proposed to examine the possibilities of increasing the trade between the remaining industrial countries and the agricultural countries by measures that fall within the purview of economic (but excluding monetary) policy.

The kind of action to which attention will be particularly drawn is action to increase the consumption of primary foodstuffs, with a view to bringing about a reasonable restoration of trade in agricultural products. This should, in turn, lead to a solution of the low price-high quota impasse in which international trade in agricultural products is involved.

International efforts in 1935 to increase consumption.

Through the Technical Organizations of the League of Nations and through the International Labour Office, Geneva performs a great deal of work in the economic and social fields which is of the very greatest value, although less widely recognized than the political activities of the League.

Problems of the consumption of essential foodstuffs fall within the purview of the Health and Economic Sections of the League of Nations and the International Labour Office and each of these, particularly the first and last, has done a certain amount of independent work in connection with the question.

Resolutions moved by the Australian representatives at the League Assembly and at the International Labour Conference of 1935 performed the useful function of drawing attention to the way in which the problems of public health and of world agriculture were related and as a result of the widespread interest aroused in the Assembly, the League has undertaken an investigation into the possibilities of increasing consumption of foodstuffs in all its aspects.

It is impossible here to deal with the medical or social aspects of undernutrition. A Committee of Scientific Experts prepared a preliminary report on the "Physiological Bases of Nutrition" in November 1935 for the League's enquiry and it is sufficient to say that it is possible, in the light of modern nutritional knowledge, to lay down standards by which the adequacy of the diets of different classes of the population can be judged.

Great Britain, despite its unemployment, is undoubtedly amongst the wealthiest and best nourished countries of the world, yet a report entitled "Food, Health and Income", prepared jointly by the Rowett Institute and the Market Supply Committee (published on March 12th) has shown that by comparison with an optimum standard the diets of 50 % of the population are inadequate, so far as the protective foods are concerned. This does not mean that there is any starvation in the United Kingdom or even that any considerable section of the population is undernourished in the ordinary sense, but it shows that, in the wealthiest countries, there is great scope for social policy to make improvements in public health through encouraging the adequate consumption of the health promoting foods.

The amount of similar data from other countries is limited but it has to be borne in mind that conditions for the poorer classes in the United Kingdom are at present in many ways very favourable since they are able to buy many foodstuffs at prices certainly lower than those in most other European countries.

Action by State and Local authorities to promote the consumption of health-giving foodstuffs, particularly by the very poorest classes and by school children in the State aided schools, falls within the scope of social policy and involves considerations which are not necessarily entirely economic. The growth of nutrition consciousness among European nations would, however, almost certainly result in national nutritional policies.

It is proposed in the next section to suggest what would be the beneficial effects upon international trade if social, and possibly financial policy, comes to be directed towards increasing consumption.

Effects of national nutritional policies.

The reason why the adoption of national nutritional policies may be expected to have important beneficial repercussions on

world trade is because such policies would naturally lead towards that division of production which is the very basis of trade.

To illustrate this point, agricultural foodstuffs can be divided into three categories :

(1) Wheat, maize, other cereals, animal feeding stuffs, sugar.

(2) Meal, butter, cheese.

(3) Milk, eggs, vegetables, fruit.

To-day in most of the industrial countries of Europe attempts are being made to produce all these foodstuffs with the exception, of course, of the tropical products.

Present policies aiming at agricultural self-sufficiency have, however, very serious repercussions of which the following points are illustrative.

High costs of production necessitate high prices and these restrict consumption, with unfortunate repercussions on health; unwillingness to import restricts exports and this, in turn, increases unemployment; in commercial and even in political negotiations the restricted area for possible commercial concessions to other countries decreases bargaining power.

These factors are all recognized but the agriculture of industrial Europe must be maintained. To achieve this objective, however, it is by no means necessary for the industrial countries to aim at producing 100 % of their wheat or sugar requirements nor need they place insuperable barriers to imports of meat and fruit. What is necessary is that their farmers should be fully occupied in the production of commodities for which they will receive an adequate return.

The Nutritional Authorities have placed milk, vegetable fruit and eggs high on their list of health promoting foods. These are products naturally suited both to the agricultural and social conditions of the European farmer or peasant. It has been estimated that to bring liquid milk consumption in the United Kingdom up to the optimum level for health, the dairy herds would have to be increased by 60 %, and this would mean an additional 2,000,000 cows. A similar order of increase would be needed in other countries and for the other products.

National nutritional policies should, therefore, result in a gradual reorientation of European agriculture towards an increased reliance upon the cow, the hen, vegetables, and fruit, and

a gradual decrease in the pressure upon Governments to afford extreme protection to wheat, sugar, etc.

The change would not be rapid and Europe would, of course, continue as always to produce a large proportion of, for instance, her wheat requirements. The effects upon international trade would, however, be wholly beneficial. Increased milk and egg production in Europe would necessitate increased imports of animal feeding stuffs and a gradual revival of world markets for wheat, maize and meat might be looked for.

Defence considerations might be expected to delay the re-orientation of European agriculture but as it became realized, firstly, that animal husbandry leads to high soil fertility and would thus enable a country to produce food in an emergency with less reliance upon imported fertilizers and, secondly, that enlarged herds provide in themselves an invaluable food reserve, the present devotion to cereals and sugar would become less intense.

Conclusion.

The various methods that may be suggested for freeing world trade are not necessarily alternatives. Attention has been directed in this memorandum to one particular solution because it has been much less discussed than such solutions as a tariff truce, multilateral agreements on tariffs, regional tariff pacts, etc. Statesmanship will still doubtless do its utmost along these lines. The enactments of a crisis period to meet the difficulties of adjustment to low prices may be expected to be considerably more difficult to reverse than they were to impose. The approach here suggested will facilitate the process, while furthering a movement towards social betterment which the under-nutrition of substantial sections of nations renders essential in view of the potentialities of the world for producing all the necessary foods.

February 1936.

(Signed): ***

**Separate memoranda
from the Economists consulted by the Joint Committee
on
THE PROBLEMS
OF
MONETARY STABILIZATION**

**JOINT COMMITTEE
CARNEGIE ENDOWMENT-INTERNATIONAL CHAMBER
OF COMMERCE**

**Separate Memoranda
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JUNE 1936

**Headquarters of the Joint Committee :
INTERNATIONAL CHAMBER OF COMMERCE**

**38, cours Albert Ier
PARIS VIII^e**

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The following series of reports on the problems connected with Monetary Stabilization has been divided into two main headings, between which the separate memoranda have been allocated as follows :

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PART I

The significance of stabilization

**Memorandum
on the
relations between currency instability
and tariff (and allied) changes**

by

Professor Dr. Andreas PREDÖHL,
Professor of Economics at the Institut für Weltwirtschaft, Kiel

**1. *The conflict between currency stability and economic
autonomy***

The problem of the stabilization of currencies cannot be considered without a study of the relations between the monetary standard and trade policy. In the course of history these have shown marked interdependence. Above all, however, and this is most important, they are systematically related in the sense that every form of monetary policy involves certain inevitable consequences for trade policy, while every fresh line of trade policy pursued involves necessary adaptations of monetary policy.

*related
to
trade &*

A solution of our problem cannot be arrived at by the study of foreign trade policy only : (it is necessary to investigate the entire field of a country's economic relations abroad) The various items making up the balance of payments are strictly interdependent, which makes it impossible to isolate the policy controlling trade-activity at the international frontiers in its relation to the monetary policy, from the policy which exerts an influence on the movements of the other items of the balance of payments. Moreover, the policy controlling these other movements is in the same sense important, and no less important, than the policy controlling external trade-activity. This observation is borne out by the title of the relevant section of the committee's report, which speaks of the "relations between currency instability and tariff (and allied) changes".

However, to be consequential, the problem must be looked

upon from an even broader point of view. (The foreign economic policy of a country as the policy of linking the national economy to the world economic system is no longer to be regarded as a complex of measures divorced or capable of divorce from internal economic policy.) In proportion as tariffs have been replaced by quotas, licences and import prohibitions, and in the large extent that market regulation has superseded free competition, internal and external economic policy have become inextricably interwoven, most particularly where economic regulations have consolidated to a genuine planned economy of whatever degree of development. But in any case the foreign economic policy of a country must be considered as part of its general economic policy, whether the latter be expressed in measures bearing upon the home market or upon economic affairs reaching beyond the frontiers. Consequently, investigations in this section of the Committee report, at least in their basic implications, must encroach upon the sphere of observation which is subjected to special study in section 1 (d) under the title of "exchange stabilization and the problem of internal planning".

An enquiry into the relations between monetary policy and economic policy in this wider sense leads to the following fundamental results which may serve as a *point of departure* for our further investigations. (Every fixing of international currency exchange levels, that is every stabilization, leads to definite internal consequences in the individual national economies, brought into effect through the balance of payments.) It is not fundamentally important whether this process is automatic or whether it is promoted by the regulating hand of economic policy. It is even imaginable that this regulating hand may have to produce the necessary effects of stable exchanges in the face of heteronomous tendencies. However, economic policy must adapt itself to the rules of the international market mechanism, or at least not run counter to these rules, if exchange relations are to remain stable. This does not imply that in all divisions of the national economy the procedure must equally conform to the classical principles. But neither export and import trade nor trade possibilities in the home market should be so severely barred and bolted by economic policy as to put beyond the bounds of possibility an equilibrium between home and foreign markets, adequate to ensure the balance of payments. On the other hand, autonomous regulation of the home markets, whether directed

at business transactions within the country or at the nation's foreign trade, leads in every case to definite effects upon economic relationships abroad, effects which are reflected in the value of the currency in terms of foreign currencies. An autonomous economic policy, working on principles irreconcilable with the international market mechanism, implies fluctuating rates of exchange. It is impossible to pursue an entirely autonomous economic policy while at the same time undertaking to maintain a definite currency exchange relationship. Any such attempt necessitates the interruption, by exchange regulations, of the direct connection between home and foreign markets and the removal, by artificial measures, of the disequilibrium existing between these markets.

(The antithesis leaves room for a number of possibilities, inasmuch as different degrees and forms of currency stabilization may be linked with different degrees and forms of autonomy.) Only empirical investigation can determine whether or at what point a synthesis is possible. The antithesis implies no verdict upon the value either of currency stability or of autonomy. Whatever one's own attitude toward the latter, it would be a mistake to set up as a dogma the primacy of currency stability and consequently to demand the sacrifice of autonomy; a mistake, because such a postulate can be defended on *economic* grounds only. Purely economic reasoning, guided by the ideal of the maximum social product, demonstrates that this maximum can only be arrived at by a far-reaching international division of labour and proves that such division of labour is only possible under stable rates of exchange and with free interplay of natural compensatory tendencies. Economists are inclined to overlook the fact that even the theory of the maximum economic product rests on a political fundament, i.e. it presupposes recognition of the claim of the economic factor for precedence, as against the other factors in social life. (They forget that, seen from a different political standpoint, economic reason may appear as a political unreason.)

Moreover, it would be most unrealistic to raise to a dogma the precedence of currency stability over economic autonomy. That would be to disregard certain vital forces of social life in the interest on a unrealistic dogmatism; a renunciation of all the practical possibilities of economic policy. Businessmen and theoretical economists have wasted much valuable time in passing

resolutions on the unreasonable conduct of political affairs and in uniting in utopian claims based on orthodox principles. It is for us to be unpolitical in the best sense of the word, to examine the facts objectively and without prejudice and to reckon with realities as we find them. Otherwise the labours of the International Chamber of Commerce/Carnegie Committee will have been in vain. In this particular section of the study it is our task to find out how far the universal development of economic autonomy has proceeded, to determine whether and to what degree the actual stage of this development permits a stabilization of currencies, and to decide whether and how far it is possible to abandon autonomous policy in the interest of currency stabilization.

II. *Autonomy as a result of economic crisis or natural evolution*

A preliminary survey of present-day economic policy shows the auspices as extremely unpromising for currency stabilization, developments having unquestionably been in favour of economic autonomy. All over the world we encounter measures aiming at autonomy and reckless, in this policy, of disturbing reactions on the stability of monetary values : market regulations, fixed prices and wages, quotas, embargoes on capital investment, all are designed to produce internal stability and stimulate business activity at home. Even the few countries still recognizing the primacy of currency stability have been forced by the autonomistic aspirations of other nations to adopt measures irreconcilable with currency stabilization. (This observation is borne out by the statistics which disclose disequilibria and national peculiarities of development in all spheres of economic life : prices and costs, wages and interest, production and savings-schemes have developed differently in every country and have in particular reacted very differently to economic influences coming from abroad.)

These facts have been called irrelevant and are frequently looked upon as effects of the crisis and the attendant collapse of currency systems. They are considered as mere emergency and defensive measures, adopted by Governments anxious to ward off the worst effects of world economic chaos. And it is, of course, true that the breakdown of the system of international economic solidarity gave an enormous impulse to autonomous economic

policy. Nor can it be denied that the majority of relevant measures were not adopted until *after* the outbreak of the crisis. This being the case there may be a temptation to argue that autonomy would automatically disappear with the reestablishment of currency stability and that economic policy would once more fall in with the requirements of the international equilibrium.

However, this type of argument misinterprets the economic and political significance of the crisis. The boom preceding the crisis conceals the underlying structural metamorphoses then in preparation. The great boom ending in 1929, as striking instance, prevented the decisive flaw in the world economic structure, unilateral international political indebtedness (some of it directly, some indirectly political) from showing noticeable effects. The world economic mechanism worked satisfactorily. The crisis — initially a purely cyclical phenomenon — set the pent forces free. And on the ensuing depression devolved depression's appointed task of carrying out the long-due structural changes. The more far-reaching this structural evolution, the graver and longer the depression. The nature of the economic changes under observation has nothing to do with the fact that they first appear, and in great number, during the depression. Their immediate occasion, but not their cause, may lie in the crisis.

On the other hand, it would be a mistake to conclude that those steps taken in the direction of economic autonomy since 1929 or 1931 have necessarily any claim to permanency. Any such idea is given halt by their lack of system and uniformity; it is finally refuted by the fact that the measures in question are by no means equally anchored in tradition. Quite a number are obviously mere emergency measures, unrelated by any system to the general line followed by economic policy or practice of the past. There are others, however, with a history going back decades. They were first prompted by the Great War and received new and stronger impetus through the world economic crisis. But they are doubtless rooted in long-term economic evolution. We need but mention those sweeping reversals, described in caption as the industrialization of the agrarian countries and the return to agriculture of the industrialised, a development going back to the earliest defections from free-trade. Nor is the almost universal national regulation of agricultural markets a result of blind chance. It is rather the logical consequence of older experiments which aimed at the removal of the chaotic condition

in which agriculture lay, under the rule of advance capitalism. The increasing immobility of the national levels of real wages has been arrived at by a long process of evolution. And the same applies to the diversion of national capitals, for investment in the national interest, into the hands of ever more centralised authorities. This last feature may even be observed in those countries which have in other respects left ample scope for the free interplay of economic forces. Even the very recent and very activist stimulation of the trade-cycle cannot at this hour be regarded as a mere phenomenon of crisis.

(We find ourselves faced by a pronounced dualism in the development of automatic policy; to a considerable extent it is a phenomenon of crisis and, as such, open to repeal. For the remainder it is a necessary product of development and irrepealable.) Those features depending on the crisis will disappear as the crisis is overcome, or may at least be abolished, as they will have lost their original sense; while those for which normal development is responsible must be regarded as inherent. It is certain that these latter features irremovably stand in the way of any final solution of the currency problem based on stability of exchange rates; and therefore render impossible a return to the classical gold standard with automatic movements of gold and capital, as well as monetary and credit policy exclusively based on these. However, it remains an open question whether it renders unfeasible *all* forms of currency stabilization.

This question cannot be answered with the help of statistics or other empirical methods. This would imply the possibility of a strict delimitation of the features conditioned on the one hand by the crisis, and on the other by natural evolution; which of course is impracticable. We should also have to be able with accuracy to compute the force of the evolutionary tendencies, which lies still farther beyond the bounds of possibility. However, we are not helpless before the problem. We must merely abandon the idea that only an economy, aiming at the maximum social product, is capable of rational organization, while it is in the nature of political policy to be irrational. We must rather try to grasp the practical sense of economic autonomy and, looking at things from its view-point, further deduce whether, and to what extent, the idea of currency stabilization is reconcilable with autonomy in practice. Though political leaders have often proved as fallible as the economists, we may thus gain at least

a hopeful point of departure for further suggestions to the political powers that be.

What is the aim of a policy of economic autonomy? (Not the maximum economic product by the maximum welfare of the people in every direction) This policy is prepared to make economic sacrifice, when the achievement of the maximum economic product involves an endangering of other aims. On the other hand, autonomous policy does not go to the other, the minimal extreme, of an autarchic or near-autarchic condition which would guarantee to the people mere naked existence. Such radical methods would threaten detriment not only to the economic aspirations of social life but equally to all others. For these other aspirations, whether populative, cultural or relative to the national defence, are only capable of achievement on the basis of a sound economy. Should the co-ordination of these aims call for a strengthening of the material basis, a tightening up of international trade-relationships, if essential to economic improvement, would still be in harmony with the basic idea of autonomy. In this sense, concessions may even have to be made to the international marketing system, if the autonomic state is to avoid impeaching its own ends.

(The equilibrium-point of the various national aspirations is very far from being the same in all countries. It varies from country to country, according to dissimilarities in material resources and talent, cultural and civilisation standards, political structure and aims) Upon those political features depend the manner and extent in which it is "appropriate" for any given country to engage itself to the international economic webwork. The manner of this participation will be indicated by a kind of ranking-system of the country's products, according to which some will be admitted to international trade while others are excluded from it. One country, for example, may wish to preserve for the home-producers the domain of the key-industries; another, the provision of food-stuffs. As to the volume of international trade essential to a country for the attainment of the above-mentioned equilibrium, it will be the greater, the more top-heavy the distribution of the country's natural resources. Great nations, materially well and evenly equipped, may allow political considerations to take precedence of foreign trade-associations. Smaller nations again, with top-heavy natural resources, must at all costs, even to the exclusion of further

political ambitions, strain towards the maintenance and strengthening of foreign trade-relations. The general welfare, in their case, lies in the fulfilment of this single endeavour.

Yet, whatever may be the interest of a country in foreign trade and, correspondingly, in exchange stability with all its implications for economic policy, the fact remains that no great nation is entirely uninterested in stable exchange-rates. However well-equipped with raw materials, the necessary assumptions for autarky, they may be, they all rely for accumulation of wealth and increase of profits on an expanding foreign trade. It is true, of course, that the foreign trade of an autonomous state, if it is particularly skilfully managed and particularly favoured by the circumstances of the moment, may profit from vacillating currency values. But in the long run, fluctuating rates of exchange are bound to exercise a constricting effect on the foreign trade of every country, even such a one. This fact, as one can quite understand, is not yet realised in those countries that have just derived substantial profits from devaluation of their currencies. It will be eventually effectively demonstrated by the appearance of elements inhibitory to further national progress, unless that national progress reconciles itself with the idea of a general world-recovery by way of stabilised exchange-rates. The world trade-situation cannot regain healthy normality without an all-round currency stabilization.

The establishment of free-trade areas is equally helpless to solve the problem, though it improves the chances of autarky for the participating countries. Such customs unions are largely a means of avoiding a forced attempt at autarky and, as such, are a typical expression of the kind of autonomous policy born of crises. In the long run, they can offer no satisfactory solution of the international trade problem, being incompatible with the basic principles of autonomy. Customs unions and the idea of autonomy are on common ground only when such unions are created between states that have a feeling of political unity or are at least subject to a unified political orientation. Otherwise, customs unions represent nothing but a partial return to free-trade; and the free-trade system lies diametrically opposed to autonomy. It must be added that customs unions come less in conflict with autonomic ideology when based on preferential tariffs than when based on free-trade : for here they do not prevent the contracting parties from pursuing a foreign trade policy in harmony with

their political aspirations. But one or several of such unions cannot take the place of a system of world-trade founded upon all-round currency stability and allowing room for the autonomous reservations of the individual nations.

The above observations go to prove that evolutionary autonomy has not developed and very probably will not develop beyond the point where currency stabilization is still possible. Currency-exchange stabilization will of course have to permit the further undisturbed development of autonomous tendencies, as far as they are inherent in economic evolution. It will be called upon to unite countries of widely differing economic structure, countries having to reckon with very varying degrees and prospects of autonomy. It follows that methods of balancing short-term currency fluctuations will differ widely between countries. Some countries will be able to rely more or less on automatic processes, others will have to balance currency fluctuations by means of artificial manipulation. The Committee Report will therefore be well advised to take these facts early into consideration in forming concrete suggestions as to the technical management of currencies.

On the other hand, economic policy may be expected to unburden itself of autonomous emergency-measures and to be guided once more, so far as possible, by the rules of international market mechanism. We must at least insist upon the repeal of such emergency-measures as are fundamentally opposed to currency stabilization. But it should be understood that many of these temporary measures, in their origin purely products of an emergency or defensive policy, can now be revoked only at the cost of great economic sacrifice. Once carried into effect, they tend to become part of the economic life of the nation, particularly where they have give rise to long-term capital investment. This reflection is further pertinent to the striking changes visible in the structure of the foreign trade of those countries that were forced, by the beackdown of world economic relationships, to resort to artificial exchange regulations. But all these considerations only give added urgency to the plea for all-round stabilization, in the interest of the nations in general and each nation in particular.

III. *Economic Hypotheses for stabilization*

By demonstrating that those features of autonomy inherent in ordinary economic evolution are not fundamentally opposed to a general stabilization of currencies, we have already made it equally clear that they could no more have been the ultimate reason for the disruption of international trade which followed on the crisis. They may have served as an additional irritant, but they were certainly not the seeds of chaos. What other factors contributed to the unhinging of world trade-relations and the breakdown of the currency-systems, is another question. And are they still active? We may disarm autonomous opposition-forces to stabilization, on the one hand by their disbandment, on the other by their reconciliation; but if those other disruptive factors remain active, then our pains will have been in vain. The necessary assumptions for a successful stabilization will be unfulfilled. And indeed (external considerations of political policy do exercise a decisive influence on the interplay of currency-system and economic policy) Of these extraneous political factors, which run as contrary to the international marketing-system as they do to the principles of autonomy, all owe either their existence or at least their form and tendency to one primary factor. (On this point, one can speak of unanimity of opinion among theorists and business-men alike). That primary factor is *unilateral international indebtedness*, political or of political origin.

Let us shortly recall the effects which can be traced to this one factor. During the Great War, the European nations engaged in the struggle were forced to realise their capital stocks, while the United States, on the other hand, amassed capital holdings. This resulted in a general shifting of horizons. To begin with, significant streams of American capital poured in to the vacuum created for it in Western Europe : essentially war-materials, supplied on credit. After the War, the field of Central Europe was re-opened to foreign financiers and large quantities of American capital flowed into Germany, particularly after the inflation. This influx was swollen when the Western European powers passed over to Germany their ordinary war-debts, to be borne by her as reparation-debts. For this the absolute lack of capital created in Central Europe by the Great War was preserved as a *statu quo*

and had to be continually counteracted by further capital importations from America.

It is clear to us to-day that these abnormal movements of capital could not fail to destroy the international economic equilibrium. Continued unilateral transfers of capital become in the long run impracticable, unless accompanied by exportations of goods and services paid out of a productive surplus. This was made impossible, on the one hand, and, on the other hand, by the autonomous aspirations and trade policy of the creditor America. However, the gradual undermining of the very foundations of the world economic structure by this economic recovery following the crisis of 1920-1921; to all outward appearances the mechanism of capital movements was functioning normally. The flaw in the structure of the world economic system was only realized after the outbreak of the depression in the United States in 1929. The flow of American capital into Germany was cut off by the crisis, and from that moment the mechanism of capital (loan) repayments ceased to work. Moreover, the sudden withdrawal of short-term credits caused a fundamental disorganisation, the worst consequences of which could only be warded off by radical autonomous emergency measures.

It is characteristic for the following years of depression that international indebtedness, by fundamentally disorganizing world economic relations, acted as an effective bar to economic recovery. To the strength of this bar we may attribute the length and severity of the depression. Finally, it was also responsible for the breakdown of currencies and the effect of this breakdown upon business and trade-policy. Admittedly, it has now been partially removed. Reparations and inter-allied war debts have been annulled in practice, if not by law, and the private indebtedness attributable to war reparations has materially diminished. Yet the burden of the remaining debts is heavy enough to prevent the re-establishment of an international equilibrium. *Mutatis mutandis*, this applies to all international debts. Weighing, as they do, particularly on the agricultural countries, they stand in the way of a reconstruction of the international economic edifice. International indebtedness must be reduced to a level corresponding to the actual capacity for payment of the debtor-countries and, on the other hand, to be willingness of the creditors to accept payment, if this bar is to be removed, curren-

cies to be stabilized and channels to be laid by which the several autonomous (national) trade-recoveries may converge in a general world-recovery.

All the other factors that stand in the way of stabilization are of a secondary nature. This even applies to the uneven distribution of gold. It is true that the changes that have resulted from international indebtedness and the consequent breakdown of currencies are both far-reaching and complex, finding expression in many countries in the unfavourable balances of trade and services which make it difficult to maintain currency stability. But their challenge to currency stabilization is no more insurmountable than that offered by the inherent, and therefore ineradicable, tendencies toward economic autonomy. Moreover, as soon as the primary cause of former and future disequilibria has been eliminated, most of these secondary factors can be removed by the selection of appropriate stabilization levels and by rational management of the currency. Of course, a removal of those trade barriers that are due neither entirely to crises nor to inherent trends of economic development would not fail to have favourable effects upon stabilization and the consequent increase in the volume of international trade. But the removal of these secondary barriers is not essential for stabilization and the consequent improvement of economic conditions. Moreover, the co-ordination of national economic progress with a general trade-expansion may be expected itself to overcome many secondary obstacles.

Finally the problem under consideration is to be seen in its connection with the world political situation. Currency stability is not only subject to outside influences of the past, but will be exposed to new ones in the future. Revolutionary political events, placing the economic world before a radically different situation, would at once give new impulse to those autonomous tendencies which are by nature opposed to currency stabilization. The mere danger of outside political attacks on the international economic situation prejudices unfavourably initiative to stabilization. Currency stabilization cannot be undertaken with any prospect of success unless these dangers can be averted and political peace assured.

February 1936.

(Signed): Andreas PREDÖHL.

Memorandum
on
new technical arguments for postponing stabilization
by

Dr. Hubert Douglas HENDERSON,
Joint Secretary Economic Advisory Committee since 1930

I am asked to contribute a memorandum on Part I Section (2) of the Outline which has been prepared. Certain questions have been formulated for consideration under this heading¹. It will be convenient if I deal in the first instance shortly with the first two of these questions, reserving the remaining three for treatment in the general argument which I propose to develop.

I disagree with the view that foreign trade is likely to be stimulated by fluctuating parities as such. When the currencies of different countries are out of their proper relation to one another, when, for example, the currency of one country is seriously "over-valued" relatively to that of another, it may well be that a readjustment of parities which would correct this over-valuation would be on balance beneficial to international trade. This is the more likely in that the removal of such an over-valuation, by alleviating internal conditions of strain and depression in the country concerned should serve to abate the disposition to raise tariffs or impose other trade obstacles which may otherwise be expected to arise. Again it is possible that good on balance may result to international trade from a reduction in the parity of a country which, although not possessing an over-valued currency in the ordinary sense has suffered in an exceptional degree from a fall in world markets in the prices of commodities in the production of which it is largely interested. In short, the actual effects in international trade of an alteration in exchange parities will largely depend on the special circum-

¹ For further information on these questions, see the sub-titles of the memorandum by Prof. Mises, p. 156.

tances of the countries whose currencies are reduced in relative value. In general, however, I am of opinion that fluctuating parities, by creating additional hazard and uncertainty, will be prejudicial to international trade, and there is no validity in my judgment in the arguments that have been put forward to support an opposite view.

The above is subject to a possible qualification (leading on to the second question) if the alterations in exchange rates are of a character which involves a general devaluation in terms of gold. A devaluation in terms of gold has, or may be given, the effect of increasing the money value to the gold reserves of central banks. It is possible that recovery from conditions of trade depression may be materially assisted by an increase in central bank reserves, and international trade may share in the general stimulus resulting from the general process of trade recovery. Subject to this possibility and to the others previously mentioned, I am of opinion that the influence of competitive exchange depreciation will be in the deflationary direction as the consequence of its prejudicial effect upon international trade.

Thus in general, and subject to various possible qualifications in exceptional circumstances, I am of opinion that conditions of exchange instability or uncertainty are adverse to the development of international trade. How serious the prejudicial effects are likely to be will depend on the degree of exchange instability or uncertainty on the one hand and on the character of the international trade on the other. Long-term contracts which involve a long period of time before the payment for the goods ordered is actually made will be more seriously affected by the possibility that the exchanges may vary in the meantime than the sale of commodities for payment in the near future. The reactions of exchange instability upon international trade will, in short, be greater the more the trade partakes of the character of international investment.

The new arguments which in my opinion need to be seriously weighed before a policy of early stabilization is adopted are of a different character from those considered above. I would sum them up as follows : (1) the problem of maintaining a reasonable measure of economic stability under a regime of fixed exchange parities is much more difficult than it used to be as the result of some extremely important changes that have taken place in the general economic environment. (2) These changes in the

economic environment have also greatly increased the importance of maintaining a reasonable measure of economic stability relatively to that of securing the largest development of international trade. In order to make these propositions clear I must pass at this stage to a broad historical argument.

The nineteenth century was a period of rapid expansion of international economic life. A large and steady growth of international trade went hand in hand with a similarly large and steady growth of international investment, with a large-scale migration of population and with a remarkable development of an international division of labour between the industrial and thickly populated countries of Western Europe and the countries of the New World. The former supplied the latter with the finance, the industrial products and also with the population requisite for their development and received in exchange steadily increasing quantities of foodstuffs and raw materials. This economic intercourse was advantageous in a high and conspicuous degree to both parties concerned. Indeed to the more thickly peopled countries of Europe it supplied a means of escape from what had previously seemed an inexorable dilemma. In Great Britain certainly in the early part of the nineteenth century the minds of thoughtful men were haunted by a sense of the extreme difficulty of securing any real improvement of social conditions in face of the obstacles presented by the Law of Population in conjunction with the Law of Diminishing Returns from land. As population grew, proportionately more food was required. Yet more food could only be obtained either by bringing poorer lands into cultivation or by working existing land more intensively, both of these methods entailing a diminishing yield for each additional unit of effort applied. The difficulty was overcome as soon as the development of ocean transport permitted by bringing into cultivation not the poorer lands in the Old World but the virgin lands of the New.

It was this, together with the rapid growth of the productive power of industry that made possible the remarkable improvement in the standard of life which took place in the Western World in the latter part of the nineteenth century. Indeed, the development of division of labour between the Old World and the New based on real and urgent mutual needs was perhaps the central feature of world economic life in the hundred years that preceded the Great War. It was largely, I think, due to the important part played by international trade of this character that

international trade in general came to enjoy a good name. It was, I am convinced, no accidental coincidence that Great Britain, which depended more than any other country in Europe on the development of the agricultural resources of the New World was also the country in which Free Trade ideas obtained their strongest hold. Similarly the fact that this development required international investment on a large and growing scale helped to give a good name to international investment in general.

The prestige and the smooth working of the international gold standard system were largely attributable in my view to the same set of circumstances. Assured exchange stability was an important if not an essential condition of large-scale international investment, and large-scale international investment was essential to obtain the food and raw materials which the rapidly growing populations of the lending countries required. Hence it was the first *desideratum* of a monetary system that it should ensure exchange stability. Nor under the conditions that prevailed did the objective of exchange stability require as a rule any obvious sacrifice of other elements of economic welfare. The countries which lent the greater part of the money for the development of new agricultural communities were also the countries which were the best equipped for producing the capital goods which the new communities required. Again, they were also the countries which provided the principal markets for the primary products which resulted from the investments that were made. Under these circumstances neither the investment of capital abroad nor the subsequent payment of interest or dividends gave rise as a rule to any formidable "transfer" problems. Without the necessity for any stipulations or regulations a high degree of correlation was automatically secured both ways round between the movements of money and the movements of goods.

A profound change has taken place in the conditions which underlay this pre-war economic development. The populations of Western European countries are no longer increasing rapidly : many of them are now virtually stationary and are likely to decline in the comparatively near future. The consumption of food increases comparatively little as the result of a higher standard of life, so that when numbers cease to grow the demand for food increases only at very slow rate. Accordingly the Western European demand for many agricultural products has ceased to expand with its old rapidity. On the other hand, the

progress of agricultural technique is now proceeding at a more rapid rate than formerly, especially in the agricultural exporting countries. In the case of many agricultural commodities accordingly the growth of productive power resulting from technical progress is now more than sufficient to keep pace with the growth of demand that can be expected, without any further expansion of productive areas. One of the outstanding features of the world economic crisis of recent years has been a severe and widespread agricultural depression marked by the phenomena of overproduction and redundant capacity which were previously regarded as essentially industrial phenomena. The severity of the world agricultural depression is no doubt largely attributable to special circumstances, which represent the aftermath of the Great War, and the incidence of the depression on the exporting countries has been greatly aggravated by the development of agrarian protectionism in the importing countries of Europe. But the development of high agrarian protectionism is itself an indication and a symptom of more fundamental changes. Increasing imports of food no longer wear in Europe, no even in Great Britain, their former aspect of a welcome means of satisfying an imperative need: the aspect which is most prominent to-day is the menace which they present to the stability of domestic agriculture.

In these circumstances, we can hardly expect to see in the next generation a further development of an international division of labour along such complementary and mutually advantageous lines as those of the nineteenth century. (It must rather be expected in my judgment that whatever mitigations may be made in the more extreme trade restrictions which have been imposed during the slump of recent years, international trade will continue for long to be subject to a greater measure of restriction and control of an essentially protectionist character than existed before 1929.) As regards international investment there is likely to be a greatly diminished scope for the function to which the international investments of the nineteenth century were so largely directed, namely, that of developing new sources of agricultural supply by constructing means of communications. Doubtless there will be a development of new types of international investment, notably that which appears to be taking place of the erection of branch works or the creation of subsidiary concerns in one country by large businesses which are domiciled in another. But such developments are less likely than the charac-

teristic nineteenth century type of international investment to commend themselves to the publics of the lending countries as representing a beneficial process which domestic monetary systems should be designed to encourage.

1 Meanwhile the presumption that international movements of money will be associated with corresponding movements of goods has become far weaker than it was. The capacity to produce machinery or other capital goods is now widely distributed throughout the world; and it cannot be assumed that a country which raises a loan abroad (unless stipulations to that effect are expressly made), is likely to use it to purchase goods from the lending country. Similarly, it can no longer be assumed that the normal effect of the loan will be to increase the future capacity of the borrowing country to export goods from to the market of the lending country, or indeed to other world markets.

2 There has been, moreover, a striking development in recent years of capital movements which have no direct relationship to any movement of goods. The traffic between the leading stock-exchanges of the world in existing securities or shares has assumed larger dimensions. At one time, investors or speculators in Great Britain or on the European Continent may buy heavily in Wall Street; while at another an opposite movement may develop. Such transactions affect the exchanges in precisely the same way as a new foreign loan, unaccompanied by a corresponding movement of goods. Finally, in recent years, we have seen 3 emerge the phenomenon of large floating balances of short-term money, which may be moved from one centre to another in accordance with fluctuations of confidence.

↑ (These developments, in my judgment, greatly increase the difficulties and disadvantages that might result from re-establishing the gold standard.) It is of the essence of the gold standard system that if a country is losing gold on a considerable scale and for any length of time, it must apply the corrective of a higher Bank rate, or a curtailment of the volume of credit. Such action is necessarily deflationary in character, detrimental to the internal trade activity of the country concerned. But, under the conditions that prevailed in the nineteenth century, it was usually not unreasonable to assume that the fact that a country was losing gold was an indication that its balance of trade had become unfavourable and that this in turn was an indication that its costs of production had become too high relatively to those of other coun-

tries. Thus a slight deflationary pressure might serve to correct what lay at the root of the trouble, and restore equilibrium not merely in the exchange-rates by attracting short-term money from abroad, but in the international trade balance also.

(Under the conditions that now prevail, such assumptions can no longer reasonably be made.) Under a regime of fixed parities, a country might lose gold on a large scale, not because of any change in the sphere of international trade, but because investors had become "bulls" of the securities and equities of another country. The movement might not be attributable to any action on the part of its own nationals, but might reflect a return of confidence on the part of foreigners in the domestic policy of their own country. Again, so long at least as severe restrictions are maintained upon international trade, a moderate internal deflation might fail to improve a country's trade balance materially. Finally, under certain circumstances, the curtailment of credit or raising of Bank Rate might have to be carried very far, if it were to achieve its primary purpose of checking the outflow of gold. For, if the capital movement responsible for the outflow was attributable to hopes of large capital gains, it would not be easily checked by a tightening of the money market at home.

Thus a country which set out to maintain its currency at a fixed parity without having recourse to any system of "exchange control", might find that its internal economic life was subjected to more frequent and far more serious disturbances, as the result of the measures necessary to maintain parity, than were common in the nineteenth century. In view, moreover, of the strength of the other tendencies adverse to international trade, that have been indicated, it might easily find that this sacrifice of internal stability brought no appreciable compensation in the shape of a larger volume of international trade. Furthermore, if such difficulties and disadvantages were to arise in practice in any considerable degree, the possibility that the regime might once again be overthrown would present itself to men's minds as a contingency to be reckoned with; and the satisfactory working of the gold standard system would be further prejudiced by lack of confidence in its continuance.

These considerations are of a character which should not in my judgment be lightly set on one side. For the most part, as I have tried to indicate by the development of my argument, they are rooted in tendencies which must be expected to persist. It is

true that one of the factors to which I have referred, namely the existence of a large mass of floating short-term balances, may perhaps be regarded as largely the consequence of conditions of exchange uncertainty and instability, and it is arguable therefore that no serious difficulty would arise from this factor, if the exchanges were securely stabilized. But no such emergency character can be attributed to the growth of international traffic in stock-exchange securities. This represents merely one aspect of a more general tendency for the investing public to pay increasing regard to possibilities of capital appreciation. This traffic is more likely to increase than to diminish (unless specific measures are taken to check it by "exchange control", regulations or by other means), and its scale would be increased rather than diminished by any exchange stabilization that was regarded as definitive.

Not only is the danger greater than it used to be that a country might be exposed, under a regime of fixed parities, to a serious instability of internal credit conditions. The tendencies of the day increase the weight which it is necessary to attach to this consideration. There are reasons for fearing that owing to the influences of some of the tendencies that have been indicated, notably (the movement towards stationary populations and the spreading of a semi-speculative psychology in regard to investment, the economic system may have become inherently more unstable and more subject, in the absence of remedial policy, to prolonged periods of severe depression). If this view is well-founded, it becomes the more important, on the intrinsic merits of the case, that the authorities of a country should be able to pursue a credit policy adapted to the requirements of the economic situation. However this may be, public opinion throughout the world has been deeply impressed by the severe depression of recent years and is increasingly reluctant to accept the view that such catastrophes lie outside the control of a wisely-directed policy. It is a real disadvantage of a system of fixed parities that it does in effect withdraw in large measures the control of credit conditions from the sphere of deliberate policy. In these circumstances, it seems probable that public opinion, in Great Britain at least, though it might be persuaded with misgivings to accept a return to a system of fixed parities, would revolt violently against it in the next depression of trade that ensued.

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I turn to consider the expedients of "wider gold-points" and

“flexible parities”, which are referred to in the Outline. The efficacy of wider gold-points would clearly turn on how much wider was the margin between the gold-points. If the margin were of the magnitude of 10 per cent., the fall of the exchanges of a country towards gold-export point would supply a powerful check on any adverse capital movements, since those withdrawing or exporting money from the country would incur thereby a substantial exchange loss. But it may be doubted whether the purposes of exchange stabilization would be satisfied, if so wide a margin were permitted. Indeed, if the exchanges were allowed to vary freely within such wide limits, the exchange variations that might ensue would perhaps be more disturbing to trade than those incidental to a more informal regime, in which a country attempts, so long as it conveniently can, to keep the exchanges steady at the existing level. On the other hand, with a much narrower margin between the gold-points, it would become doubtful whether the prospect of a comparatively trifling exchange loss would provide a sufficient safeguard against the possibility of large-scale capital movements. It would not be easy, indeed, to determine how wide the margin would need to be provide an adequate safeguard against this danger. I find it difficult to suppose, therefore, that the expedient of wider gold-points could ever be regarded as both necessary and sufficient by itself. If the authorities of any country were to take the view that it would be unduly rash to return to a fixed parity without the protection of wider gold-points, it is virtually out of the question that they would be content with slightly wider gold-points; they would require the further safeguard of reserving their freedom, in the event of exceptional pressure, to make a more substantial alteration in the parity.

This leads to the other expedient of “flexible” parities. If this is interpreted to mean that the authorities of a country would remain entirely free to alter the parities provisionally established, without being exposed to any imputations of bad faith, this would provide a complete safeguard against the dangers that have been indicated. The only question is whether such a system would be accepted as meeting sufficiently the purpose of exchange stabilization, as differing indeed enough from the present informal arrangements, to make it worth while to undertake the laborious negotiations, including an agreement on the provisional parities, that would be required for its formal enactment. This is a

question which is unlikely to be answered in the affirmative for at least some time to come. It may be observed, however, that it might well be part of the establishment of a regime of flexible parities that the countries adhering to it would undertake to eschew a deliberate depreciation of their exchanges with a view to raising internal prices or improving their domestic trade, that they would undertake in effect only to alter their parities in a downward direction in response to an outflow of gold, and as an alternative to a curtailment of credit. Thus the initiation of a system of "flexible" parities might mark a renunciation of dangerous possibilities of exchange policy; and, in view of the movement of opinion that are developing in many parts of the world on monetary questions, circumstances may arise in which a general renunciation of this character would have a considerable reassurance value.

Whatever the exchange arrangements of the future, I am of opinion that considerable exchange equalization funds, such as have been established in recent years, will continue to be necessary. The need for them arises from the large scale which capital movements, unrelated to the movement of goods, have assumed. Against large capital movements, the protection of exchange equalization funds is essential if a reasonable measure of exchange stability is to be secured. There exists none the less the danger that the policies pursued by different countries in the administration of their exchange equalization funds may at any time come into conflict, thus giving rise to serious confusion and ill-feeling. One of the advantages of the formal adoption of a system of "flexible" parities would be that it would provide a safeguard against this danger.

In conclusion, there is a further important aspect of the question to which I think it desirable to refer. The essential problem is that of how to reconcile exchange stability with the large-scale dimensions which capital movements unrelated to movements of commodities have assumed in modern times. If these capital movements remain uncontrolled, at least as between the leading financial centres, I am inclined to conclude that it will be impracticable over any future which it is profitable to contemplate to restore fixed parities of exchange. But it is not out of the question that it will ultimately be found desirable to solve the dilemma by re-establishing fixed exchange parities while subjecting capital movements to effective control. Many countries at the present

time maintain their currencies in name at least, at a fixed parity with gold by means of comprehensive systems of "exchange control" under which supplies of foreign exchange are only allocated for approved purposes; and these systems of exchange control have led on to a considerable number of "clearing agreements" between different countries, designed to facilitate their mutual trade. It cannot reasonably be doubted that hitherto these systems of exchange control, as mitigated by the clearing agreements have been more prejudicial to international trade than moderate exchange fluctuations would have been. But it is conceivable, as Mr. Einzig argues, that the clearing agreements may undergo a progressive extension and result eventually in an international system under which foreign exchange is made freely available for commodity transactions while capital movements are rigorously controlled. Apart from a possible evolution of this kind, it is conceivable that other steps may be taken by the authorities of different countries to check undesirable international capital movements. If by such means it is found possible to eliminate the risk of large capital movements unrelated to commodity transactions, the restoration of a system of fixed exchange parities may once more become practicable. These possibilities are, however, too remote and speculative for it to be worth while to discuss them further in the present connection.

February 1936.

(Signed): H. D. HENDERSON.

**Memorandum
on
new technical arguments for postponing stabilization**

by

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**I. *How far is the theory that foreign trade is stimulated by
fluctuating parities true?***

Fluctuations in the exchange ratio between a country's national currency and the foreign currencies affect the conditions of foreign trade until prices, wages and interest rates have been adjusted and a new equilibrium has been established. They influence foreign trade for a limited time only, not for ever: their effect is in the short run, not in the long run.

Some authors used to denounce this opinion as old-fashioned doctrinairism and believe that modern experience has proved that both the stimulating effects of a rise of foreign exchange and the paralysing effects of a fall of foreign exchange may last. Of course, the proof that monetary fluctuations influence foreign trade in the short run only has been given by the classic economists. But the opposite view is an older concept; it was maintained by seventeenth century Mercantilism, and since then by all friends of depreciation, especially by the European and American Bimetallists in the last decades of the nineteenth century. In vain great efforts have been devoted to refuting the validity of the classic doctrine. Its logic is above all criticism; it is an irrefutable economic proposition.

It is not correct to say that the conditions assumed by the orthodox theory no longer exist and that therefore its conclusions are not applicable to the present situation. Conditions have changed and the economic world is very unlike what it was a

hundred or hundred and fifty years ago. But the elementary conditions presupposed by the classic doctrine have not been touched by these changes. They subsist as long as there are prices, markets and international transfer of commodities. It is not true to say that the conditions assumed include free trade between the nations. The world in which the classic economists lived was divided by trade barriers like our own. It was just this fact that there are checks both natural and institutional to the transferability of capital, labour and commodities from country to country which made them discriminate between home trade and foreign trade.

What has changed are neither the conditions assumed by the orthodox theory nor the fact that there are trade barriers between the nations, but the appreciation of the effects of foreign exchange fluctuations.

There is first of all the problem of wages and of unemployment. In many countries wages did not fall as low as the depressed state of trade required. The salaries and wages of public servants are in some countries too high in respect of the public revenue; it seems impossible to restore budgetary equilibrium except by a reduction of the pay roll. In trade and industry, wages are in some countries too high as compared with the prices at which the products can be sold. The rigidity of wages has been so far successful as real wages did not fall in the years of the slump. But on the other hand the volume of unemployment increased as the entrepreneurs were not able with falling prices and unchanged nominal wages to employ the same number of hands as before.

It is obvious that the proposals to do away with the rigidity of wages are very unpopular. But it is not fair to charge those who see no other escape with the blame of hardheartedness. Those who prefer the devaluation of the standard also aim finally at a reduction of real wages. All the proposals in favour of devaluation are based upon the tacit assumption that nominal wages will remain unchanged, that means that with rising prices of commodities real wages will drop. Of course they do not expressly mention this point. But when speaking of reduction of costs they mean nothing else but a reduction both in gold wages and in commodity wages with unchanged nominal wages at least for some time following the devaluation of the standard. The

reduction of the cost of production which has to stimulate exports it to a large extent a reduction of the cost of labour.

It is true, the friends of devaluation assume that prices, especially retail prices, will for some time remain unchanged. But this is a fallacious assumption. If the prices on the world market do not change, if therefore wholesale prices for all imported raw materials and foodstuffs go up, then retail prices have to rise too. There may be a time lag between the rise of wholesale prices and the rise of retail prices; but in the end an adjustment takes place.

There are still more items in the bill of costs. There is especially the burden of debts and of payment of interests. Devaluation means in the first line an alleviation of the debts. But the creditors, to whose disadvantage this measure works, are not the rich. In former times the creditors were generally the rich, and the debtors generally the poor. In our age of bonds, saving deposits and insurance, things are different. The creditors belong mostly to the salaried and wage earning classes. The sums credited are the poor man's lot of the national riches. They represent the non-consumed portion of labour's income, they are labour's reserves for the days of unemployment, sickness and old age, for the bringing up of the children and for the support of the widows. The debtors are mostly the entrepreneurs, the capitalist, who own the shares of the corporations, and the landed proprietors and the farmers.

As far as devaluation reduces cost by reducing the burden of debts, it shifts income from the most numerous class of modern society to the relatively small group of proprietors and entrepreneurs. The policy of devaluation which owes a good deal of its popularity to the humanitarian point of view condemning a cut in wages — of course nominal wages — does not only fail in attaining wage stability; it impairs besides the situation of the less wealthy classes by reducing their savings.

The stimulus which rising prices of foreign exchange give to the export trade is to some extent due to the fact that for a period of transition and adaptation entrepreneurs are ready to sell the imported raw materials which are contained in the manufactured goods for less than their world market price. The manufacturer has bought these raw materials by paying or borrowing a sum of local currency. If the prices, in terms of local currency, which he may obtain for his produce give an adequate allowance of this sum, he does not mind that the same amount of

local currency means now less in terms of foreign exchange and that he will not be able to get for it the same quantity of imported raw materials.

The encouragement which export trade gets from devaluation is due to something like a subsidy received at the charge of all classes connected with foreign trade. Labour contributes by a cut in real wages, creditors by the reduction of their claims, entrepreneurs by losing a part of their capital in selling at prices too low for the replacement of the materials used. Whereas in general an increase in exports means at the same time a corresponding increase in imports, it is different when the increase of exports is due to a depreciation of the standard only. On the one hand the sums received for the exported goods do not increase in the same proportion as the quantity exported, and therefore the exporting country does not get the additional means for an adequate increase of imports. On the other hand depreciation makes imports more difficult as there is a time lag between the rise of foreign exchange and the rise of the home prices of the imported goods. The stimulating effect is limited to exports; imports are rather hindered than encouraged.

It may be doubted whether the economists of a country which has depreciated its currency may look with satisfaction on the increase of exports due to the depreciation. Their countrymen are selling more abroad; but they are not adequately rewarded for the additional export. In the big inflations of the post-war period people used to denounce these additional exports as a selling out and reproached the foreigners with taking advantage of the distressed state of their currency.

On the other hand the countries whose imports from the areas with depreciated currency are increasing are not prepared to accept this inflow of goods. That these goods are cheaper than those manufactured in their own country and that they are sometimes sold at prices which do not make sufficient allowance for the replacement of the raw materials used in their production, makes them consider the transaction as a dumping. Measures to restrict such additional imports are proposed and very often adopted. In this way (under the present conditions of a general dislike for imports), the encouragement of exports due to the upward movement in the price of foreign exchange does not lead to an upheaval but rather to a further restriction of foreign trade.

Confining their reasoning to their own policy only, nations

see in a non-stabilised currency system and in the opportunities to depreciate which it affords a means to increase exports and to fight against imports. What they like to ignore is that the increase of exports due to monetary conditions arouses in foreign nations the tendency to use repressive measures.

It cannot be denied that for a limited time a country's exports are stimulated by a rise of foreign exchange. In this respect the belief that fluctuating parities stimulate foreign trade is founded on fact. On the other hand the instability of the currencies of many countries, just because it stimulates artificially their exports, increases in other countries the inclination to make trade barriers higher and more effective.

II. *What is the case for and against the view that competitive exchange depreciation is deflationary?*

Depreciation means for a time increased exports and reduced imports. It enables a country for a time to undercut world market prices and thereby to aggravate the tendencies working for a decline of the prices of the goods exported. On the other hand the consumer whose income, in terms of foreign exchange or gold, did not increase at all or not in the same degree as the price of foreign exchange went up can no longer afford to buy the same quantity of imported goods. Imports are decreasing because the consumption of imported goods drops. In this respect the belief that the depreciations which have taken place in the last five years contributed to the fall of prices on the world market is founded.

However, the importance of this factor should not be over-rated. There have been other stronger tendencies working for the fall of gold prices.

III. *Should we accept the view that wider "gold-points" will enable a restoration of stability in exchange?*

IV. *The case for and against "flexible" parities.*

It seems advisable to combine the answer to question III with the answer to question IV, as the former concerns only a special case of what has more generally to be discussed under question IV.

A gold standard with flexible parities would mean something

radically different from the old gold standard. It would transfer to the government or to some special board the power to fix and to alter the price of gold and of foreign exchange. The working of the system will entirely depend on the use the authorities make of the power given to them. They may believe that the best policy is not to use the right to change the parity at all and to let the parity once adopted last for all time. It is however more probable that they will have other views on the expediency of a change in the parity and that they will try to make the country independent of situation of the world market.

The only point on which the opinion of all political parties in all countries has always been unanimous is the condemnation of a high rate of interest. And as — in spite of the teaching of political economy and in spite of the experience of the history of banking — people believe that banks have the power to reduce the rate of interest by credit expansion not only for a short period but lastingly, there will be a general inclination for a policy of cheap money, i.e. for low rates of interest. The public will find no harm at all in a policy tending to stimulate business and to make prices and wages go up by granting additional credit. They will prefer easy money and rising prices to the maintenance of the established parity. They will try to profit as much as possible from the faculty afforded by the system of flexible parities.

When in the last five years many countries devalued their currency for the sake of preventing a further fall of prices on the home market, to avoid a rise in the rate of interest, and to give a stimulus to export trade, the measure has been considered as an exceptional one which should be employed once only and never again, as an emergency expedient justified by the unparalleled event of the heaviest slump in the world's history. It is doubtful whether people were right in this assumption. It seems very probable that unless there is a radical change in the current beliefs on monetary policy, nations will in the future again take recourse to the comfortable expedient of devaluing the currency. The situation in which some people believe that prices and interest rates are too high, that wages should not be reduced and that export trade wants an encouragement will surely occur again. Public opinion will then ask for a new devaluation and the government will find no valid reason to oppose such desires.

Even if the country's currency has been stabilised and a new parity, has been promulgated without the intention to go off it

again one day or other, things may be no different. But under a regime of flexible or movable parities repeated devaluations will be considered as a regular expedient. The enactment of flexible parities includes already a programme for new and repeated devaluations.

Flexible parities mean full power for the executive to alter or to fix the price of foreign exchange. Wide gold-points limit this faculty by fixing two points which should not be exceeded. Compared with a system of boundlessly fluctuating parities it means a closer approach to stability. It would not at all however make the restoration of stability easier to attain. As soon as the price of foreign exchange has reached the upper gold-point, the Central Bank or the exchange equalisation fund would have to follow exactly the same policy to prevent a further rise which it would have to follow under the orthodox gold standard.

V. *What are the lessons of the various Exchange Equalisation Funds?*

The most difficult problem which the reserve policy has to handle today are the precarious conditions of the banking system in times of monetary and political instability. It is obvious that capitalists are anxious to avoid as far as possible losses by devaluation. They therefore hold big balances with the banks of those countries whose currency they consider more stable than the currency of their own country. That foreigners use to entrust large sums to the banks of Great Britain, France, Switzerland and the Netherlands is under present conditions rather a disadvantage than an advantage for the credit and currency situation of these countries. When the foreign depositors believe that the country's currency will drop in respect to gold they wish to transfer the deposits to countries whose currency is supposed to be for the moment more stable in respect to gold. The banks are of course not able to pay back at once a great amount of the deposits received. If the Central Bank were to leave them without assistance they would have to suspend payments. But if the Central Bank provides them with the notes wanted for the repayment of the deposits the additional issue of great amounts of bank-notes, which are immediately used for buying gold or foreign exchange, makes the foreign exchanges go up rapidly. No Bank Reserve and no Exchange Equalisation Fund can stand such a sudden attack.

It is obvious that the proposals for a devaluation of a country's monetary unit recommended by influential political leaders frighten the public. It is not correct to say that the attacks of speculators endanger monetary stability. It would be more correct to say that the continuous discussions on the advisability of devaluation induce depositors both natives and foreigners to withdraw deposits and to buy foreign exchange, and that these buying make foreign exchange go up.

A successful reserve policy cannot be limited to the appropriate administration of the Bank's reserves and of an Exchange Equalisation Fund. What is wanted is to put an end to the uncertainty concerning the future conduct of monetary policy. It is intolerable that governments and parliaments hesitate for years between the maintenance of the present parity and a new devaluation.

February 1936.

(Signed): Ludwig von Mises.

Comments on new technical arguments for postponing stabilization

by

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- I. How far is the theory that foreign trade is stimulated by fluctuating parities true ?
- II. What is the case for and against the view that competitive exchange depreciation is deflationary ?
- III. Should we accept the view that wider " gold-points " will enable a restoration of stability in exchange ?

I. How far is the theory that foreign trade is stimulated by fluctuating parities true ?

It appears to me that in order to answer this question adequately, a clear distinction must be drawn between various issues which, owing to the peculiar circumstances of our own time, are generally confused with one another. I shall distinguish, in what follows, between :

- (a) The *general* case for fluctuating parities;
- (b) The *special* case for fluctuating parities, i.e. the argument that it is *by this means* that the world can climb out of the depression;
- (c) The position of a single country (1) at all times; (2) at a time of depression.

It is only by limiting the " universe of discourse " in this way that valid deductions can be drawn.

(a) International trade is, in essence, nothing except the exchange of goods and services between individuals, firms, corporations, etc. situated at different geographical points. Local conditions of demand (themselves determined by a complex of

circumstances — historical standard of consumption, the local level of income, changing agricultural conditions induced by alterations in the way of life, changes in technique, propaganda, etc.) create a market for given products at a given place at a given moment of time. Local costs of production, at this and all other points, determine whether the commodities demanded will be produced at point A or a point B — the costs of transport having naturally to be taken into account. In a world state, with a single currency, and without tariff barriers, the problem would resolve itself into the same elements as those present inside the limits of a single country at the present time. (Local demand conditions determine *what* shall be consumed; local productive conditions determine *where* the commodities will be produced)

Inside a single country, and in the world as a whole, continuous production requires that the consumer pays an amount equal to the costs of production, including normal profits. An elaborate financial mechanism is required to ensure due payment of the sums owing and owed, but there is no difficulty in seeing what are the fundamentals of the situation. Apart from "transfer expenditures", i.e. pensions, or, more generally, receipts from social services — the possibility of demanding anything depends upon the possession of valuable property or the rendering of valuable services — i.e. the person demanding must himself be in a position to render a service in order that he may receive the income by means of which he demands. The extent of the demand is therefore limited by the size of the income received; the extent of the supply, by the volume of orders given. Each individual and each locality has to produce in order that demand may eventuate. But this is in effect equivalent to the statement that given different conditions for the production of different things, the market for the individual determines his demand and his demand determines the market for others. At a given moment of time, an individual may sell more than he is buying, and may therefore accumulate a cash balance, but this is a circumstance which is quite independent of national frontiers. (Whether within or without the frontier, there is at all times a "float" of unspent balances, destined in normal periods to be utilized for investments or for current expenditure.) It follows from all this that the fundamental cause of "international" trade so-called is independent of the nature of the currency system. International and inter-local trade alike rest on foundations much deeper than

the de facto currency régime. It is, nevertheless, also a fact that different countries possess different national "currencies". So long as all these different national currencies were organized upon the same general principle, the existence of such different currencies was a matter of very minor importance. The fact that a certain weight of gold or silver was divided into a different number of currency units in the U.S.A., Germany, France or Great Britain, could not alter the fact that, in the end, all these units were identical. The interchange of products might have been still easier if the units had been everywhere the same, but the restrictions imposed upon international exchange by what was substantially only a difference of nomenclature, could not be regarded as of the very first order of importance. Given a uniform currency system (questions of tariff apart), the whole world must be regarded as a common trading area. Since the unit in which costs were estimated was a common one, local differences of costs arising out of circumstances unconnected with monetary problems were given their maximum significance: since the unit in which demand expressed itself was also a common one, local variations of demand also received *their* maximum significance. It would be absurd to pretend that the enormous growth of the international trade of the world during the 19th century was a *direct* product of a common standard of value — it is impossible to pretend, on the other hand, that that expansion would have been possible without a common standard. For the growth of international trade requires not only short-term relations between individuals, but also long-term relations, in the shape of capital transactions of very many different kinds. Europe had to finance not only the construction of its own "public works" and its own industrial and agricultural revolutions, but also those of the rest of the world — in return, it was entitled to receive interest in sinking funds on the capital which it had advanced. But, in the absence of a common standard, the loan of capital on the one hand, and the receipt of interest on the other, became a speculation. Speculation no doubt attracts some minds and repels others, but it is difficult to believe that the efforts to establish a common standard, which is the characteristic feature of 19th century currency history, were based upon an entire misreading of human psychology. Uncertainty, on balance, is deterrent: it follows that economic progress in the last century could not have been so great if monetary difficulties

had been greater. They were, in themselves, difficult enough — but the direction which reform efforts took is significant : the task of the Ministers of Finance and of the Central Bank of countries like Russia, Japan, Italy, Brazil, Mexico, Argentine, was to bind the local currencies to the world standard : the fact that that standard was gold was in the end of lesser importance than the circumstance that it was *international*.

It is now suggested in many quarters that the whole experience of the 19th century was illusory and that international trade, so far from benefiting from certainty, would benefit from uncertainty. It appears to me that from the standpoint of the general case, there is only a single consideration to be brought forward : Would it benefit e.g. France or Great Britain, if every department of country were to have its own special currency ?

(b) Such a condition of affairs would be regarded as undesirable on one ground, but that ground is a very important one, viz. that it would increase uncertainty. Now uncertainty might be tolerable if the movements of goods and services were instantaneous in all cases, that is, if payment and counter-payment were not separated by a time interval, or were only separated in all cases by a time interval which did not involve serious increase in the risk factor. The existence of long-term investment, where the risk factor runs into decades in certain cases, makes uncertainty unendurable, if it exceeds very moderate limits.

The case for uncertainty, that is, for generally fluctuating currencies, must therefore rest upon special considerations. The modern case for uncertainty rests upon the assumption that, given fluctuating currencies, trade depression can be more quickly overcome. This assumption involves two quite different sets of considerations.

1. It may be argued, firstly, that thereby a recovery of external trade *generally* may be brought about, involving favourable repercussions upon total production.

2. It may be argued, secondly, that though a general recovery of international trade cannot be brought about in this way, yet the *indirect consequences* of fluctuating currencies may be favourable to recovery.

These two arguments have nothing in common except that they involve a common conclusion, viz. a fluctuating rate of exchange. They must be separately examined because their intrinsic content is so very different.

(A) The first argument proceeds from the familiar fact that in every period of depression the level of costs falls less quickly than the level of prices, and that, given modern social policies, it is difficult to *force* costs down. That being so, it is argued that if the exchange is allowed to fall, the costs of exports to the foreigner will decline. The export goods of country A, it is assumed, will now be cheaper to the importers of country B; similarly, the export goods of country B will now be cheaper to the importers of country A. It is easy to see where the fallacy lies if this simple version is taken; if both country A and country B lower their exchange *simultaneously* no such favourable repercussions will take place. For A's exports in B's currency will now cost as much as they did before; so will B's exports in terms of A's currency. It is quite true that, if A lowers its rate of exchange relatively to B, A's exports to B will cost importers in B less, and B's export to A will cost the importers in A more, whence there will be a change in the situation relatively advantageous to A, but *in this case*, at the expense of B. It appears, then, that the general case for fluctuating currencies rests upon a confusion of the advantages of a reduction in the external value of a currency to a single country with the advantages which would result to all countries from an all-round reduction. Taking all countries together, at a single moment of time, the result of an all-round "cut" in rates of exchange would resemble what, in the opinion of certain economists, follows from an all-round cut of wage costs; everyone is in the relative position as before.

So far as internal exchange is concerned, an improvement of external trade would have only an indirectly stimulating effect. Nevertheless, in the case of certain countries, this indirect effect might be of great importance. This is the implicit assumption contained in what may be termed the "special case of the special case" for all-round devaluation. Given that all-round depression results from an all-round decline of international trade; given further, that all-round devaluation would stimulate foreign trade, then, it may be argued, indirect but beneficial consequences will follow, even so far as internal trade is concerned. But this argument proves too much. For, if it is true that an increase in international trade stimulates internal trade, it is equally true that a decline of internal trade has a depressioning effect upon external trade. Now, external devaluation cannot have a *direct* effect upon internal trade — except in the manner discussed under (2)

above. It follows that, *unless trade depression is purely a function of the foreign trade situation*, all-round devaluation cannot bring about general trade recovery, for the simple reason that, unless internal trade recovers, the volume of foreign trade, even given depreciation, will not recover, since, *ex hypothesi*, that volume is in part a function of the volume of internal recovery.

It is perhaps desirable to add that the argument for all-round depreciation as a general method for curing *cyclical depressions* is not in the least strengthened by the fact of the successive devaluations which have been witnessed in Europe in the last few years. For, naturally, the position of country B is weakened if country A devalues, and the position of C is weakened still further by the combined effects of the devaluation of A and B. The recovery of A may have been at the expense of B, and that of B at the expense of C. An all-round devaluation would merely prevent these adventitious advantages from being secured; but this is not the same thing as proving all-round recovery. It follows from this that if countries A, B, C, ... have devalued, it may be necessary for countries X, Y, Z, ... to follow suit, not because of the general advantages of devaluation, but because of the special disadvantages *otherwise* imposed upon them.

(B) The special indirect advantages claimed from fluctuating currencies during the period of depression are of an entirely different kind, and require much more serious consideration. In sum, they amount to this: that without a fluctuating currency, certain types of monetary policies, capable of assisting recovery from depression, would be either impossible, or, at any rate, less easy to apply. For a "reflationist" policy of cheap money, accompanied, as it might be, by public works and an unbalanced budget, might from time to time involve either a temporary fall in the rate of exchange or (given fixed exchanges upon either gold or foreign currency reserves) losses of reserve. The monetary authority, in the latter case, would be driven to pursue a short-term exchange policy inconsistent with its domestic policy. To protect its reserves, it would have to practise restriction at the very moment when internal needs demanded expansion. The evil is accentuated by psychological repercussions; the deterrent effects of (relatively) dear money cannot be reckoned only in terms of the increased burden involved. The loss of confidence in the outlook which is involved in rising money rates at such a

time would hold up recovery to an even greater extent than appears at first sight.

Here, again, it appears to me that the popularity of the argument is due to an illegitimate generalization of the implicit assumptions underlying it. *Firstly*, it is assumed that what is true of the psychology of one group is necessarily true of all groups, that is, because, in Great Britain, for instance, a decline in the external rate of exchange is viewed with greater equanimity than a rise in Bank rate, it must be *generally* true. *Secondly*, it is assumed that because a single country cannot without danger to itself, practise a policy of reflation without a currency capable of fluctuation, this must also be true of all countries taken together. *Thirdly*, it is assumed that — the desirability of reflation being taken for granted — currency fluctuation is a part of the price which must be paid for it; that there are no alternative ways by which short-run disturbances from without can be countered. All these assumptions seem questionable.

For, if there is a common attempt to implement a reflationist policy, the difficulties envisaged and which are alleged as the grounds for flexibility of exchange will not arise. An unwarranted rise in Bank rate in a single country practising reflation can only be due to a failure of other countries to do the like. *It is the absence of a common monetary policy in a period of depression, not the presence of fixed exchanges, which is the real difficulty.* It remains true that a single country may have to sacrifice exchange stability if it desires to pursue an autonomous policy of reflation in a world of divided monetary policies. It also remains true that, if every country considers only its own domestic situation and is governed by the same psychological considerations as every other, *but without taking account of the state of feeling elsewhere*, all of them together may have to resort to fluctuating exchanges. But that is not at all the same thing as proving that fluctuating exchanges are an *a priori* condition for a policy of reflation. A general policy of reflation is perfectly consistent with the all-round retention of fixed parities, even if no common currency policy exists, for there is still the alternative of allowing gold reserves temporarily to run down. It may be argued that, although a decline in the foreign exchange reserves is preferable to a rise of Bank rate at home, yet it may upset opinion abroad, and thus bring into action forces which destroy

the very fixity of exchange it is intended to preserve, by inducing a flight from the currency. But the international repercussions arising from a sharp fall in the external value of a currency may be equally serious; and there is no guarantee whatever that a very sharp fall in the external value of a currency will not upset opinion even inside a country which on balance prefers a given short-run rise in the rate of exchange to a given short-run rise of Bank rate.

(c) How radically different the position of a single country¹ is from that of all countries taken together has already been made clear by inference in the preceding sections. Perhaps the difference can be best summed up as follows : a single country can improve its position at the expense of other countries, but all countries together cannot possibly do this. The special advantages which a single country can draw at all times are two in number :

First, if it suffers from a specially rigid cost structure and at the same time is largely dependent on foreign trade, it can overcome that special disadvantage by means of a flexible exchange. For the fall in its exchange will check its imports and stimulate its exports. Further, if it allows its exchange to fall by more than the difference in the cost level, it will actually gain at the expense of others : the under-valuation of its exchange, whether deliberately induced or brought about by speculation or the movement of short-term balances, etc., will enable it to invade the markets of others, in spite of its generally disadvantageous position. This position of advantage will be reinforced if its cost position is not specially disadvantageous, and if the internal cost of living is not greatly influenced by the necessity of importation; if, in other words, its imports are largely raw materials intended to be worked up and re-exported. But it is manifest that general under-valuation is an impossibility. If the currency of country A is generally under-valued, that must mean that all the currencies are over-valued in A. If the pound is under-valued in terms of the dollar, that must mean that the dollar is over-valued in terms of the pound. A general attempt to derive the advantages resulting from undervaluation is thus out of the question.

¹ This whole issue is enormously biased by the single case of Great Britain, to which a separate memorandum is devoted. Here the case is argued in general terms.

As regards a period of depression, a single country lowering the value of its currency can draw to itself a larger share of the world's exports, provided other countries do not follow suit. At the same time it can, by lowering its exchange rate, reduce its share of world imports; home production taking the place of extruded import. In the short run, therefore, currency depreciation on the part of a single country does cure, or help to cure, depression, so long as the conditions implicitly assumed go on existing. But whether they will or not, is a question of fact, which must be discussed under the following head, namely :

II. *What is the case for and against the view that competitive exchange depreciation is deflationary ?*

By "competitive exchange depreciation" is understood a progressive decline in exchange rates, taking place as a continuous process. Country A having lowered its rates, country B follows suit, followed by C, D, E, followed in their turn by country A again, and so on.

The view that cyclical depression can be cured by progressive exchange reductions has been examined above. But what we have to examine at this stage is not the argument that general recovery cannot be brought about by this means, but the argument that this progressive process of depreciation, so far from bringing about recovery, will result in a progressive process of deterioration.

The argument is a two-fold one. (1) Given the fact of depression, there is *ex hypothesi* a limited market. Let country A lower its rate of exchange relatively to country B. Export to B will now temporarily increase. It depends upon the elasticity of supply in A as to what the increase in exports will be, given a certain rate of fall in the exchange rates. But if the market in B is inelastic, the forcing of exports from A, so far from increasing the gross income of producers of export products in A, may actually reduce that income. Further, if country C sees its market in B contracting as a consequence of the fall on A's rate of exchange and is therefore forced to imitate A's example, there will be a stimulation of exports from C also; the net effect must be to diminish the aggregate receipts of producers both in A and in C, unless the fall in price in B stimulates an increase of con-

sumption sufficiently great to overcome the effect of the fall in price. There is not necessarily any favourable repercussion in B generally, for though, if A and C's exports resulted in an aggregate increase in their receipts, they would be in a position to increase their effective demand for B's products, if A and C's aggregate receipts fall short of what they would have been had they not forced their exports, all that happens is a substitution of one product for another (for example the consumption of butter is stimulated, that of margarine falls) without any general stimulation to production. The net effect is to increase the real income of consumers and further to reduce the real income of producers.

(2) Further, in actual fact, the process of exchange depreciation is not allowed to work itself out without let or hindrance. The effect of competitive exchange depreciation being temporarily to stimulate exports from the countries that first depreciate their exchanges, other countries retaliate, not merely by lowering their exchange rates, but also by increasing the restrictions they impose upon foreign trade generally. If country B, for example, raises its tariff in proportion to the fall of A's exchange, producers in A stand to gain nothing; if by more than this, they will actually lose. If country B imposes a quota such that the aggregate amount which can sell is so reduced that the sale-proceeds at the new rate of exchange are less than they were before, again A will lose. But a reduction in A's aggregate income must have indirect consequences upon the whole of the price situation; not only upon A's export prices, but upon A's import prices as well.

The truth is that, in the modern world, currency depreciation is a double-edged weapon. If the forces implicit in currency depreciation were given free scope, they *might* bring about recovery. That is one conceivable line of argument, but in fact, they are not given free scope. The resort to depreciation involves recourse to tariff and quota restrictions which neutralise any favourable effects that, under appropriate conditions, they might have. It follows that to attempt to prove any particular thesis relating to depreciating currencies by an appeal to facts is quite impossible; for the *de facto* situation is the combined result of currency depreciation, exchange restriction, increases in quotas and tariffs, and the maintenance of the *status quo ante* elsewhere. An inductive proof or disproof of the validity of the view that exchange depreciation, given modern conditions, is deflationary

is therefore out of the question. I am inclined to the belief that the balance of argument ¹ is with those who urge the affirmative in this particular controversy.

III. *Should we accept the view that wider " gold-points " will enable a restoration of stability in exchange ?*

The case for wider " gold-points " may be summed up under the following heads :

(a) They would reduce the necessity for taking immediate action when there is a pressure upon the exchanges of a country since the rate of exchange must fall (or rise) by a greater percentage before such action is technically called for, since the Central Bank will now only sell gold or foreign exchange at a higher price in terms of the domestic currency.

(b) The possibility therefore exists that in a certain number of cases, at any rate, no action need ever be taken at all by the Central Bank. For there may be a " turn of the tide " due to the disappearance of the influences which have temporarily made the exchange unfavourable, or these unfavourable factors may give way to favourable ones. Since remedial measures can be postponed for a rather longer period of time, a greater opportunity is given for " self-correction " of the exchanges.

(c) Moreover, if the rates of exchange can swing through a wider arc, powerful reinforcing factors can enter into operation. (i) Thus, when the exchange is at gold export point, since this point is *ex hypothesi* lower (or higher) than it was before, the temptation to buy the currency in question is increased, since the profit on the ultimate resale is *ipso facto* greater. (ii) On the other hand, the possibility of a wider swing in the exchange should deter the purchase of the currency in question when the exchange is at gold import point, because no profit can be made on resale, and the chance of loss on resale is increased, since the gold-points are widened. In other words, the currency becomes more attractive, in proportion to its cheapness, and less attractive in proportion to its dearness, and as the currency can be dearer and

¹ But only the balance of argument in general. It is throughout implicit that a single country, given certain assumptions, is capable of profiting from depreciation. The generally deflationary effects of depreciation are, of course, strengthened, if the currencies of exporting areas are deliberately undervalued.

cheaper than it was before the gold-points were widened, the widening of the gold points *would* result in the introduction of reinforcing factors of an important kind.

The *a priori* case for a widening of the gold-points is thus one to be taken seriously. Before it can be regarded as conclusive, the following points must be borne in mind :

(d) Any difference that can be made under heads (a) and (b) cannot, in the nature of the case, be regarded as entering very seriously into the fundamental problems at issue. Serious disequilibria must be overcome by more fundamental devices, and, from the short-run point of view, the maintenance of larger reserves would be as useful a means of avoiding the immediate recourse to alternative methods of control (primarily a rise of bank rates) as a resort to wider gold-points.

(e) The fundamental short-run issue is, perhaps, this : will the use of wider gold-points in all cases affect the flow of funds in the way desired ? The compensatory action of widening the gold-points discussed above really rests upon the assumption that such *movements are redistributed over time*, without the aggregate volume of the flow being affected. But there is no guarantee that this aggregate flow will *not* be affected, or that it would not be affected in a manner adverse to stability.

(f) It is a commonplace that speculation profits by uncertainty. A currency system in which the difference between buying and selling prices equals zero would only give rise to speculation, if there were doubts whether the absolute parity could be maintained. Every increase in the divergence between the upper and lower limits within which the external value of the currency can alter must necessarily increase the chances of speculative gain, *and must therefore alter the quantitative terms of the problem*. Even given that the flow of speculative balances always corresponds to the technical necessities of the moment, still, to rely upon these flows is to rely upon an instrument which alters the underlying features of the case. For although it may be true that a speculative inflow at gold export point will drive exchange upwards more rapidly than it would otherwise have been driven, the reverse is also the case, that is, a "favourable" exchange position is less stable than it would have otherwise been.

(g) Whatever may be thought to be the weight of the argument *pro* and *contra* presented above, the mere existence of wider gold-points cannot possibly be regarded as the fundamental con-

dition of a return to exchange stability; at best, wider gold-points would represent a minor technical device intended to reconcile the technical exigencies of the exchange position with the desirability of not disturbing internal conditions for the sake of merely temporarily external disturbances. Any practicable widening of the gold-points would still leave unaffected the major conditions necessary for a practical return to a stable exchange. It would be perilous in the extreme if it were for one moment imagined that a subordinate technical device could replace equilibrium in the balance of payments (involving, in the end, an appropriate relation in the price and income structure of different countries) as the primary condition of a stabilized exchange.

IV. *The case for and against "flexible" parities.*

1. By a flexible parity I understand the case in which a currency, though *de facto* pegged to gold or to another currency, is not legally so associated, or, in the event of its being legally associated, an express reservation is made that, under given conditions, the right to alter the parity is reserved.

The case for such a currency system is simple. Circumstances may easily arise, it is argued, under which the retention of the existing parity is impossible. The level of costs and prices in the world outside the area in question may rise or fall disastrously — in the first case, the retention of the fixed parity would involve an unnecessary inflation; in the second place, the retention of the fixed parity would involve an equally unnecessary deflation. Alternatively, the level of costs and prices in the outside area may remain in equilibrium, but inside the area in question the economic situation may have undergone a drastic change. In order, for example, to avoid social convulsions, a general rise in the cost level may have taken place there. Unless parities are flexible, a rise in the cost level would involve disequilibrium in the balance of payments, a struggle to maintain parity by means of a sacrifice of external assets, perhaps a renewal of social struggles (wage cuts, etc.) in order to restore external equilibrium. Why not meet the situation simply by means of a fall in the external value of the currency? The case for a flexible parity, in other words, is simply that by means of it (a) external pressure can be avoided, (b) internal disequilibria can be neutralised.

II. The case against flexible parities can be stated thus : Firstly, it is quite obvious that if a single country reserves to itself the right to " insulate " itself, others can do so also. The result would be that the whole international currency system would be built up upon the basis of all-round *uncertainty*. But fixed parities are intended to reduce uncertainty, not to increase it. If every country retains the right to alter the parity of its currency, given the existence of circumstances, internal or external, which it regards as unfavourable to itself, then the ultimate situation may be worse than if the whole system were " unfixed " from the beginning.

Secondly, it is exceedingly difficult to lay down in precise terms exactly what are the circumstances under which a resort to flexibility is to be sanctioned. If the parity is to be altered on every occasion in which some slight sacrifice is called for, that is, if flexibility is to be resorted to for the purpose of *short-run adjustments*, the fixity of the parity becomes a farce. If, on the other hand, fixity is to be the rule and deviations from parity are to be the exception, then advantages of flexibility vanish, except in the " abnormal " case, and in the abnormal case there is no necessity for *a priori* reservation of a right to change the parity; a change of parity under *such circumstances* is justified by the circumstances themselves.

In other words, the case for flexible parities is prejudiced by the circumstances that they are either dangerous or useless. They are dangerous, in so far as the right to resort to a change of parity is a direct encouragement to make use of them more and more frequently, so that, in the end, fixity is sacrificed to flexibility. They are useless, in so far as experience shows that there are conditions of disequilibrium so grave as to require a departure from the existing parity. When such conditions arise, the existing parity will be departed from. But it makes a great deal of difference, psychologically, if it is recognised that the breach of parity " could not be helped ".

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(Signed): T. E. GREGORY.

Memorandum
ON
exchange stabilization and the problem of internal
planning

by

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*I. The relation between currency instability and internal
planning.*

The term "internal planning", as used in the following memorandum, includes all state or collective control of the economic life of a country, aiming at a material direction or "steering" of its economic activity.

Most of this planning arose from emergencies due to the war, or to depressions of single branches or of the whole of economic activity. Its aims is, therefore, either to overcome the depression or to maintain a constant state of equilibrium, that is, continuous prosperity.

Most planners hold that each country is able to promote a national policy of recovery independent of the state of the world market or of other countries. That means necessarily disregarding the connection with the price and cost level of other countries and therefore of fixed parities with other currencies, either during the realization of this plan or generally in the future. Unstable foreign exchange rates are thus the inevitable consequence of an automatic recovery policy and of national planning, independent of the world market.

This connection between currency instability and national planning can be shown not only in the writings of many monetary experts but also in the ideas of the leading statesmen who have been inclined to planning. The attitude of monetary reformers to internal planning is, of course, not uniform. Whilst

some leaders, like Keynes, are in favour of planning in general, others, like Warren, seem to hold that monetary planning in the form of managed currency will render superfluous planning in general or in other fields. But precisely the latter authors contend that the price level and the equilibrium of internal economy is more important than the stability of foreign exchange and should form the chief aim of monetary policy, to which stable exchange rates should be subordinated. So the ultimate results of the proposals of monetary reformers and of other planners on currency are, in fact, the same.

What has been said of authors on monetary reform and on planning applies also to the statesmen who tried to apply their proposals. Thus President Roosevelt declared explicitly during the World Economic Conference of 1933 : " The sound economic system of a nation is a greater factor in its wellbeing than the price of its currency in changing terms of the currency of other nations. " That is to say that the development of the internal market should be the chief aim of all planning, without regard to its effects on foreign exchange. Similarly, in Germany and Italy exchange control and restrictions were intimately connected with internal planning in the form of public works and the development of home production. Other countries like England, Sweden, Norway and Australia, gave up general planning on a big scale. But by devaluation, credit expansion and increased protection, a national recovery policy, independent of the state of other countries, was promoted.

Thus stable currency and internal planning seem to exclude each other. But this convention only holds true if this sort of planning is really genuine planning, that is, if it promotes equilibrium and economic stability in the long run for all concerned. Therefore the fundamental question arises : have, these planning measures been really a success ? Have they brought a quicker recovery of the different countries and of the world, and have they created in the long run a better equilibrium of the economic body ?

II. *The actual results of internal planning in the past.*

Reviewing the results of post-war planning, one must make a distinction between emergency measures and planning in the defined sense.

Emergency measures like those conserving the national credit and bank machinery, preventing the ruin of agriculture in front of an overwhelming fall of prices, and giving assistance to the army of unemployed without any insurance help, are mere social necessities which maintain the basis of economic life and of human society, without trying to influence the direction of economic activity. Inasmuch as the state restricts its influence to measures of that sort, it is promoting economic stability.

Most planning of the last decades goes, however, much further. It tries to direct, to "steer", economic activity in order to attain some ideal of economic or social order, or to restore the former state of prosperity. This aim not only pre-supposes a verified knowledge of the causes of the disequilibrium, but also a complete insight in the correlations of economic factors and a univocal standard, according to which economic life has to be directed. In fact, most planners hold that the disorder is due to one single cause, the control of which entails the control of the whole economic activity. So they are trying to influence very different factors with the following results.

A. Planning in the field of foreign trade

The means of this planning are : duties, import restrictions, clearing and compensation agreements. Their common aim is : to protect single branches or the whole economic life of a nation from an impending crisis by keeping off or mitigating foreign competition, and to replace foreign imports by inland production.

Neither of these objects could be attained anywhere in the long run. With the present rate of technological progress each gap, arising from the keeping off of foreign competition, is filled almost immediately by inland production, so that no alleviation from competition is attained, but, on the contrary, an increase of unused productive capacity which engenders new protection. At the same time, the cutting off of foreign products creates new centres of crisis in foreign countries, which reacts adversely on the exports of the protecting country and leads to a reduction of world trade. The same applies in the long run to compensation and clearing agreements. Collective planning in this field has, therefore, not led to a higher order of equilibrium, but has, on the contrary, destroyed the continuity of economic development.

B. *Monetary planning*

Most measures of planning in the field of currency are not based on scientific laws which have been empirically verified, but on abstract theories, obtained through a deduction from formal equations in view of a definition, that is, from truisms which are uncritically made the basis of a causal interpretation, and naively applied to reality.

If an attempt is made to test the results of the different measures by an empirical and statistical analysis, the actual facts in no way corroborate the generalizations and hopes of monetary planners.

(In the first place it cannot, in most cases, be shown that the pretended effects are really the result of planning, but rather of chance.) So it is highly doubtful whether the relative stability of the price level in the United States between 1922 and 1928 can be assigned to the policy of the Federal Reserve Banks, because they acted on about a dozen different motives. The same applies to the devaluation of the different currencies or the relative stability of the price level, following the devaluations. Very often the monetary reformers interpret the policy of central banks quite differently from the bank lenders themselves. Therefore a great part of planning exists in ideologies only.

(Further it is questionable whether the actual measures have had the stated results in the money market.) The actual inefficiency of the discount and even of the open market policy in the United States between 1922 and 1929 is notorious. The same applies, in part, to the methods of credit expansion and of the gold buying policy in the United States after 1933. If the discount policy in England has been more successful, it is only because it had less ambitious objects.

Then (it is very doubtful whether the actual results on the money market had the pretended influence on economic activity.) There is even no empirical proof of the pretended exact relation between volume of money and prices. Still more doubtful is the connection between a stable price level and the equilibrium of economic life. The experience of the United States shows that the index of wholesale prices cannot be relied upon as a guide of monetary policy. Even the causal relations between credit expansion and recovery are questionable. In fact, the monetary

planners concede in theory that these measures work only under certain conditions. In practice, however, they operate with them as if these limits did not exist; though it would be more reasonable to suppose that in practice the results would be smaller than in theory.

Lastly, the hopes of the monetary planners are disappointed by the numerous unexpected and contrary results of their measures. Thus the Federal Reserve Policy before 1929, instead of promoting stability, sound business and liquid commercial banking, as intended by the compilers of the law, fostered the disequilibrium of the economic body by furthering involuntarily the speculation in securities, the investment business, the brokers' loans and, thereby, overspeculation and overinvestment. Likewise the monetary planning in the form of devaluation has increased the instability of the world economy, strengthened the deflation in gold and the crisis in the gold bloc countries, revolutionized the price and cost parities between the chief countries and increased the tendency to restriction of foreign trade. So there can be no doubt that the recovery of the world as a whole, as well as that of the different countries, would have been much quicker if this manipulation of currencies could have been avoided, and the net result of monetary planning — in spite of all changing advantages for single countries — has been, not a higher form of economic order or of planning, but, on the contrary a destruction of the foundations of every lasting order, namely, of the equilibrium of cost and price parities and of the continuity of economic development which must be the highest principle of economic policy.

C. Planning in the field of production

Attempts at planning in the field of production are the beginnings of a corporative economy in Italy and the United States (codes) as well as the voluntary and compulsory cartels in industry and the control schemes for staple agricultural commodities.

In the United States the real planning devices of the codes have never been really applied owing to the pressure of more urgent problems. In Italy, too, the corporative economy in its strict sense dates only from the beginning of 1934, and very few sessions of their organs have been held. These beginnings have,

up to date, developed no new principle of higher planning, but form only the continuation and intensification of the traditional interventionism. This policy could not prevent Italy from being affected practically in the same way as other countries by the present crisis.

Two developments only, which are to be found in other countries also, can be regarded as attempts at a higher form of planning, namely, compulsory cartels and the control of the creation and extension of enterprises. Cartels may prevent the ruin of the market during the depression, if they do not prevent an equitable adaption of prices to general conditions, which is not always the case. In the long run they have missed their aim, because the keeping of prices has fostered bigger expansion of capacity and increased the fixed elements of the economic life to the detriment of the others. The control of new plants may hinder overcapacity during the crisis, but in the long run stifles technical progress and the ability to compete with foreign countries, because nobody can foresee what the future importance of a new enterprise or process may be.

The experiences with the different artificial control schemes for raw materials are similar. They may hinder the ruin of the market during the depression. In the long run, however, they have fostered the instability of economic life by keeping prices uneconomically high, thus spelling overproduction and sudden falls of prices. They lead to higher gyrations of prices and production than in a state of free competition.

All these attempts at planning are doomed to failure, because the direction of production is undertaken without any previous knowledge of all the facts and of their interrelation.

D. Planning of income distribution or capital investment

All attempts at keeping incomes artificially high or increasing their buying capacity, as a means to foster recovery, have failed because :

(1) The disproportion between consuming power and productive power is not the cause of the crisis, the purchasing power of the masses having grown faster than production before 1929.

(2) The increase of nominal or real wages means a corres-

ponding increase in costs, so that an additional purchasing power cannot arise.

(3) The most important problem of recovery is the increase of capital investment which is discouraged by the previous increase in labour costs.

(4) The problem of creating purchasing power is not merely a quantitative, but a qualitative question, namely, to produce the right products and to attain the right relation between the different prices.

As to public works, the experience of Germany and the United States show that they serve only as a means to alleviate the consequences of the depression and not as a method to start recovery and to reach a higher form of planning, because in no instance the income created was higher than the money expended in the works.

III. *The fundamental problems of internal planning*

All attempts at planning start consciously or unconsciously from two suppositions : either they hold that economic life is governed by objective laws, resulting in certain correlations of factors and cyclical fluctuations of total activity, or they suppose that humanity is able to control at its will the development of history and social structure.)

Where the adherents of planning start from the supposition of objective laws, the aim of planning can only be to discover the normal activity of economic life and to adapt the actual activity to this norm or standard, in order to limit the deviations. Planning includes therefore in this case the knowledge of the normal trend, of the normal cyclical and long-trend variations, and of the normal relation between the different factors, and to this effect we should possess exhaustive data and a univocal interpretation of them.

Up to the present there is neither agreement in regard to the fundamental factors of cyclical variations, nor do we possess sufficient data to measure the variations of these factors and their relations, nor does there exist unanimity in the interpretation of these data. On the contrary, the diagnosis is made on the basis of the most contradictory abstract theories, the verification of which is by no means concluded. So the most modest predictions

are discredited by reality, and we have practically no certain knowledge as to the normal flow of economic activity which could form the scientific foundation of real planning. Therefore, the actual measures of planning have been undertaken on the ground of prejudices, political motives or human pretensions, with the result that the instability of the whole has been increased. In any case it is utterly unscientific to regard the phase of prosperity as the norm of economic activity, as is usually done by planners.

Still more precarious is the situation of the great body of those who hold that man has the possibility to determine at will the flow and structure of economic life, because this supposition means that economic life does not obey any rule. But in an activity without rules planning would be an impossibility, because no certain or probable reaction could be expected on any measure taken by the state. In addition such an attempt would presuppose that the planning authorities would possess on the one hand a comprehensive view of total demand and total supply, a sure beforehand knowledge of the right prices and costs, and the ability to follow all variations of demand, supply, stocks and prices and that they have, on the other hand, the means to constrain all individuals to keep the prescriptions of the plan.

Both suppositions do not exist in reality. Neither the aims nor the means of economic activity are known beforehand. Both the concepts and ideas are totally divergent. Only by the competition of aims, ideas, means and methods is the selection of the ablest possible, so that the planning authorities cannot take measures beforehand, without stifling technical progress and economic possibilities. At least at the present moment all these conditions of effective planning are absent, so that the actual measures are taken without any real knowledge of the facts and the consequences in the long run. Therefore the so-called planning has nothing to do with real planning.

Actual experience, on the contrary, shows that all attempts to start a real and lasting recovery, independent of the state of the world market and other countries are sooner or later doomed to failure, quite apart from the fact that the recovery could not be accelerated by these means. Only by keeping a reciprocal contact with other nations, by realizing the solidarity of humanity and by maintaining the continuity of the relation of the price and cost level with foreign countries, a real recovery of world

economy and a stable international economic life can be attained.

The restoration of a sound and stable international trade will therefore be possible as soon as the different countries forgo internal planning in the sense of directing economic activity, because it proves to be sham-planning, which has done incalculable harm to the whole of the world and increased instability and disequilibrium.

February 1936.

(Signed): Eugen BOEHLER.

Memorandum
on
exchange stabilization and the problem of internal
planning

by

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Monetary instability is never the immediate outcome of an economic or political situation, it is always the monetary policy which leads to depreciation and instability, and not the economic, financial and political conditions of a country. When a government — let us say in time of a big war — takes recourse to inflation, its rulers believe that under existing conditions issuing of additional notes is the best way or at least the less detrimental way to provide for the means wanted. They prefer inflation to an increase in taxation, to borrowing and to reducing expenditure either because they believe that the harm done by inflation is small when compared with the drawbacks of higher taxes, loans or reduction of expenditure or because they are not familiar with the fact that an increase in the quantity of notes circulating must needs lead to a fall in purchasing power.

That in these last years the governments and parliaments of some countries went off the gold standard was due to a change in the current opinions on the ends after which monetary policy has to strive. The nineteenth century's monetary policy was guided by the idea, that for the sake of international trade stability of foreign exchanges has to be considered as the foremost goal. To avoid instability of foreign exchanges one resorted to the gold standard which it was expected would sooner or later be adopted by all commercial nations.

The radical change undergone in the last thirty years in

these opinions cannot be better characterized than by contrasting Knapp and Keynes.

(Knapp was an etatist, a protectionist, a sworn foe to every kind of freedom) Nevertheless in 1905 in his well-known book, which may be styled the manifesto of the great German Inflation, he designates as the aim to which a country's monetary policy should be directed the maintenance of the stability of foreign exchanges for the comfort of foreign trade. Eighteen years later Keynes who at that time at least considered himself still a liberal and a freetrader, announced in his Tract on Monetary Reform that more important than the maintenance of stability of foreign exchanges is the stability of the home price level. Even the German Conservative antagonist of private enterprise considered stability of foreign exchange as the foremost aim of monetary policy in pre-war times and after the war even the British Liberal and advocate of freedom condemned it. Nothing proves better the contrast between pre-war and post-war mentality.

No more would it be justified to call the aim for planning and for national self-sufficiency a product of the depression. On the contrary, the heaviness of the slump and its long duration are to a good deal due to the fact that Governments postpone recovery by their interference into home and foreign trade. There are two views on the policy which should be adopted for the sake of a betterment of economic conditions. According to one of these opinions a return to a more liberal system only would bring the end of the depression. According to the other opinion the only remedy has to be found in more government interference, in more planning and in a closer approach to self-sufficiency. Some statesmen used in their public speeches, in lectures and in articles to recommend the liberal way. But what is really done in most of the countries is just the contrary. From day to day there is more government interference and less room for the manifestation of private initiative.

We have to realize the fact that the economic ideas current today among statesmen and politicians consider every import as a mischief and believe that every measure which succeeds in keeping out some foreign produce from the home market is extremely advantageous. It is true every nation wishes to increase exports and to have more foreign tourists visiting the country. But as on the other hand every nation makes imports more difficult not only by tariffs but by the more efficacious

weapons of the quota system and puts obstacles in the way of its citizens wishing to travel abroad the volume of foreign trade and of tourism is falling continuously. There is hardly a country in the world which has not in these last five years progressed a good deal on the way to national self-sufficiency.

As long as the nations were not yet inspired by a general dislike for all kinds of imports and for all transactions which make money go out of the country they recoiled from a monetary policy of insulation and isolation. The gold standard is an international standard. In the era of Liberalism and Free Trade it was its glory to be an international standard. In our days of Etatism, Interventionism and Autarky it is its disgrace. Rising prices of foreign exchange, once presumed as disadvantageous for their repercussions on foreign trade, are today just for the same reasons considered as very recommendable.

It would be possible to isolate a country almost absolutely from the world market and to keep it out from the international division of labour and nevertheless to maintain the gold standard and fixed parities. How far such a policy can go depends on the power of the nationalistic ideology. If a Government succeeds in persuading the citizens that autarky and its corrolary, less supply of commodities, are — for some metaphysical and military reasons of independence — preferable to wealth based on international exchange of commodities and services, there are no more checks for the erection of Chinese walls round the country. The maintenance of the gold standard would not be incompatible with such a policy. The gold standard would of course have lost under such conditions its *raison d'être*. But national self-sufficiency is possible even with an international standard.

There are considerations of a different kind which seem to recommend a policy of devaluation. If the government wishes to make prices go up and to alleviate the burden of debts, it takes recourse to devaluation. As far as debts are concerned, the result obtained is final. It has been explained in the remarks to section (c), I (How far is the theory that foreign trade is stimulated by fluctuating parities true?) that the effect on the price system can be achieved for a limited time only and that devaluation is not the way to make prices, wages and interest rates on the home market lastingly free from the repercussions of the situation on foreign markets.

The policy of monetary instability and fluctuating parities is

rather a substitute for a policy of total planning than its corrolary. The nationalization of foreign trade, the most radical means for the control of dealings with foreign countries, would be able to isolate a country much more effectively than any system of unstable currency.

February 1936.

(Signed): Ludwig von Mises.

**Memorandum
on the
foreign exchange problems in the United States**

by

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FOREIGN EXCHANGE PROBLEMS IN THE UNITED STATES

A foreign exchange problem, from the point of view of the international value of the American dollar, arose in the United States immediately after the suspension of the gold standard, which occurred in connection with the national banking holiday, proclaimed by President Roosevelt on March 5, 1933. In the development of this problem, there have been three distinct periods as regards official foreign exchange policy. For the first few weeks, the situation was characterized by lack of decision as to the future of the American currency unit and of the whole monetary organization of the country. This initial period of an absence of any definite policy was quickly succeeded, in the middle of April, 1933, by a decision to depreciate the dollar, and the policy of depreciation was carried out, with some important changes of method, during the remaining months of the year. The beginning of 1934 was marked by the inauguration of a policy of provisional exchange stabilization, which is still in operation.

I. Initial Period of Indecision

The suspension of the gold standard in the United States involved not only cessation of redemption of the American currency in gold, but also prohibition of all private dealings in the metal, and an embargo on its export and import. Hence orders

and instructions concerning regulation of foreign exchange transactions have, from the outset, dealt extensively with rules for trading in the precious metal, as well as for dealings in instruments of foreign exchange.

President Roosevelt's Executive Order of March 10, 1933, forbade all banks to pay out or export gold, except by permission of the Secretary of the Treasury. It thus made formal the suspension of the gold-standard, which had been operative in fact since the banking holiday began on March 5. By the same Executive Order, a system of foreign exchange control was inaugurated. All banks were forbidden "to engage in any transaction in foreign exchange, except such as may be undertaken for legitimate and normal business requirements, for reasonable travelling and other personal requirements, and for the fulfillment of contracts entered into prior to March 6, 1933. The order further provided that "every Federal Reserve Bank is authorized and instructed to keep itself currently informed as to transactions in foreign exchange entered into or consummated within its district and shall report to the Secretary of the Treasury all transactions in foreign exchange which are prohibited".

Two days later, on March 12, the Federal Reserve Bank of New York issued a circular (No. 1176), in which rules were laid down for reporting foreign exchange transactions. All dealers operating in foreign exchange within the territory of the Second Federal Reserve District — that is, under the jurisdiction of the New York Bank — were required "to obtain from each person to whom they sell foreign exchange directly or indirectly a written declaration signed by such person describing the purpose for which the foreign exchange is purchased and certifying that the transaction in no way contravenes the Act of March 9¹, 1933, the Executive Order of March 10, 1933, or any regulation issued thereunder". Each dealer was also required (1) to file with the Bank a written report showing his foreign exchange position as of the close of business on March 3, 1933, and a similar report listing "all foreign exchange contracts entered into by him prior to March 6, 1933, for the delivery of foreign exchange after that date", classified by currencies and maturities; (2) to forward to the Bank daily reports regarding his current foreign exchange

¹ The Emergency Bank Act, under which powers were conferred on the President to regulate gold and foreign exchange transactions.

transactions; and (3) to advise the Bank in writing the fulfillment of each contract entered into prior to March 6. In case of doubt as to whether or not any particular transaction came within the scope of permitted operations, the dealers were given the right to submit inquiries to the Bank. Similar instructions were issued by each of the twelve Federal Reserve Banks for their respective districts ¹.

For almost a month following the suspension of the gold standard, the foreign exchange value of the dollar showed no tendency to depreciate. This state of affairs resulted, however, not from the efficacy of foreign exchange control, introduced at the same time, but rather from the peculiar circumstances surrounding the suspension of the gold standard in the United States.

The United States abandoned gold because of domestic, rather than international developments. The suspension of the gold standard came about as an incidental feature of the acute banking crisis, in the unfolding of which the hoarding of paper currency within the country played a vastly more important rôle than a drain of gold either into domestic hoards or abroad. Hence, there were strong reasons for regarding it as purely temporary. The United States Government possessed enormous resources, in the form of gold, for supporting the dollar exchange in case of need. In fact, such support was given during the first few weeks by a liberal granting of licences for the export of gold. A new issue of Treasury certificates, offered on March 16, carried the customary promise of payment "in United States gold coin of the present standard of value." While there was no clear official intimation as to the Administration's policy with regard to the future value of the dollar, the government's apparent indecision was, on the whole, generally interpreted as presaging merely structural changes in the gold standard system — such, for example, as the substitution of the bullion for the coinage type — rather than any alteration in the gold content of the dollar.

As a result of these and other factors, no panicky flight from the dollar occurred. The dollar exchange rate fluctuated slightly

¹ The term "person" was defined as "any individual, partnership, association, or corporation;" the term "dealer" as "any person engaged primarily or incidentally in the business (1) of buying, selling, or dealing in foreign exchange; (2) of buying, selling, or dealing in securities for or through foreign correspondents; and (3) any person who carries accounts or securities with or for foreign correspondents."

for the first few days following the banking holiday, during which there were no official dollar quotations in the foreign exchange markets, and then quickly returned to its gold parity. It remained on that level until the middle of April.

II. *Policy of Depreciation*

The period of indecision as regards foreign exchange policy ended on April 20, when the determination of the Administration to depreciate the dollar was made clear. Since no official announcement was made as to the amount of depreciation that would be sought, there began in the American monetary situation a period, characterized by uncertainty rather than indecision. The policy, by means of which the depreciation was to be achieved, was, during the first six months, almost completely passive. It was designed to permit, rather than force, the dollar to reach a lower exchange value with respect to the gold currencies. Thereafter it assumed an active character.

The inauguration of the new foreign exchange policy was accomplished by means of two far-reaching actions, both of which took place on April 20. In an Executive Order, issued on that day by President Roosevelt, notice was virtually served that the exportation of gold for the purpose of supporting the dollar exchange rate will no longer be permitted. On the same day, an amendment to the Agricultural Adjustment Bill, granting the President, among other powers, the authority to reduce the gold content of the dollar by not more than 50 per cent, was introduced in Congress by Senator Elmer Thomas, with the express approval of the Administration.

These two momentous steps quickly turned the movement of the dollar exchange rate in a definitely downward direction. The rate had declined slightly below parity during the preceeding few days, under the influence of speculation and flight of capital, induced by demands for inflation and devaluation, which began to be voiced vigourously in Congress. On April 18, the Treasury stopped issuing licenses for the export of gold for commercial purposes. And when this action was converted into official policy by the issuance of the Executive Order of April 20, the decline in the dollar exchange rate became precipitate. On April 21, the rate dropped from 99 to 90 per cent of parity. Thereafter, except for occasional interruptions in the form of slight and brief rises, the downward course of the dollar exchange rate

continued steadily until, in the middle of July, it reached 68 per cent of parity.

The administration's preoccupation with the problem of commodity prices was mainly responsible for the policy of seeking a depreciation of the dollar. President Roosevelt and his principal advisers had become converted to the theory that recovery was impossible without an antecedent rise of commodity prices; that, while many different measures might be required to bring about such a price rise, fundamentally it could not be achieved without a reduction in the gold content of the dollar; and that prosperity in the future should be sought largely through a stabilization of domestic commodity prices on a predetermined level.

At the beginning, the depreciation of the dollar was considered desirable also from the viewpoint of the competitive position of American foreign trade, as it was affected by the depreciation of foreign currencies. Accordingly, in conferring upon President Roosevelt the power to devalue the dollar, Congress stated explicitly that the amount of reduction in the gold content of the dollar should be such "as he (the President) finds necessary from this investigation to stabilize domestic prices or to protect the foreign commerce against the adverse effect of depreciated foreign currencies". This and the other monetary powers granted to the President at the same time were also intended to enable him "to secure by international agreement a stabilization at proper levels of the currencies of various governments" ¹.

However, by the time monetary policy in the United States became crystallized in mid-summer of 1933, the gold value of the dollar assumed importance only in relation to domestic prices. The price level to be achieved and subsequently stabilized was to have reference primarily to domestic requirements, especially the exigencies of the internal debt situation and the relation between agricultural and industrial prices. Since the theory under which the government was operating required for this purpose a reduction in the gold content of the dollar, the depreciation of the dollar in the foreign exchanges was regarded as necessary from the point of view of the price policy. Such depreciation — more incidentally than by design — also helped to achieve the objective of improving the competitive position of the American export

trade. On the other hand, it meant the abandonment of all efforts to secure a stabilization of the dollar exchange rate — at least until the price-raising objective had been fully attained, and possibly permanently, if the program of price stabilization was to be fully carried out.

The new monetary policy, adopted by the government of the United States, was expounded by President Roosevelt in his message to the World Monetary and Economic Conference. On July 3, he said :

“ The sound internal economic system of a nation is a greater factor in its well-being than the price of its currency in changing terms of the currencies of other nations. It is for that reason that... old fetishes of so-called international bankers are being replaced by efforts to plan national currencies with the objective of giving these currencies a continuing purchasing power which does not greatly vary in terms of the commodities and need of modern civilization. Let me be frank in saying that the United States seeks the kind of dollar which a generation hence will have the same purchasing and debt-paying power as the dollar value we hope to attain in the near future. ”

Two days later, the American delegation to the Conference was instructed to present the following, even more explicit, statement of policy :

“ The revaluation of the dollar in terms of American commodities is an end from which the government and the people of the United States cannot be diverted. We wish to make this perfectly clear : We are interested in American commodity prices. What is to be the value of the dollar in terms of foreign currencies is not and cannot be our immediate concern. ”

The startling official announcement to the effect that the foreign exchange rate of its currency unit was of no “ immediate concern ” to the government of the United States was, however, clearly an incomplete statement of the real policy. It was true only to the extent that President Roosevelt, having emphatically rejected two proposals for a provisional stabilization of the principal foreign exchange rates, made in connection with the London Conference, was, for the moment, unalterably opposed to any action that would tend to link the exchange value of the dollar to gold. But since its foreign exchange rate was the only means

of measuring the gold value of the dollar, the Administration was, in fact, not interested in the foreign exchange situation only so long as the dollar continued to depreciate. (While concentrating its attention upon such domestic measures of price recovery as government expenditure, the expansion of credit, the adjustment of wages and hours in manufacturing industries, and the curtailment of output in agriculture, the Administration was, in fact, following a policy of currency depreciation by promoting, rather than attempting to check, any downward tendency that the dollar exchange rate might exhibit.)

The way toward carrying out this passive policy of depreciation had been opened by the Executive Order of April 20, when it was announced that thenceforth, except for removal abroad of already earmarked metal and for two other minor purposes, export of gold would be permitted by the Secretary of the Treasury only "with the approval of the President, for transactions which he may deem necessary to promote the public interest. Since a depreciation of the dollar was clearly to be regarded as a matter of public interest, this was equivalent to an announcement that exports of gold would no longer be permitted for the purpose of supporting the dollar exchange rate at its old dollar parity.

With the abolition of a free market for gold, there was no way, in which the depreciation of the dollar in terms of gold — which, according to the theory under which the government operated, was necessary in order to secure a rise in commodity prices — could be influenced or registered, except through the movement of the dollar exchange rate on foreign gold currencies. Hence it was regarded vital that the dollar rate should decline rapidly and steadily, and under existing conditions, such a decline could be induced only by speculation and a substantial flight of capital from the United States. Hence, while the exchange control system continued to operate, in fact the control authorities never interfered seriously with either commercial transactions or movements of capital. The machinery of control was rather held in reserve as a means of preventing the foreign exchange situation from getting out of hand, if such a contingency were to arise.

There was, however, one important difficulty inherent in a passive foreign exchange policy, basically directed toward a depreciation of the dollar exchange. So long as flight of capital was out of the country, and so long as speculation was on the basis of an expectation of further depreciation of the dollar, these

two factors were valuable adjuncts of the policy pursued. But by their very nature, activities of this type are subject to sudden and unpredictable reversals of direction. Flight of capital out of a country may suddenly become transformed into repatriation. Similarly, speculation on a further depreciation of a currency may, equally suddenly, change into speculation on its appreciation.

This is precisely what happened with respect to the dollar between July and October, 1933. The foreign exchange rate of the dollar, after having fallen, by the middle of July, to 68 per cent of gold parity, suddenly changed its direction and, within two weeks, climbed up to 75 per cent. After another two weeks of slight fluctuation, it fell precipitately to 65 per cent of parity. Less than two weeks later, it began to climb once more, returning to a point above 70 per cent by the middle of October.

The behaviour of the dollar exchange rate after July, 1933, was thoroughly unsatisfactory to those in control of the monetary policy in the United States. The wide fluctuations which occurred were reflected in the price movements of commodities and securities. Apart from these uncertainties of price movements, the exchange rate, under the influence of more or less free market forces, exhibited a large measure of resistance to depreciation, with the result that the degree of depreciation thus brought about was less than was regarded necessary for the desired rise of commodity prices.

Accordingly, in October, a decision was made to change from a passive to an active monetary policy. A scheme was devised, which was expected to bring about an adequate degree of depreciation of the dollar with respect to gold and, at the same time, to free the gold value of the dollar from the influence of the factors affecting foreign exchange movements. This scheme, which became known as the gold-purchase plan, was announced by President Roosevelt in a radio address, delivered on October 22, and was put into effect by the Executive Order of October 25.

III. *Dollar Exchange Under the Gold Purchase Plan*

The basic idea of the gold-purchase plan was that, by means of appropriate machinery, it was possible to create and maintain a domestic price for gold, in terms of the dollar, and in this manner to control the purchasing power of American currency through the effect of the price of gold upon the commodity price

level. The plan involved the establishment of a government market for gold, which would register the current price of the metal. Under the legislation then in force, all monetary gold, outside the Federal Reserve system, had either already been taken over by the government at the statutory price of \$ 20.67 per ounce, or, if it still remained in private hands, was subject to confiscation or to expropriation at the same rate. Hence, the only metal for which a government market could be established was newly mined gold.

The question of what should be done with newly mined metal from the point of view of its disposal had come up several months earlier and was settled by the issuance of the Executive Order of August 29, 1933, under the terms of which the domestic producers of gold were given the right to sell their output at world market price, rather than the statutory rate. The Secretary of the Treasury was authorized to receive on consignment, through the mints and assay offices, all newly mined gold, and sell it, at prices "equal to the best price obtainable in the free gold market", for industrial use within the country or for export to foreign purchases. This type of machinery was clearly not what was needed for the purpose of carrying out the new policy, since the price received by the gold producers was governed by the operations of free gold markets in other countries and by the movements of the dollar exchange rate. Hence, by the Executive Order of October 25, 1933, the Order of August 29 was revoked, and a new type of government market for gold was set up. The United States mints and assay offices were still authorized to receive on consignment all newly minted gold, but they were empowered to sell it only to the Reconstruction Finance Corporation, at a price to be fixed, from time to time, by the Corporation, in consultation with the President and the Secretary of the Treasury¹.

¹ The procedure as to the determination of the price at which the gold was to be purchased by the Reconstruction Finance Corporation was not mentioned either in the Executive Order of October 23 or in the Regulations issued under this order on the same day by the Secretary of the Treasury. It was stated, however, as here presented, by President Roosevelt in his radio address of October 23. The Regulations simply stated that "a mint shall not receive gold on consignment... until the person owning the gold, or his duly authorized agent, has signed a written agreement to accept as conclusive, without any right of recourse or review, the determination of the Reconstruction Finance Corporation, or its duly

In announcing the gold-purchase plan, President Roosevelt said :

“ Because of conditions in this country and because of events beyond our control in other parts of the world, it becomes increasingly important to develop and apply the further measures which may be necessary from time to time to control the gold value of our own dollar at home. Our dollar is now altogether too greatly influenced by the accidents of international trade, by the internal policies of other nations, and by political disturbance in other continents. Therefore, the United States must take firmly into its own hands the control of the gold value of our dollar. This is necessary in order to prevent dollar disturbances from swinging us away from our ultimate goal, namely, the continued recovery of our commodity prices. ”

After describing the machinery of the new government market for newly mined gold, the President said :

“ Whenever necessary to the end in view, we shall also buy or sell gold in the world markets. ”

This last statement was of the greatest importance from the point of view of the foreign exchange policy. It clearly involved the establishment of a system of foreign exchange control by means of government intervention in the foreign exchange market. In order to purchase gold abroad, the Reconstruction Finance Corporation would first have to purchase foreign currencies by selling dollars. This would tend to depress the dollar exchange rate. Conversely, by selling gold abroad, the Reconstruction Finance Corporation would come in possession of foreign currencies, with which it would proceed to buy dollars. This would tend to raise the dollar exchange rate. The mechanism of control was, therefore, identical, in principle, with that operated by France in 1927-28, and the one set up by Great Britain in 1932.

The gold-purchase plan, introduced by the Executive Order of October 25, 1933, was in operation from that date until February 1, 1934. Up to January 15, the Reconstruction Finance Corporation acted as the purchasing agent; thereafter its functions in this respect passed to the Treasury, acting through the Federal Reserve Banks. On February 1, the arrangements prov-

authorized agent, as to the face amount of its notes due such person in consideration of the gold deposited ”. (Art. 33.)

ided by the Gold Reserve Act went into effect, and the gold-purchase plan as such passed into history.

During the whole period of the operation of the gold-purchase plan, the official price of gold was steadily advanced. The initial price announced by the Reconstruction Finance Corporation was \$ 31.36 par ounce. By the end of November, it had been advanced to \$ 33.93. On December 1, it was raised to \$ 34.01; on December 18, to \$ 34.06; and on January 16 to \$ 34.45.

The initial price announced by the R.F.C. represented 151.7 per cent of the statutory price of the metal. On the same day, the dollar price of French francs stood at 149.3 per cent of parity. In other words, the official price of gold indicated a somewhat greater depreciation of the dollar than did the foreign exchange rate. During the next three days, the price of gold was raised to 152.6, 153.7, and finally to 153.9 per cent of the statutory price. The exchange rate on the other hand, rose to 150.2 per cent of parity; dropped to 147.5; and then rose again to 149.0.

In view of this failure of the foreign exchange rate not only to coincide with the official price of gold, but even to move in the same direction with it, a decision was announced on October 29 to purchase gold in the world markets. Under the influence of this announcement and of actual purchases of gold abroad which were begun the next day, the dollar depreciated rapidly in the foreign exchanges. For a few days in the middle of November the foreign exchange rate registered a greater degree of depreciation than the official price of gold. During the last week of that month, however, the dollar appreciated steadily in the foreign exchanges. On December 1, the price of gold stood at 164.5, and the dollar-franc exchange rate at 157.0.

During the next six weeks, the price of gold was held steadily at 164.5 until December 18, and at 164.8 thereafter. The foreign exchange rate, on the other hand, fluctuated frequently and substantially, the limits to its oscillations being marked by 153.4 on December 13 and 162.9 on January 15. The official price of gold thus registered consistently a greater degree of depreciation of the dollar than did the foreign exchange rate. After the price of gold was put up to 166.7 on January 16, the foreign exchange rate first moved in exactly the opposite direction until it stood, on January 25, at 158.7. Then the dollar began to depreciate once more. However, on January 31, when the gold-purchase plan ceased to be operative, the exchange rate was 163.9, and the gold

value of the dollar in the foreign exchanges was still higher than that indicated by the official domestic price of the metal.

No official intimation has been made as to the principle which governed the changes in the price of gold during the early weeks of the operation of the gold-purchase plan. Presumably, the additions to the price of gold were based on fluctuations in some special chosen price index.

✓ IV. *Devaluation of the Dollar*

The foreign exchange position of the United States underwent a radical change at the beginning of 1934. Provisional stabilization of the dollar in terms of gold and, therefore, in terms of its exchange rate on foreign gold currencies, superseded action directed toward a depreciation of the American monetary unit as the foundation of the country's monetary policy. This basic change required far-reaching alterations in the monetary organization of the United States, in the country's foreign exchange policy, and in the whole official attitude toward the foreign exchange problem.

The depreciation of the dollar with respect to gold, which had been the guiding monetary policy of the United States government since April, 1933, was completed, at least for the time being, by the end of January, 1934. The completion of the process was evidenced by a formal devaluation of the dollar through a provisional fixation of its new gold content.

The decision to effect the change of policy was announced by President Roosevelt in a message to Congress, delivered on January 15. In this message, the President asked that the Treasury be formally authorized to take title to all American monetary stocks of gold, including those held by the Federal Reserve Banks. The President already had emergency power, under existing legislation, to take all such stocks into government custody, but, as he explained in the message, he preferred "to ask Congress for specific enactment", presumably for the purpose of making the policy a permanent one. He then made the following recommendations for definite alterations in the basic monetary organization of this country :

"The title of all gold being in the Government, the total stock will serve as a permanent and fixed metallic reserve which will change in amount only so far as necessary for the settlement of international balances or as may be required

by a future agreement among the nations of the world for a redistribution of the world stock of monetary gold.

With the establishment of this permanent policy, placing all monetary gold in the ownership of the Government as a bullion base for its currency, the time has come for a more certain determination of the gold value of the American dollar. Because of world uncertainties, I do not believe it desirable in the public interest that an exact value be now fixed. The President is authorized by present legislation to fix the lower limit of permissible revaluation at 50 per cent. Careful study leads me to believe that any revaluation at more than 60 per cent of the present statutory value would not be in the public interest. I, therefore, recommend to Congress that it fix the upper limit of permissible revaluation at 60 per cent.

That we may be further prepared to bring some greater degree of stability to foreign exchange rates in the interest of our people, there should be added to the present power of the Secretary of the Treasury to buy and sell gold at home and abroad, express power to deal in foreign exchange as such. As a part of this power, I suggest that, out of the profits of any devaluation, there should be set up a fund of \$ 2,000,000,000 for such purchases and sales of gold, foreign exchange and Government securities as the regulation of the currency, the maintenance of the credit of the Government and the general welfare of the United States may require. "

More detailed recommendations were embodied in a draft bill, which accompanied the message. This draft bill was quickly enacted into law, without any substantial modifications, and the measure went into effect, under the name of the Gold Reserve Act of 1934, on January 30, upon being approved and signed by the President.

The new act, which now governs the monetary system of the United States, provides for a permanent abolition of gold coinage and of gold circulation in any shape of form. The Treasury alone is empowered to hold the metal. All gold coming into private possession, either by new production or by importation, must be sold to the Treasury. Gold required for industrial use for the settlement of international obligations can be purchased only from the Treasury.

Against the gold held by it, the Treasury is authorized to issue gold certificates, dollar for dollar — that is, with a 100 per cent cover in metal. These certificates are to be a special type of currency. They cannot be put into circulation, but can be used only by the Federal Reserve Banks as a part of their basic reserves. The Act provides that the gold taken over from the Federal Reserve Banks shall be paid with such certificates, and introduces the following modification into the note-issuing procedure of the Reserve Banks :

Previously to the enactment of the new measure, the Banks were required by law to maintain a minimum cover of 40 per cent in metallic gold against all issues of notes outstanding, and a minimum cover of 35 per cent, in gold or lawful money, against deposits payable on demand. These minimum requirements are maintained, but gold certificates are substituted for the metal itself. Any gold coming in possession of the Federal Reserve Banks must be turned over to the Treasury in exchange for gold certificates.

The Gold Reserve Act provides that "except to the extent permitted in regulations which may be issued hereunder by the Secretary of the Treasury with the approval of the President, no currency of the United States shall be redeemed in gold". The only exception is that "gold certificates owned by the Federal Reserve Banks shall be redeemed at such times and in such amount as, in the judgment of the Secretary of the Treasury, are necessary to maintain the equal purchasing power of every kind of currency of the United States". All redemption in gold must be in the form of bullion ¹.

The Gold Reserve Act amends the devaluation provision of the monetary section of the Agricultural Adjustment Act. Under the new measure, the President is still empowered to reduce the gold content of the dollar by a maximum of 50 per cent, but it is

¹ The meaning of this section of the Act is obscure. If private individuals had been permitted to buy, sell, or hold gold, then all forms of currency could be kept on a parity with each other by making them all in effect redeemable in gold, as was, in fact, the case under the Gold Standard Act of 1900. But since gold circulation is expressly prohibited, presumably the only way in which the Federal Reserve Banks would be able to bring back to a parity with all other forms of money any particular type of currency which happens to go to a discount would be to use gold for the acquisition of foreign exchange and then sell such foreign exchange only for the kind of currency affected.

made obligatory for him to fix the new content at not more than 60 per cent of the former weight. The object of this provision, taken in conjunction with the authorization to nationalize all gold stocks, was to enable the Treasury to take immediately a substantial profit resulting from the revaluation of these stocks, without waiting for a final and definitive determination of the new gold weight of the dollar. Such a determination is still left to the discretion of the President, and can be effected by him at any point within the range of 50 to 60 per cent of the old gold content.

Finally, the Gold Reserve Act sets up at the Treasury a two-billion dollar exchange stabilization fund, to be used "for the purpose of stabilizing the exchange value of the dollar". The appropriation for the fund is made out of the profit accruing to the Treasury from the revaluation of the gold stocks. Its administration and operation is entrusted to the Secretary of the Treasury, whose actions require the approval of the President, to whom a report must be submitted annually.

In order to carry out his functions in connection with the operation of the Fund, the Secretary of the Treasury is empowered to deal in gold, foreign exchanges, and other credit instruments or securities which he may find necessary. He may, at his discretion, invest in direct obligations of the United States government such portions of the Fund as he "may from time to time determine are not currently required for stabilizing the exchange value of the dollar".

On the same day on which he signed the Gold Reserve Act — January 30, 1934 — President Roosevelt issued a proclamation, formally devaluing the dollar. The gold weight of the dollar was declared thenceforth to be $15\frac{5}{21}$ grains, nine-tenths fine, instead of $25\frac{4}{5}$ grains, the devaluation thus representing a reduction of 40.94 per cent.

In his proclamation, the President emphasized the fact that the devaluation was not necessarily to be considered as final. He said :

" This proclamation shall remain in force and effect until and unless repealed or modified by act of Congress; and notice is hereby given that I reserve the right by virtue of the authority vested in me to alter or modify this proclamation as the interest of the United States may seem to require. "

Since the proclaimed devaluation involved a reduction in the

gold weight of the dollar just above the statutory minimum fixed in the Gold Reserve Act, this means that the President has reserved the right to increase the gold content of the dollar by about 2 per cent, or to decrease it further by approximately 18 per cent. The act of devaluation was thus made provisional in character, with the final and definite fixation of the gold content of the dollar left to future determination.

V. *Provisional Stabilization of the Dollar Exchange*

The new policy involved a vital, if only provisional, commitment with respect to the foreign exchange rate of the dollar. The President's statement in his message to Congress to the effect that the granting of power to the Secretary of the Treasury to deal in foreign exchange was for the purpose of making preparations for bringing "some greater degree of stability to foreign exchange rates in the interest of our people," was the first intimation of a decision to establish and maintain stable exchange rates. While this decision was not embodied in any definite official statements, in fact, foreign exchange stability rather than manipulation of the price level by means of monetary action became the guiding principle of American monetary policy.

On January 31, 1934, the Secretary of the Treasury issued new regulations regarding gold transactions. He announced that the Treasury would thenceforth be prepared to purchase, through the United States mints and assay offices, all gold offered at \$ 35 per ounce of fine metal, less one-quarter of 1 per cent and "an amount equal to all mint charges". He also made it clear, however, that "this price may be changed by the Secretary of the Treasury without notice other than by notice of such change mailed or telegraphed to the mints". Under the terms of these regulations, which continue to be in force, acquisition, transportation, melting, treating, importation, exportation, and earmarking of gold remains prohibited, except under licence issued by agencies designed by the Secretary of the Treasury and in his discretion.

From the point of view of the foreign exchange position of the dollar, the situation, therefore, was left by the Gold Reserve Act legally as it had been prior to the enactment of the measure. The dollar is still an internationally inconvertible currency, or, at best, a currency redeemable in gold only at the discretion of government authority both as to whether or not redemption will

take place and as to the rate at which it will be effected. But from the point of view of administrative practice that has been adopted and followed, there are several extremely important differences.

In section 28 of the Regulations of January 31, 1934, it is stated that "the Federal Reserve Banks may from time to time acquire from the United States by redemption of gold certificates... such amounts of gold bullion as, in the judgment of the Secretary of the Treasury, are necessary to settle international balances". In a public interpretation of this provision, the Secretary of the Treasury announced that he would release gold for export whenever the foreign exchange value of the dollar in terms of foreign gold currencies would reach the theoretically computed gold export point. On August 14, 1934, the first shipments of gold on this basis were authorized, destined for Paris and Brussels.

So long as the Secretary of the Treasury continues, as he has so far, to interpret his discretionary powers in this manner, the gold mechanism becomes once more operative in governing the foreign exchange relations between the United States and those countries which maintain a gold standard. To this extent, the dollar is once more internationally convertible into gold at a fixed rate, and the United States is, in effect, back on the gold standard¹.

The system of foreign exchange control was somewhat liberalized just before the Gold Reserve Act went into effect. By an Executive Order, issued on January 15, 1934, the earlier exemptions from license for foreign exchange transactions originating in normal commercial, travelling, and personal requirements and in the fulfillment of obligations incurred prior to the suspension of the gold standard, were restored. The system continued to operate in this form until November 12, 1934, when it was practically abolished. In a regulation issued on that day by the Secretary of the Treasury, the following announcement was made:

"Licences may be granted, and a general license is here-

¹ From this point of view, the new monetary system in the United States is similar to the systems which existed before the war in Austria-Hungary and Italy. The currencies in these countries were not convertible into gold, but the monetary authorities were, in fact, willing at all time to release gold at fixed rates for the purpose of effecting international payments.

by granted, to all individuals, partnerships, associations, and corporations, authorizing any and all transactions in foreign exchange, transfers of credit, and export of currency (other than gold certificates) and silver coin. "

Only the requirement for a reporting of transactions was retained. However, exemption from reporting was authorized for transactions under \$ 5,000 in any seven-day period and for persons not carrying accounts abroad or accounts in the United States for non-residents.

The Exchange Stabilization Fund was set up at the end of April, 1934. Its operations, like those of the British Exchange Equalization Account, have been shrouded in deepest official secrecy. There are no indications, however, that it has ever been used to any substantial extent, nor that there has been any need for resorting to its operation on anything more than a minor scale.

The powers granted the President in the Gold Reserve Act with respect to a definite fixation of the gold content of the dollar and as regards the maintenance and operation of the Exchange Stabilization Fund were for a two-year period, which could be extended by a Presidential proclamation for another year. On January 10, 1936, the President did so extend the period to a full three-year term. Hence, without new legislative enactment, the gold content of the dollar must be definitively prior to January 30, 1937.

February 1936.

(Signed): Leo PASVOLSKY.

Memorandum
on
devaluation experience in Czechoslovakia

by

Dr. Antonin BAsCH,
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To express an opinion on the expediency of currency devaluation in Czechoslovakia and the results of this measure, it would be necessary to analyze the economic evolution as a whole as well as all factors of economic policy from the onset of the depression. We shall confine ourselves to recalling certain characteristic features of the economic situation from the beginning of the depression to the devaluation of February 1934.

The monetary policy of Czechoslovakia is based on the principle of a stable currency pegged to gold — in the form of a gold exchange standard. Politically and psychologically, this idea was firmly rooted in Czechoslovakia, a country which had not suffered from excessive post-war inflation and which, on the contrary, had stabilized its currency following thorough deflation. Czechoslovakia alone, of all Central European States, abstained from taking advantage of the transfer moratorium and, in 1931 and 1932, repaid short-term foreign loans amounting to *circa* 3 milliard crowns. Owing to Czechoslovakia's previous financial and monetary policy, its foreign indebtedness was relatively unimportant and did not warrant its inclusion among the great debtor countries of Europe.

In October 1931, however, notwithstanding a comparatively favourable position of the balance of payments, Czechoslovakia was obliged to introduce measures of *foreign exchange control*. This necessity arose in the first place from the difficulties encountered by Czechoslovakia in the collection of its debts in

neighbouring countries. These States having ceased to transfer the exchange-value of their imports from Czechoslovakia, the latter was on the point of becoming a *creditor country* for its neighbours of Central and Eastern Europe. These were the circumstances, together with the menace of capital flight and the prospect of having to grant foreign credits, which led to the introduction of foreign exchange control, a measure governed exclusively by pre-occupations of a monetary order.

Difficulties of debt collection led to the institution of clearings. These, in their turn, resulted in trade complications, in the compression of the volume of external trade, at the same time exercising a constantly increasing influence on the movement of prices. Moreover, Czechoslovakia, being the only country of Central Europe to pay for its imports in uncontrolled exchanges, gradually became a centre of attraction for foreign export trade. This made it necessary, in the interest of both currency and production, to stem the flood of foreign wares which menaced to submerge the country. Thus, the measures of foreign exchange control, applied in the form of import control, gradually developed into an instrument for the *defence of national production*, and, above all, of agricultural production. This also had a *marked influence on the evolution of the price-level*.

Technically, the position of the Czechoslovakian currency remained firm, and the note circulation cover was invariably in excess of the legal minimum. But economic conditions grew worse and worse, as was shown by all indices of economic activity. The number of unemployed workers increased rapidly, while industrial production declined in the same proportion. The money market narrowed down owing to the repayment of foreign credits, the requirements of the State, the freezing of assets abroad and increased hoarding, while the high money rate proved a heavy burden for debtors already suffering from the decline in the prices of their products. All liquid capital on the market was absorbed by the State; the condition of the public finances grew worse and worse. The slackening of economic activity resulted in an appreciable diminution of public revenue, while public expenditure increased with the necessity of assisting the unemployed and making good the railway deficit. The most substantial symptom of the economic depression was the decline of the export trade, which assumed alarming proportions.

From 20.5 milliards in 1929, the exports declined to 13.1 mil-

liards in 1931 and to 5.8 milliards in 1933 : in other words, they fell to a figure corresponding to 29 % of their value in 1929. In a country so dependent on export trade as Czechoslovakia, this diminution of exports forcibly entailed a reduction of industrial activity, and it became more and more evident that, *without increased exportation, it would be impossible to promote an appreciable revival of this activity.*

In these circumstances, an endeavour was made to trace the causes of this throttling down of the Czechoslovakian export trade, to devise measures of improvement and thus to promote a general revival of economic activity. What is clear is that one of these methods might have consisted in a *re-organization of commercial policy*, the object of which would have been to encourage the import trade, in particular, from countries with clearing agreements, with a view to receiving compensation in the form of exportation to the said countries. But the political and agricultural situation precluded this solution.

At this juncture, Czechoslovakia was faced with another problem, namely *that of prices* : the internal prices, *calculated in gold*, were invariably *much higher* than those of Czechoslovakia's competitors and of countries with a free market. This being the case, the solution of the problem of the export trade depended *a priori* upon that of the *price problem*. The price movement in Czechoslovakia had kept pace neither with that of countries which had gone off gold nor with that of certain of the gold standard countries. It had been impossible to deflate as rapidly and radically as would have been necessary in order to eliminate the difference of the price-levels. In view of increasing unemployment and the decline in economic activity, it was evident that, even if deflation had been technically feasible, *it would nevertheless have been impossible to persist in this direction, for political and psychological reasons.* The deflationist tendency, an outcome of exchange and lending policy, was counteracted by a reverse tendency, based on the financial policy of the State and on the commercial policy, which, by controlling imports, in particular, agricultural produce, formed an obstacle to the gradual adjustment of prices. In these circumstances, numerous were those who advocated a *monetary solution* designed to remedy the situation, i.e. to alleviate the general stagnation of business. The disciples of currency action considered that the principal cause of the depression was a monetary phenomenon

(i.e. the increased value of gold) and did not realize that certain causes and difficulties were also due to the industrial situation and structural modifications of production and international trade. In political circles, there was even a strong current of opinion in favour of action by the Central Bank with a view to economic revival based upon the *financing of important enterprises of equipment and machinery*, the renouncement by the State of a balanced budget and the free circulation of currency.

Czechoslovakia has in fact had recourse to *currency manipulation* in the form of a devaluation of the currency unit. This measure was applied in February 1934 with a view to affording some measure of relief to national business as a whole, but did not take the form of the currency experiment advocated by the partisans of inflation. The result of the actual devaluation was to reduce the currency unit by $\frac{1}{6}$ of its gold-content and at the same time to peg it to a new gold parity, and thus to *maintain the relationship of the Czechoslovakian currency with gold*. The object was to *eliminate the disparity of the internal and external price-levels, so as to reduce the obstacles to the export trade, and, by the revival of the latter, to promote industrial activity*.

In order to appreciate the effects of the Czechoslovakian devaluation, it is necessary, in the first place, to recall the *objections* made to this measure. It was alleged that devaluation would result in a further rise of prices which would deprive the export trade of the advantages thereby obtained, that the price problem would then have to be dealt with *per se*, and that everything would have to be begun over again in a different form. The apprehensions concerning a rise of prices following currency devaluation proved to be unfounded. The wholesale price-index rose from 647 at the moment of the devaluation to 711 in the spring of 1936, i.e. by about 10 % in two years, only half the figure corresponding to the depreciation due to devaluation. But we must not lose sight of the fact that world prices and the indices of most other countries also marked an *upward trend* during the same period. In England, for instance, the index rose in 1933 from 88.3 to 91.8, in France from 350 to 364, in Switzerland from 88.3 to 91.1, in the United States from 78.8 to 86. If we set aside the increase coefficient due to the evolution of the world market, there remains a coefficient of less than 10 % due to devaluation. And this coefficient is largely due to the corn monopoly instituted in 1934,

for it cannot be denied that the increase of the corn prices affected the general price-level. The wholesale foodstuff price index rose from 636 to 718 during the period from February 1934 to March 1936, i.e. by 11 1/2 %, while the index of industrial materials and products rose during the same period from 667 to 702, i.e. by 5 %. It may therefore be said that the apprehensions to which the devaluation gave rise, as regards a rise of prices detrimental to the export trade, have not in general been justified. The *profits* realized by the export trade as a result of the devaluation *have so far been maintained*, but only in so far as the price factor plays a decisive role. But this, as a matter of fact, is the case only in the so-called free markets, i.e. those which are not affected by clearing or compensation agreements or by the quota system. The upward trend of the Czechoslovakian exports since the devaluation is due precisely to relations with the so-called free markets.

In 1933, the exports totalled 5,853 million crowns, in 1934 7,280 millions, in 1935 7,415 millions. The revival of the Czechoslovakian export trade began in the very year of the devaluation, i.e. at a moment when the influence of the price-factor was at its strongest. It is also necessary to reckon with the mathematical increase due to conversion to a new parity. The following year saw the beginning of a period of stabilization when the increase recorded coincided with the general evolution of world trade. A further increase of the Czechoslovakian foreign trade was impossible, for, apart from the growing obstacles to world trade recovery, one of the prerequisite conditions of the plan envisaged, namely, the increase of the import trade, had not been fulfilled. But this increase of the export trade (roughly 1 1/2 milliards) over two years was not in itself sufficient to bring about a substantial decrease in the number of unemployed, nor did it provide a strong stimulus to industrial production. It nevertheless contributed, at any rate in part, to an expansion of production and greater activity of numerous enterprises. It may therefore be said that devaluation acted in certain respects as an impetus to the export trade, but it remains true that its effects were, above all, of a psychological order. In a certain measure, it engendered optimism, put an end to inflationist tendencies, and furnished a basis of constructive work *for the systematic improvement of the economic situation*. In particular, the *money market* was closely followed, the judiciously chosen starting-point being the

necessity of reducing the money-rate in order to stimulate production and to create an economic and psychological basis for the consolidation of long-term credits. The problem was complicated by the fact that the State budget was not balanced; the State accordingly absorbed the lion's share of the liquid capital on the market, depleting the reserves and tautening the rates. Notwithstanding these difficulties, the improvement of the moral atmosphere resulted in an increase of available capital and in the ceasing of hoarding. From 1934 onwards, the deposits no longer decreased, and it was even possible to note a slight increase of 0.6 % as compared with a decrease of 5.1 % in 1933; in 1935, the increase was 2.2 % despite the fact that the calls made by the State on available capital amounted to 2 1/2 milliards. This evolution of the money market led to a general reduction of the money-rate which, in its turn, resulted in a re-organization of interest rates in 1935. This upward trend of the money market should, in normal economic conditions, have resulted in increased activity in private enterprise and in the building trade. But, in view of the uncertainty of the moment, exceptional international conditions and a Government policy which is not all too well disposed towards industry, the amount of the private capital invested is as yet insufficient to form the basis for an economic revival. Numerous efforts have therefore been made to induce the State to combat unemployment by means of public works, and in certain quarters it has been proposed that these works should be financed by a Central Bank Loan. But although the lending policy of this institution has become more *elastic* since the devaluation, in particular as regards the financing of agricultural production and the export trade, *it nevertheless expressed its disagreement with the financing of such enterprises by note issue.* This has not prevented the financing of an important fraction of the public works on the basis of short-term credit operations by the State, resulting in a certain expansion of credit and an improvement of purchasing power. It should be recalled that in 1934 and, above all, in 1935, production increased in various countries, such as France, Austria, Great Britain, Sweden, the United States and certain overseas countries. It is therefore possible to say that there has been a general revival of economic activity. This recovery has, to some extent, been perceptible in Czechoslovakia, although less accentuated as regards industrial production than in numerous other

European countries. In many of the latter, increased production was a result of public investments and orders in connection with the arms industry. The armaments boom has recently spread to Czechoslovakia and, in this country, as elsewhere, has resulted in an improvement of the economic situation.

Despite the constant increase of the public debt, public finances show a gradual improvement, particularly noticeable in 1936. The technical position of the crown has not varied; the balance of payments, is, as whole, equilibrated; there is no appreciable fluctuation of gold and foreign exchanges, apart from a falling off during the last six months, due to various psychological causes, external political complications, the stocking of raw materials, etc.

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The main features of economic recovery in this country, subsequent to the devaluation, may be summarized as follows :

Czechoslovakia resorted to currency devaluation as a remedy for the evolution of the internal price-level in relation to the world price-level or that of various countries. For economic, political and social reasons, it was impossible for Czechoslovakia to adjust internal to external prices by means of deflation. Czechoslovakia therefore devalued in a proportion of 1/6 with a view to adjusting prices and to *avoiding a further rise*. The new monetary unit was immediately pegged to gold, since Czechoslovakia, in view of conditions prevailing in Central Europe, did not wish to run the risk of allowing its currency to fluctuate to auto-stabilization at any level. The essential purpose of the devaluation was therefore to eliminate the difference of level between internal and external prices, to cope with the decline of the export trade and to *create a new basis for the organization of economic recovery*.

The Czechoslovakian devaluation was not accompanied by an upward movement of prices, as forecast by some; the actual increase, which intervened mainly in 1935, was due to the evolution of world prices and also to the corn monopoly and other action as regards the price of foodstuffs. The export trade has derived from this measure the expected benefits and has increased by approximately 1 1/2 milliards (1/4). This upward movement ceased at a moment when international trade as a

whole entered upon a period of stagnation, owing to the large number of clearing agreements and the increasing obstacles to exportation. The Czechoslovakian exports are therefore directed towards the free markets. *Such are the effects of devaluation in Czechoslovakia; they could not be otherwise, since the whole object of this measure was to eliminate the difference of the price-levels.* In particular, there could be no question of devaluation being used as a stimulus to purchasing power or demand.

Meanwhile, one of the effects of the relative tranquillity due to this measure was to stimulate saving, the constitution of new capital being facilitated by the fact that the depression is drawing to an end; at such moments, it is well known that money and financial markets are generally very easy. The Central Bank initiated a more active lending policy, while the Re-Discounting Institute, founded for the purpose, succeeded in rigourously controlling the market for securities with fixed interest rates, and autonomous organizations were more active as regards capital investments. With the upward trend of world trade on the one hand, and the favourable prospects afforded by the armaments race on the other, it is possible to state that Czechoslovakia is entering upon a period of economic recovery. This revival is not the immediate result of the devaluation; but it is nonetheless true that a deflationist policy would have delayed or entirely compromised recovery.

Devaluation, therefore, could not in itself bring about recovery in international price and business conditions, but it nevertheless served to abridge the disturbances attendant upon the abatement of the depression and to speed up the onset of recovery. It may be suggested that, if most countries had in 1931 devalued in a similar proportion or if they had pegged their currency to sterling, the effects and the length of the depression would have been reduced. No currency manipulation, not even devaluation, can provide a remedy for a depression of so complicated a character as the present one. In certain circumstances, which vary according to countries (e.g. in Belgium the situation differed from that in Czechoslovakia), devaluation may afford a measure of relief, it may shorten the period of depression, and, psychologically, may create an atmosphere of calm promoting the solution of various problems, which it would be much more difficult to solve under a deflationist regime. In Czechoslovakia,

it was impossible to expect the devaluation to work miracles of economic recovery; this measure has nevertheless stemmed a further downward movement, afforded some measure of relief to the export trade, promoted the resumption of a market policy and stimulated research with a view to the improvement of industrial activity.

May 1936.

(Signed): Antonin BAsch.

**Memorandum
on the
experiences of the sterling area**

by

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I. The following figures are important in connection with the subsequent discussion :

*A. Imports and Exports in terms of national currencies :
1929 = 100.*

	<i>Imports</i>					<i>Exports</i>				
	1931	1932	1933	1934	1935	1931	1932	1933	1934	1935
Great Britain.	72	59	56	61	63	54	56	50	54	58
France . . .	73	51	49	40	36	61	39	37	36	31
Denmark . . .	87	64	71	76	74	78	67	72	73	75
Japan	56	64	87	104	112	53	65	87	102	117
U. S. A. . . .	48	31	33	38	47	46	31	32	41	44
Sweden	80	65	62	73	82	62	52	60	72	71
Germany . . .	50	35	31	33	31	73	45	39	33	34
Australia . . .	38	46	47	58	67	74	78	92	81	90
Canada	48	35	31	40	42	53	46	50	63	69
Belgium . . .	67	46	42	39	48	73	47	44	42	50

B. Indices of national industrial production, 1929 = 100.

	1931	1932	1933	1934	1935
Great Britain . . .	84	84	88	98	106
France	89	69	77	71	67
Denmark	100	91	105	117	121
U. S. A.	68	54	64	66	76
Sweden	85	79	82	100	—
Germany	68	53	61	80	94
Canada	71	58	60	74	81
Japan	92	98	113	129	142
Belgium	81	69	71	72	81

II. These figures seem to make it clear :

(a) That, in general, taking countries both within and without the sterling area, the degree of general trade recovery, as evidenced by the indices of industrial production, is greater than the degree of recovery in the volume of foreign trade. This is true, even in the case of Japan, the country which is supposed to have gained most by the process of currency depreciation.

(b) That the countries of the sterling area — though to a varying extent — have recovered to a greater degree than countries forming part of the gold bloc, or countries such as Germany, practising exchange control, modified by the " controlled depreciation " of specific forms of currency.

(c) That the turning point came, even in the countries of the sterling area, some time after the depreciation of the currency involved. Thus, to take the case of Great Britain, the turning point in production came in 1933, the turning point in exports and imports in 1934. The turning point in Swedish industrial production came in 1933, in imports and exports in 1934. The same is true of Denmark; in the case of the United States (which, though not a member of the sterling area, devalued its currency as the result of crisis in 1933), the turning point was more definitely the year 1934 (when de facto stabilization had been re-introduced) than the year 1933 itself. France, on the other hand, the country of rigid adherence to a fixed parity accompanied by a drastic use of import restrictions, has the worst record of any country included in the tables cited above. Lastly, Japan, the country with the most favourable record on balance in all respects, has not for some time resorted to any further depreciation of its currency.

(d) That these diverse experiences seem to point to one general conclusion, viz : that to ascribe continued recovery on the one hand, or continued depression on the other, purely to currency depreciation, would appear to be an over-simplification of the problems at issue.

III. (a) Even if recovery within the sterling area could be directly ascribed to currency depreciation, this would not be conclusive as regards the world as a whole, since recovery in the one area might be in part at the expense of recovery in the other areas.

(b) Moreover, the direct influence of currency depreciation in encouraging tariff and quota legislation must not be overlooked. The fact that international trade has not recovered to the same extent as internal production has in the main been attributed to the close relationship between these administrative factors in the modern world.

(c) The continuance of depression in the gold bloc group of countries is not conclusive as regards the effects of fixed parities, unless psychological repercussions are taken into account. The position can be put as follows : the world has been faced by a trade depression from which recovery was sooner or later to be expected. Thus, what has to be explained is not the *fact* of recovery in the sterling area, but the *failure* of recovery to take place elsewhere. Given that uncertainty as to the future of a currency exists, the failure to recover may be directly ascribed to that circumstance. For uncertainty leads to a flight from the currency, either into gold or into foreign exchange. This lack of confidence may be due purely to a rational consideration of the cost-price factors involved, or it may be due to the influence of political considerations, or to both in combination. It follows that the failure of France to recover cannot be conclusive : because *there*, where there is a lack of confidence, there is no recovery : because there is no recovery there is a lack of confidence. Thus, a cumulative process of economic disintegration has set in. Unless it can be shown that the lack of confidence is *exclusively* due to the economic situation, and further, that that economic situation can be cured by currency depreciation, it cannot be concluded that the absence of recovery in the gold bloc countries is directly due to a failure to devalue. For, unless the lack of confidence is *entirely* due to a failure to devalue, devaluation might add to, rather than diminish, the prevalent lack of confidence.

IV. So far as the sterling area is concerned, it is necessary to distinguish between (a) the general situation of the "dependent" areas; (b) the special situation of particular countries within the sterling area; (c) the position of Great Britain herself.

(a) *The general situation of the "dependent" areas.*

It can be said with confidence that *unless* the overseas raw material producing areas had followed the downward course of sterling, their position would have been positively worsened,

since Great Britain represents to them a major market. They could only have gone on selling in that market at falling prices, so that the aggregate national income would have gone on falling also. Exporters' incomes would have fallen directly, the incomes of those engaged in the "secondary" industries would have fallen by direct repercussion of lower spending power on the part of exporters. The nominal sterling debt burden would, indeed, have decreased as a consequence of the decline of the value of sterling in terms of local currency, but this circumstance, though important, is less important than the maintenance of the general level of incomes. Any single overseas area, standing out of the general tendency to peg with sterling, would have found itself cut out of the British market unless it could reduce its internal level of costs sufficiently to adjust the cost of production to the lower level of sterling receipts converted into terms of local currency. Since these countries remain in adjustment with the pound sterling, recovery in the British area, however caused, was bound to have favourable repercussions upon them.

(b) *The special circumstances of particular areas.*

Recovery, in certain cases, may have been assisted by special demand circumstances, which cannot form part of any general theory. Thus a change of fashion or an increase in re-armament expenditure, leading to an increased demand for wool, may have helped Australia or the Argentine *without* any general improvement taking place. The building boom in Great Britain, however brought about, increases the demand for timber. Moreover, there is a special influence connected with quota legislation which must not be overlooked. Given an inelastic demand for a certain product, say bacon, the net effect may well be that the price for this product rises so much that, in spite of a drastic decline in the volume of exports, the aggregate amount received is in excess of what would have been received under freer conditions of entry. The retention of a "free" gold market, accompanied by (relatively) stable costs in the gold-mining countries, has obviously resulted in a great growth of the profitability of gold-mining and of prosperity for all those engaged in connection with it. Thus *some* — perhaps an important part — of the recovery in the sterling area is to be accredited to the operation of special factors.

(c) *The position of Great Britain*

It appears that, on balance, the advantages accruing to Great Britain lie rather in the realm of psychology and of monetary policy than in the realm of foreign trade. The immediate effect of the abandonment of gold was a sharp fall in the external value of sterling, which had a temporarily stimulating effect upon foreign trade, but the abandonment of gold by Japan wiped out much of this temporary gain. From the specific foreign trade point of view, probably the greatest benefit was that it enabled a clearly unsuitable parity to be abandoned, and disposed once and for all of the mistake made when the pre-war parity was readopted in 1925.

From the *psychological* point of view, the abandonment of gold came as a great relief, simply because of the prevalent belief that *both* the parity and the gold standard were inimical to British interests. Obviously, if a large section of the population has come to entertain some such ideas, whether justified or not, the abandonment of gold must have a stimulating effect, and that it *did* have this effect cannot admit of much doubt.

Further, the sense of relief thus produced was an important element permitting of a "cheap money policy". In the absence of a lack of confidence in the currency outlook, cheap money is an inevitable accompaniment of depression: in the case of Great Britain, so far from the abandonment of gold reducing confidence, it increased it, and thus made the Government's conversion policy even more successful than it might otherwise have been. No doubt the remarkable fall in the long term rate of interest is in part due to other factors *as well*, e.g. the continued influx of funds from abroad. But in so far as lower interest rates have depended upon the continuance of a sense of security, it must be urged that the primary condition to be overcome was the "defeatism" which characterized British opinion about the position of the pound in the first two years of the depression. Cheap money, in its turn, by bringing about the building boom, has been the main element of British recovery. Hence, under the peculiar circumstances of Great Britain, the abandonment of gold has been productive of *net* benefit.

May 1936.

(Signed): T. E. GREGORY.

**Memorandum
on the
depression experiences of gold block countries**

by

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DEPRESSION EXPERIENCES OF GOLD BLOCK COUNTRIES
(France, Switzerland, Netherlands, Poland, Italy)

Since the fall of sterling in 1931, there has been a marked divergence between the economic evolution of countries which have remained faithful to the gold standard and that of countries which have successively gone off gold or have confined themselves to maintaining the gold standard in a purely nominal form.

Even in countries which have maintained the gold standard, the evolution has not been identical. It is possible to distinguish three different processes : on the one hand, France, Switzerland and the Netherlands, which for economic, social and political reasons, have made deflationary attempts which have been counteracted by a simultaneous effort to maintain prices; on the other, Poland, which has been able, thanks to the agricultural character of its economic structure and its autocratic form of Government, to intervene with sufficient energy as to eliminate all differences in the internal price-levels and between the home and foreign price-levels. Italy, finally, is in an intermediate position between the two; in this country, the action of the Government has been exercised with a view to the reduction of certain prices and the development of certain branches of national production, regardless of economic returns; during the past year, moreover, under

the pressure of new circumstances, Italy ceased to form part of the gold bloc and entered the ranks of nations with managed currency.

The evolution of the group formed by France, Switzerland and the Netherlands is characterized by a fundamental feature which lies at the root of all their difficulties : *a general and constant decrease in income* owing to the general price slump and the slackening of economic activity. In France, from 1930 to 1935, the decrease is marked by the following figures : 245 milliards in 1930 and 160 milliards in 1935. In Switzerland, the corresponding figures are 8 milliards and 6.2 milliards respectively. We have not been able to obtain corresponding figures for the Netherlands, but the fact is incontestable. This general decrease has entailed twofold consequences :

The first is a *chronic budgetary deficit*, notwithstanding important reductions of expenditure in the Netherlands, Switzerland and France alike. This deficit leads in its turn to a borrowing policy which results in the absorption of liquidities by the State, to the detriment of private industry, and in the maintenance of a *relatively high rate of interest* on both money and financial markets. This rate of interest, which varies according to the three countries (it is higher in France than elsewhere), contrasts with the extremely low rates of long-term interest which are a feature of the markets of Anglo-Saxon countries. Moreover, efforts to equilibrate budgets are thwarted both by the charges entailed by fresh loans and by the necessity of including in the communal, departmental and provincial budgets at the same time as in the State budget, increasing credits for unemployment. *Thus the policy of budget deflation pursued by these three countries is constantly counteracted by increased expenditure resulting from the depression.* Certain of the countries under consideration, e.g. France, have been unable to cope with the situation otherwise than by the direct reduction of their loan coupons, and all of them have had recourse to a general reduction of the salaries of civil servants.

A second consequence of this constant decrease of income is the *effort made in all three countries to maintain such income at its former level* and to prevent a reduction of agricultural and industrial prices. It is mainly in the interest of agriculture that this policy has been pursued — in the form of direct subsidies, extremely restricted quotas designed to ensure maintenance of

the price level and protective duties (in the case of both industry and agriculture), or in the form of Government purchases of certain commodities at fixed prices.

This series of measures, designed to prevent a reduction of home income, results, on the other hand, in the *maintenance of the cost of living* at a level which differs considerably from that in countries which have resorted to devaluation. This difference of the price-level, which it is difficult to measure accurately on the basis of indices, since it varies according to the basic year, naturally reacts on foreign trade in so far as it tends to reduce exports and to promote imports. Hence *re-inforcement of measures of protection* and a *system of export bounties* which is in itself a heavy charge upon the State.

To put it briefly, the effort of the gold standard countries to lower prices and reduce State expenditure has been thwarted by the contrary tendencies imposed by circles interested in maintaining income at the same level and by the additional expenditure entailed by this tendency. Consequently, the price-index of the gold standard countries, and, in particular, that of the cost of living have not fallen in the same proportion as these indices in countries such as England and the United States, and the difference between wholesale and retail prices, which has constantly been reduced in the latter, has remained at a high level in the gold standard countries. These general features having been set forth, it would seem useful to examine rapidly the special situation of each of these countries from the point of view of prices, production, unemployment, rate of interest and budget. I intend to do so briefly.

France

Before the War, France, with its harmoniously balanced agriculture and industry, was able to surmount periods of depression with comparative facility. During the nineteenth century, it was observed that important crises, as in 1873 or 1907, which caused such violent upheavals on certain European and American markets, only resulted in difficulties of a temporary character for France. The post-war evolution in France has made this country more vulnerable. This evolution has, in fact, consisted in *progressive industrialization*, which took place very rapidly, in particular, from 1920 to 1928. The return of Alsace and Lorraine

with their textile and metallurgical industries, the reconstruction of the devastated regions with a capacity of production exceeding that of 1913, the rapid expansion of the export trade under the very influence of inflation were so many factors contributing to this development. It is sufficient to say that the power of industrial steam-driven machinery increased threefold between 1919 and 1931 (from 2.5 millions to 7 millions KW.) and that hydraulic power was doubled during the same period. This increasing industrialization finds its echo in external trade : the importation of foodstuffs increased in proportion, and that of manufactured articles decreased, while the exportation of foodstuffs remained at an almost constant level and that of manufactured articles increased. Thus, the structure of French foreign trade is becoming more and more comparable to that of the industrial countries of Western Europe. Notwithstanding an evolution, which made its economic structure more vulnerable than formerly to the repercussions of a crisis, France was spared its effects up to the middle of 1930, and certain economic indices remained favourable even up to the end of that year.

It was only from the beginning of 1931 that the depression became acute, and it may be said that *since that moment every further fall of the pound sterling has been accompanied by an aggravation of the depression*. In particular, the returns of all industries connected with travelling decreased considerably during the period 1932-1935 whereas the affluence of foreigners during the period prior to 1930, owing first to the fall of the franc, then to its stabilization at a relatively low level, had constituted one of the characteristic features of the general French balance of trade and had profoundly influenced the whole economic life of the country.

Beginning in 1930, the depression appears stabilized since the end of 1935, and today definite symptoms of recovery may be perceived. It is therefore interesting to examine the effects of the depression in the interval between 1931 and 1935.

1. *Prices.*

Generally speaking, wholesale prices already began to fall in the spring of 1929, following the lead of world prices. After marking time at the end of 1931 and during the first quarter of 1932 (at about 69 points compared with 100 points in 1928), the fall continued at a lower rate of speed until May 1935, when a

minimum of 59,4 was reached; after a slight recovery to 63 in December of the same year, the downward movement was resumed and continued to a final minimum of 49,9 in July 1935. Since that date, the upward movement has continued without interruption, reaching 5 points (10 %) at the end of the year. However considerable the downward trend may have been, it must be remembered that it was less important than that of the British gold prices which, compared with the same year (1928) fell to 42,7 in March, recovering as far as 47 in December. Nevertheless, above all if account be taken of the fact that in 1928 the British gold prices must have been slightly higher than the French prices, the difference between the two levels does not seem very serious in this respect. It is more striking if a distinction is made between national prices and the prices of imported products. The latter have, as is natural, closely followed the world prices, while the former have been firmer and although already at a higher level, have, during the past few months, shown an equally strong tendency towards recovery; they reached 62,5 in December, compared with 57 in July. As regards the British index, there is a difference of 10 points. But it is doubtful whether this gap gives the exact measure of the disparity between the French wholesale prices (raw materials and semi-manufactured products) and the corresponding Anglo-Saxon prices which it is only possible to estimate on the basis of the absolute prices. But this can only be done in the case of certain products such as corn, maize, hemp, mutton, butter, aluminium, hyperphosphates, coal; in regard to all these products, the difference is considerable, while it is slight in the case of non-ferrous metals and cotton. As regards the former, however, it is necessary not to lose sight of the part played by customs duties. For tallow, jute, and pig-iron, the French prices are lower than the Anglo-Saxon prices¹. This disparity, moreover, does not appear to hinder the export trade. As repeatedly stated, the decrease of the latter has not been greater in France and the other countries of the Gold Block than in countries with a depreciated currency. Only it must not be forgotten that the export prices are frequently much lower than the home prices. The producers themselves admit that they recover the whole of their overhead costs on the home sales, a system which enables them to make lower prices abroad.

¹ Comparison established on the basis of the prices published in the *Bulletin of the International Statistical Institute*.

The cost of living continued to increase until the last quarter of 1930 (114,5 compared with 100 in 1928). A first stage in the downward movement was accomplished in 1931 (102,3 during the last quarter), and was followed by a period of relative stability up to the end of the first six months of 1934 (100,5 during the second quarter) succeeded by a further fall, accentuated in July 1935, owing to the effects of the decree-laws on rents (90,4 during the third quarter compared with 94,4 during the second). A fairly sudden increase took place at the end of the year, as a result of which the index rose by nearly two points; it was doubtless partly of a seasonal character, but nevertheless signified at least a stoppage of the downward trend, if not a reversal of the movement. The difference between cost of living and wholesale prices is considerable, even if the disparity of 1928 was of a contrary character. There is also a considerable disparity as regards the cost of living index of Great Britain, since the British gold index, according to the same basis of comparison (1928), is lower than 60. Wholesale prices being selling prices and cost prices being conditioned by the cost of living, it will be realized that the margin of profits of undertakings has been reduced or even transformed into loss.

The fluctuations of the *cost of living* index show the effect of the measures taken by the public authorities to maintain the agricultural price-level (quotas in 1931 and market re-organization in 1935). It is possible that these measures, apart from their political and social utility, may have been of some use, from the economic point of view, in so far as they maintained the purchasing power of the farmers, but they most certainly acted as a brake upon the impending normal adjustment.

As regards salaries, as far as it has been possible to ascertain, they kept pace with the cost of living and only decreased very slightly up to 1933. Since that moment, there has been a marked decrease. The present reduction percentage is as a general rule about 15 %, i.e. comparable to the reduction of salaries imposed by the State.

2. *Production and Unemployment :*

Apart from a slight improvement during the end of 1932 and the beginning of 1933, French industrial production constantly declined until the end of 1934 (decrease of 45 % from January 1930 to December 1934). During the first eight months of 1935,

it remained practically stable. Since then, it has shown a certain tendency to improve (74,8 in November compared with 73 in August on the basis of 100 for 1928). As ever, average fluctuations conceal the conflicting fluctuations of the component indices. The basic industries are stable or tend to improve and only secondary industries show a tendency to decline. Thus the *building* and *mechanical trades* reached in November the same level as in August, the *metallurgical industry* improved by 1,25 % *extractive industries* by 3 %, the *textile industry* by more than 6 %. The *rubber industry* is also improving, while the *leather industry* is less active (— 3,2 %) following a revival during the first half-year, as are also the *paper* and *motor* industries. The general level of industrial activity is nevertheless lower than in November 1934. The decline is general, except in the case of the *metallurgical industry*, which has not varied from one year to another, and the *textile industry*, which has improved by more than 18 1/2 %.

Industrial activity may also be measured according to the effective number of hours of work in establishments employing more than a hundred workers (Cf. *Activité économique*, N° 1, April 15, 1935, p. 15). The curve movements confirm the decline of 1931-1932, the recovery at the end of 1932 and the beginning of 1933 and the ensuing relapse. They also confirm the slight improvement of the past months and indicate the quarters in which it was noted. The general curve of the *number of hours of work in establishments employing more than a hundred workers* reached in November the same level as in July and fell slightly in December. For the first time in two years the figures show an improvement over the preceding year; the 1935 curve is higher in November than that of 1934 and maintains its position in December.

This improvement, however, only concerns the number of hours worked and not the number of workers employed.

This being the case, the persistence of unemployment can hardly be a matter for surprise. But, quite recently, there has been a very slight improvement. The number of registered unemployed increased less rapidly during the winter of 1935-1936 than in the course of the last winter, and, at the end of February 1936, there were only 487,000 registered unemployed against 503,000 at the end of February 1935.

As regards *agriculture*, the situation has been dominated by

the fall in world agricultural prices and, in 1931, by the sudden influx of animal and vegetable products from countries of Central Europe endeavouring to sell their surplus crops, timber and cattle at any price in order to produce foreign exchanges. The pressure exercised at that moment on the French agricultural market, which is clearly reflected in customs statistics, was such as to lead agricultural circles to the conclusion that their only means of protection lay in the establishment of increasingly numerous quotas. These quotas have gradually been extended to all agricultural products and, at the present moment, it may be said that the price of these products is, in reality, determined by a continued system of management, which from month to month regulates the extent to which the French market is open or closed to foreign products.

This result is due, let us repeat, not so much to the depression as such as to the general currency collapse of 1931. It will have serious and lasting consequences. The income of the rural population — a high percentage in France — has fallen by 50 %, from 60 to 30 milliards between 1929 and 1934, a decrease greater than the average fall in the general income of the nation. The Government's efforts to maintain corn prices by administrative purchase at fixed prices have failed in the long run, but have held up the adjustment of production to consumption. For certain products, e.g. wine, it has been necessary to limit the cultivated area.

This situation has had serious repercussions on all industries depending on agriculture.

Other results of the depression which should be mentioned here are : in the first place the *reduction of railway traffic* in the form of a reduction both of the number of loaded waggons and of revenue. At the end of 1935, the number of loaded waggons was 35 % lower than in 1928 and 38 % lower than the post-war maximum figures of December 1929. This reduction exceeds slightly that recorded for industrial activity as a whole (circa 30 %).

Since the end of 1935, there was a slight improvement and in January 1936, traffic returns were higher than in 1935.

In December 1935, for the first time after a constant downward movement, the product of the *turnover tax* exceeded that for the same month of 1934. As regards external trade, notwithstanding the upward trend of world trade during the last eighteen

months, French external trade again decreased during the first six months of 1935. It remained to some extent stable during the third quarter, with a slight improvement in October and November, but exports were lower by 60 % value and 38 % volume than in 1930. For imports, the decrease was respectively 62 % and 47 %.

Since the fall of the pound and the dollar, the *money market* has been dominated by currency instability and by the fluctuations in pound and dollar rates, entailing now an exodus, now an influx of gold. Since the currencies have appeared more stable, the apprehension concerning an eventual devaluation of the franc gave rise to an exodus of gold whenever political events appeared to strengthen the grounds for such anxiety. These outward movements of gold reached some 16 milliards in 1935 and a further milliard in January 1936. This situation results in considerable fluctuations in the hire of short-term money, which, after being maintained at a very low level at the beginning of the depression, is now much higher.

The *financial market* and the *rate of interest* for long-term borrowing are entirely dominated since 1932 by the position of the State finance. With the aggravation of the budgetary situation and the elimination of private bond issues owing to the depression, the State's share in loans issued on the financial market absorbed an increasing portion of the latter. Last year, this share amounted to almost 75 % of the total issues. This virtually complete absorption of new liquidities by the State has increased year by year and has resulted in a constant rise of the rate of interest for long-term borrowing which, for State, railway and Colonial bond issues at present amounts to about 5 1/2 or 6 %; in other words, the *situation of the financial market* is entirely dominated by that of the public finances. Stock exchange activity has constantly decreased. The first signs of recovery date from the past two or three months, and this improvement is a symptom of currency pre-occupations rather than the result of normal activity. It is therefore necessary to refer to the situation of the public finances to understand the evolution of the money and financial markets. This situation is dominated, as we have said above, by the decline in the national income and by the difficulty of adjusting a budget calculated for a period of prosperity and continuing to support a disproportionate debt derived from the war to the new situation created by the depression.

The 1932 budget, voted in 1931 at a moment when the effects of the depression were already acutely felt, included expenditure figures which were the highest since the war : 53,229 millions; revenue recovered on this budget did not exceed 37,098 millions. Since 1932, constant efforts have been made by successive Governments to restrict expenditure, which, for the general budget, has been progressively reduced from 53 milliards in 1932 to 47 milliards in 1935. The most recent and greatest reduction was effected by the decree-laws as from July 1935. The 1936 budget provides for a sum of 40,307 millions, but the decrease of revenue outpaced the reduction of expenditure. From 1932 to 1935, the figures of revenue collected in the course of each year were as follows : 37,098; 36,611; 35,389; 33,283 millions. If to this we add self-balancing and miscellaneous revenue, the *ordinary* budget would, in theory, appear to be balanced in 1936. But we must also add an extraordinary budget (armaments credits of 6,265 millions) and the expenses borne by the Treasury. During the preceding years, the budget deficit was increased by the growing railway deficit, which is borne by the State. Owing to the depression and the competition of motor vehicles, railway traffic has been considerably reduced, so that the yearly deficit of the various railway companies, which is entirely borne by the State, reached in 1935 a figure of some 4 milliards, which could only be decreased in virtue of a reduction of their debt effected through the decree-laws.

To railway expenditure must be added a series of advances of various kinds imputed to the Treasury on the grounds that the total could be recovered in the course of subsequent years. Thus, the deficits to be covered by the loan amount to about 70 milliards. This is a figure by which the public debt has been increased since January 1930. At the beginning of 1936 (despite the 1932 conversion and the reductions effected by the decree-laws of 1935), the annual charge of the debt figuring in the budget amounted to 15-16 milliards compared with 13 milliards in 1931. If we include in the debt proper military and superannuation pensions, we reach a total of nearly 25 milliards, *about the half of the whole of the State budget*. If it be recalled that national revenue does not exceed 60 milliards and that the communal and departmental budgets must be added to that of the State, it is difficult not to realize that this charge (derived in a large measure from the

war and the consequences of the war) is out of proportion to the revenue of the country.

Notwithstanding efforts which are yearly renewed, insufficiency of revenue, owing to the unceasing decline of the economic activity of the country, has constantly thwarted the endeavours of those who hoped to have succeeded in balancing the budget. This is the most serious vicious circle created by the depression and that which merits the most careful attention. During the last six months of 1935, actual revenue has invariably fallen short of estimates by $\frac{1}{4}$ or $\frac{1}{5}$ of the latter, and at present it is possible to calculate that at least 15 milliards will be necessary in 1936 in order to meet expenditure which is not included in the budget.

Netherlands and Switzerland

In the Netherlands and Switzerland, the situation is in many respects similar to that in France; in particular, there is a strange resemblance between the fluctuations of wholesale and retail prices, the differences between these two price-levels and the disparity between home prices and Anglo-Saxon prices. The most that can be said is that the cost of living in the Netherlands and Switzerland is slightly higher than in France, this difference being due to the fact that these two countries have not suffered from the post-war depreciation of the French franc. It would seem interesting to examine the respects in which the situation in these two countries differs from that of France. We will first take the Netherlands.

Generally speaking, it may be said that the financial situation of this country is more favourable and that its economic situation is less favourable, than that of France.

From the *point of view of currency*, the situation of the florin, like that of the franc, is extremely strong, and the lack of confidence from which it appeared on various occasions to suffer, was due to the same causes as in France, namely, the idea that the Government, for economic or financial reasons, contemplated devaluation.

As in France, the *Budgetary problem* is acute. But the public debt has not reached a disquieting figure. The consolidated debt is roughly 2,700 million florins and the floating debt, estimated with due reference to existence of Treasury claims which cannot

be called in immediately, amounts to some 550 million florins. The charges figuring in the 1936 budget total 147 millions. In other words, the capital debt per head of population is about 400 florins and the charges about 18,5 florins (in French francs, fr 4,000 and fr 185 respectively). The French State debt amounts to about 8,000 francs and the charges amount to fr 300 per head, together with fr 250-300 for the annuity debt and the State's participation in the railways. The Netherlands, which remained neutral from 1914 to 1918, have not had to bear the charges entailed by the war. In this respect, their situation is more favourable. Still, there is an appreciable budgetary deficit since the beginning of the depression. Leaving on one side the extraordinary budget which is normally covered by the loan, we find, in 1934, according to provisional figures, a deficit of 58 million florins; in 1935, according to the credits and expenditure voted, a deficit of 85 millions; finally, the estimates for 1936 provide for an increased deficit of 119 millions. The deficits have continued, notwithstanding reduction of expenditure (not including the refunding of debts) from 1931 to 1936 from 900 to 700 million florins. The deficit of 119 millions in the 1936 budget has been made good a saving of 93 millions and new taxes to the amount of 26 millions.

It should be noted that an economic revival would affect the Netherlands more directly than France. Not only would it react upon revenue, but owing to a less onerous public debt, it would also lighten expenditure. In the ordinary budget, the "social" credits would be rapidly reduced, and all extraordinary expenditure born of the depression would tend to decrease (agricultural subsidies, indirect industrial subsidies in the form of quotas, assistance to the unemployed, subsidies for merchant shipping, etc., amounting in all to about 300 millions).

The *rate of interest for long-term borrowing*, although not as high as in France, is nevertheless excessive, particularly for a commercial country like Holland; it varies according to fluctuations and confidence in the national currency, between 4 and 4 3/4 %.

On the other hand, the depression would appear to have affected the Dutch economic structure more than the French. The colonies, with the sale of their abundant raw materials, played a considerable part in the Dutch balance of payments; on the other hand, the annual payments to the mother country,

amounting to 400 millions on its investments, acted as an impetus to internal trade. Finally, it was inevitable that the Netherlands, which for many years have played the part of banker and intermediary, should suffer acutely from the shrinkage of international trade and from a shipping crisis which proved disastrous for their relatively highly developed mercantile marine. The closing of the British market in 1931, the impoverishment of Germany and the foreign exchange control established by that country made it extremely difficult for Holland to sell to its two best customers. Finally, it has been more difficult for the Dutch economic structure — which is in the highest degree adjusted to the international division of labour, with an industry specializing in manufactured goods such as incandescent lamps and radio-electrical apparatus — to adapt itself to a world whose frontiers are closed in the first instance to high-grade products, whose restricted purchasing power reduces the demand for these very products and whose policy must be directed towards self-sufficiency.

The Netherlands have been compelled against their will to make a sacrifice to autarky in the form of agricultural subsidies and quotas designed to encourage the creation in their country of new industries offering possibilities of employment, the consequences of which, as regards the maintenance of prices, have been the same as in France. At the beginning of 1936, industrial production amounts to about 2/3 of the 1928 figures, the number of unemployed far exceeds 400,000 or 5% of the total population, internal traffic (wares handled in nine of the principal stations) had shrunk to one half of its volume in times of prosperity, imports and exports were reduced to one third of their volume in 1929.

The position in *Switzerland* is in certain respects more similar to that of Holland than that of France. The exclusively farming character of its agriculture, the high grade of its industrial products (watch- and clockmakers' wares, precision instruments, lace industry), and the German crisis, have counted for a great deal in the falling off of national economic activity. Further factors are the reduction in the number of tourists, which has seriously affected the situation of the hotel industry and the returns of the Federal Railways (in part also due to the shrinkage of the transit traffic), and, finally, increased unemployment. All this has proved a heavy burden on the public finances.

The Swiss budget shows an increase compared with that of 1929. This is partly due to the fact that all expenditure is included and that there is no extraordinary budget. The only exception to this rule is that revenue from the Federal Railways does not figure in the budget. Following the recent financial measures, expenditure is now estimated at some 500 million Swiss francs compared with 372 millions in 1929. The increase is largely due to the measures taken to sustain the price-level and to assist the unemployed. It would be necessary to add the *railway deficit*, for which a credit of 40 millions figures in the 1936 budget, as well as that of the *cantonal budgets*. For the 25 cantons, expenditure has remained stable since 1931, roughly 700 million francs, the deficit being 53 millions in 1933 and 45 millions in 1934 (there are as yet no definite figures for 1935). The total federal and cantonal expenditure therefore approximates 1,200 million francs, or, according to official estimates, hardly 1/6 of the national income. In France, the State budget alone represents far more than a quarter of this income. By adding to the above figures the expenditure of the communes, we reach an approximate total of 1,600 millions or about 1/5 of the national income, whereas, in France, according to Mr. Dessirier's estimates, by including the State, the communes and the departments, we reach a total of more than half the national income.

In a recent statement, the Federal Council announced that the *consolidated debt of the Federal Administration* had increased by 42 million francs from 1932 to 1935, while the *Federal Railways debt* had increased by more than 80 millions. To these figures should be added an increase of the *floating debt* by 33 millions between 1932 and 1934¹. For 1936, the Federal Administration will not require over 10 millions, but 160 millions are necessary for the Federal Railways. Numerous loans, amounting to a total of 310 millions, mature between 1935 and 1939. Those repayable in 1936 and 1937 will naturally be converted, for in the total absence of all resources, it is absolutely impossible to repay them. It is impossible as yet to foresee what will happen in the case of the loans which mature later.

But there are two weak points in the Swiss economic position : private indebtedness, in particular, the mortgages of

¹ The public Federal debt, the debt of the cantons and the Federal Railways debt are approximately 2 milliards Swiss francs each.

the farmers, and the banking situation. The decline of agricultural prices has had a much more serious effect than in France, for the farmers' debts are much heavier. The mortgage bonds in the hands of the Swiss banks represent a total of more than eight milliards of francs with an annual interest of at least 500 millions, the greater part of which devolves upon the farmers¹. This is the price paid for up-to-date equipment enterprises. The importance of this debt will be realized, above all, if recalled that the income of the agricultural section of the population for 1934 is estimated at only 1 1/2 milliards.

As for the situation of the banks, it is partly governed by this capital tied up in mortgages, which is somewhat in the nature of a frozen asset, but also by the capital immobilized in Germany during the period immediately preceding the depression. The losses sustained by Swiss business owing to the fall of the *Sperrmark* (stopped marks) were estimated at 2 milliards; at all events, numerous banks, in particular at Basle and Zurich, were obliged to apply for a moratorium. The situation is, however, improving daily.

We will now quote for Switzerland the essential statistics quoted in the case of the Netherlands. *Wholesale* prices fluctuate round 65 on the basis of 100 taken for 1928, they are accordingly higher than in France and in the Netherlands; the *cost of living* is stabilized near 80, at a level similar to that of the Netherlands, lower than in France, but only because the cost of living in the two former countries is much higher during the year of reference. *Industrial activity*, after declining to a minimum of 68 during the first quarter, revived to about 73 during the third quarter of 1935, but unemployment is constantly increasing and in December 1935, the figures exceeded by almost 30 % those of December 1934. On the other hand the *weight of goods carried* has been, since the autumn, higher than in the corresponding months of 1934, and is only 20 % short of the 1929 maximum. As in other countries, *external trade* has undergone a considerable reduction; exports have shrunk to almost 1/3 and imports to 1/2 of their value in 1929.

Thus, although comparable as a whole, the respective situations of the three countries of Western Europe which have

¹ The Statistical Yearbook 1933 reports average indebtedness of *circa* fr. 4,500 per hectare.

remained faithful to the gold standard are by no means identical. The eventual stabilization of currencies would in all three cases bring about an improvement, owing, more particularly, to the international trade recovery which would be its corollary. In this respect, the effects would doubtless be more patent in the Netherlands than in the other two countries. But the question would certainly be raised whether stabilization should not go hand in hand with an adjustment of parities such as at least to reduce the margin between the internal price-level of these three countries and that of foreign countries. For France, the question is complicated by the excessive fixed charges of the State and the collectivities which would have to be reduced, while in Switzerland, it is in the first place the private debts which require re-adjustment. Holland is certainly the country which would benefit most and most rapidly by a recovery, but its situation is nevertheless ambiguous; economic recovery should normally enable the national structure to regain its former aspect, but on the other hand, it would be difficult not to continue to protect new industries the creation of which has been encouraged. In all three countries, the recovery, even if preceded or accompanied by currency adjustment, would still leave important problems to be solved.

Poland

As already stated, Poland differs from the other countries of the gold block, owing to energetic measures of deflation which have enabled it almost constantly to maintain its prices at the world price-level. In the Polish history of the depression, it is possible to distinguish two periods : the first, from 1929 to the last quarter of 1931. During the whole of this period, Poland suffered from the depression and its consequences, for the same reasons as all agricultural countries of Central and Eastern Europe, the only difference being, perhaps, a sounder credit policy. But with the fall of the pound sterling, the situation changed. Whereas all the other countries in question defended their economic structure by numerous customs restrictions and systems of exchange control, Poland applied strictly the rules of the gold-standard and endeavoured to adapt its economic structure to the situation by encouraging a fall in prices. During this second period, it is also possible to distinguish two phases. In

1932, 1933 and during the greater part of 1934, industrial prices declined less than agricultural prices, and the deflation culminated in a distress, the depth of which is revealed by sociological inquiries into conditions in the Polish agricultural classes. From the end of 1934, the Government exercised on industrial prices a pressure which culminated in the decrees of November 1935, disbanding numerous cartels opposed to a fall in prices. As agricultural prices, at all events, those of cereals, are showing signs of recovery, the situation of the peasants is improving, and their increasing purchasing power is in its turn a stimulus to industry.

Let us first examine certain indices showing the degree of adjustment of the Polish economic structure, the measure of its recovery and the domains in which recovery is as yet hardly noticeable. *Wholesale prices*, based upon 100 in 1928, reached a minimum of 52 in March 1935, rising approximately to 52.7 at the end of the year, a slightly higher level than that of British prices, but the margin is relatively unimportant. The *cost of living* has constantly decreased; despite the rise in foodstuffs, the downward trend has continued during the past few months, owing to the fall in prices of manufactured products. It is about 60, scarcely higher than in Great Britain, although the latter has devalued by 40% and the zloty is still at par. The reward of this policy is to be found in the *internal trade figures*: the *industrial production*, which had fallen to 54 in 1932 (this very low level is accounted for by intensive deflation on the one hand, the loss of the external market on the other), has enjoyed an uninterrupted recovery, exceeding today 70 (+ 30% above the lowest level), the upward movement being due, up to 1935, to recovery in the consumer's goods industries, and since about a year, to a strong improvement in those producing capital goods. *Railway traffic*, which shrunk by 2/5 from 1929 to 1932, has since recovered to such a degree that it is only 12% less than during the first of these two years. Only *external trade* and *unemployment* are still in a critical phase, but this is hardly a matter for surprise since the same is the case even in devaluation countries. At all events, in Poland, unlike other countries of the gold block, the *number of unemployed* fell in 1935 below the figures for the corresponding months of 1934, trade also improved, since exports have remained stable, and, owing to industrial recovery, imports rose by 7% from 1934 to 1935.

A few words on the *budget policy* of the Government. It has applied the strict principle of budget equilibrium, but has as yet been unable to achieve absolute equilibrium, notwithstanding a reduction of salaries of 25 to 30 % from 1931 to 1935. From 1930/1931 to 1933/1934, the deficit constantly increased, rising from 63.5 millions (2 1/2 % of the expenditure) to 371.6 millions (17 1/2), and it is still 220 millions for the first nine months of 1935/1936. The budget estimates for 1936/1937 are balanced by reduction of expenditure and increase of revenue, by the institution of a special tax on salaries (15 to 20 % according to the monthly rate of salary) and by the raising of the income tax rate; on the other hand, business taxes are reduced under the decree laws of November. Taken as a whole, *budget expenditure has been reduced by 25 % since 1929.*

Before concluding this too summary statement of Polish experience, it is also necessary to dwell upon the decree laws the object of which is to enforce deflation in those sections of economic life which have hitherto opposed the greatest resistance to this measure. A first series of decrees reduced *all debt charges* (reduction of the interest rate of building and mortgage credits, suspension of the capital repayment of all debts to urban credit institutions, reduction of legal rate of interests, of private pensions); the second series envisages on the one hand a reduction of taxes (reduction of business taxes) and that of the so-called "rigid" prices: among 216 national ententes, the Government disbanded 93, whose existence could not be justified from an economic point of view and had only led to an exaggerated widening of the margin between the wholesale and retail prices of industrial products. This measure resulted in a reduction of the prices of coal (13 % for fuel coal and 7 % for industrial), cake (10 to 25 %) and iron (10 %). Further, a direct agreement with the cartels concerned led to a reduction of 11.4 % in oil, 20 % in sugar, and 15 % in paper prices. On its part, the Government consented to reduce the *railway tariff rates*. All these measures were based on the idea that, in view of the fall in agricultural prices and accordingly, in the purchasing power of the peasants, it was necessary to reduce industrial prices to a level permitting of the absorption of the whole of the production reserved for the internal market. The Government considers that this goal has now been reached and the firmness of world agricultural prices will be of further help in this respect.

What conclusions can be drawn from this brief statement? Poland, like all other countries, would derive the greatest benefits from a stabilization of currencies : in the first place, the assurance that it will not be compelled by currency depreciation in the countries in which the world prices are constituted, to renew a deflationary effort which it hopes to have terminated, in the second a revival of world trade by which its business circles will be able to benefit owing to the perfect adjustment of their cost prices. In Poland's case, contrary to other countries previously considered, it would not seem that any currency adjustment is necessary, nor that any section of its economic structure is in need of special attention or far-reaching re-organization. But it is necessary also to emphasize that only the preponderance of agriculture and the relatively very modest standard of living of the Polish population made it possible first to experiment with deflation, secondly, to carry it through without encountering any appreciable resistance on the part of the social classes on which it fell most heavily.

Italy

The Italian situation will be dealt with more summarily, for Italy is in practice no longer a country with a gold currency. Although the parity of the lira is still theoretically maintained, and official stock exchange quotations are hardly below par, the effective private rates mark a depreciation of 30 to 40 % and bullion is sold over the counters of the Bank of Italy, at prices which confirm a recognized depreciation of 22 %.

It is somewhat difficult to describe the complicated policy of Italy in terms which are at once brief and accurate. Partial concession to deflation by reductions of salaries and wages and by the restriction of margins of profit of enterprises culminating in the important conversion of February 1934, together with a far-reaching measure of autarky, in particular, as regards agriculture. Taken as a whole, the period in question may be regarded as characterized by coercive measures of price reduction and by veritable latent inflation: budget expenditure increased constantly notwithstanding reduction of salaries, rising from 20 milliards in 1929/1930 to 24,500 millions in 1933/1934. The deficit was considerable, reaching 6,300 millions during the latter year. From 1930 to 1935, the internal debt increased by 17 milliards, half of this increase being accounted for by the floating debt,

while "deferred payments" allocated over fifty years, increased from 65,400 to 74,500 millions during 1931 and 1932 alone. This accounts for the revival of activity shown by the indices of a period beginning with the second half of 1932: increased industrial production, increased employment, reduced unemployment, maintenance of the railway traffic which declined in all other countries.

Since 1934, schemes of colonial conquest have resulted in a revival of industrial production which has progressed more rapidly than in any other country except Japan, but the upward movement ceased in the summer of 1935, when monetary difficulties began to impede purchases of raw material. The financial difficulties increased, as revealed by the backward conversion of August 1935. The new loan securities are 5% rent securities, exempted from succession and deed of gift duties, issued at a rate of 95 lira for 100 lira normal capital value. These securities can be procured in exchange for 3 1/3 redeemable securities of the conversion of February 1934. The latter which were quoted at 68 lira at the beginning of September are now accepted for 80 lira. As the exchange is effected on the basis of security per security, the subscriber has to pay a supplement of 15 lira cash; for this payment he is granted every facility and delay.

The definitive results of the 1934/1935 budget were published at the end of December. The deficit is 2,939 millions. On the other hand, the estimates for July 1935/1936 show an increase of 29 millions. But the expenses of the colonial expedition (with the exception of the debt service — one milliard) do not figure in the estimates. The naval budget is increased by 300 millions, the air budget by 139 millions, the Corporations budget by 28 millions. Owing to the inflation, the estimated revenue exceeds by 2,394 millions that of 1934, but it is impossible to give the figures of the effective deficit. According to the monthly Treasury accounts, the expenses of the Abyssinian campaign reached a total of 359 millions from January to July 1935, 1,345 millions from July to October (632 millions for September), and 2,400 millions for the last quarter of 1935: for 1935, a total of 4,095 millions. Two decrees of December 24 and January 9 authorized the opening of a credit of 3,150 millions (one milliard for the colonial budget, 1,500 millions for the Army, 250 millions for the Navy, 300 millions for the Air Budget and 100 millions

for the internal budget) . During the first quarter of 1936, the campaign will cost almost 5 milliard lira.

Nevertheless, despite the pressure exercised by the Government, wholesale and retail prices increased owing to military requirements, the necessary inflation and sanctions. The result of the last is to speed up evolution, initiated at a much earlier date, in the direction of absolute autarky, a system of State monopoly of external trade and banking credits (reform of March 3). The redistribution of Italy's purchases and sales, with the elimination of countries applying the sanctions, encounters moreover insuperable obstacles.

The affirmation that Italy, with an internal debt exceeding 150 milliard lira, prospects of important future expenditure, the high prices imposed by its agriculture and industry, regardless of economic considerations, will be unable in present circumstances, to derive great benefits from currency stabilization, can hardly be regarded as a rash judgment. For this country, it will probably be necessary to resort to monetary adjustment approaching more nearly the post-war devaluations than the Belgian devaluation of 1935 and such devaluations as the other countries of the gold block eventually envisage.

February 1936.

(Signed): Charles RIST.
Philippe SCHWOB.

**Memorandum
on the
experiences of countries applying foreign exchange
control**

by

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FOREIGN EXCHANGE CONTROL

**EXPERIENCE OF COUNTRIES APPLYING THIS SYSTEM
DURING THE ECONOMIC DEPRESSION**

For the critical observer, it is essential, when endeavouring to form an opinion on foreign exchange control, to bear in mind a whole series of facts. Foreign exchange regulations have been applied and submitted to a practical test in numerous countries. Before expressing a general opinion on the subject, it is necessary to investigate the actual process of development in several countries. For reasons inherent to the subject, it is impossible to abstain from a somewhat detailed description.

I. *Survey of foreign exchange regulations in different countries*

The following survey deals with several countries in which regulation of the exchange market has become an outstanding feature¹. We will begin with Rumania, continue with the

¹ It is noteworthy that countries which have remained or appear to remain aloof from more or less compulsory foreign exchange control have occasionally been compelled to resort to similar methods: England during the winter of 1931/32; the U.S.A. in March 1933. Belgium and Italy are also among the number.

foreign exchange policy of Czechoslovakia, Germany and Denmark, and conclude with that of the South American States. The situation in Austria is briefly dealt with in the chapter "Gradual abolition of foreign exchange control" (Part III). The situation in certain other countries is touched upon in Part II.

1. *Rumania.*

In theory, the monetary authorities of a country are able to adopt an attitude which varies according to the difficulties that may arise in connection with the maintenance of the exchange parity. Leaving on one side the case of monetary authorities adopting a passive attitude in regard to exchange fluctuations and unhampered development of rates, there remains the choice between devaluation with virtual or legal stabilization at a new level and an attempt to maintain the former rates by the supervision and regulation of the exchange market. (We will abstain here from entering into the possibility of operating with exchange equalization credits.) It is certain that, from a theoretical point of view and as practically tested in many cases, devaluation is a process which confronts national institutes responsible for the development of the exchange rates with numerous and difficult tasks. Devaluation alone is insufficient; decisions must be taken in regard to the estimation of earlier debts in so far as the gold clause is operative; in certain circumstances, an exchange equalization fund must be constituted, etc. But in no case is it possible to query which constitutes a heavier burden for the currency authorities — devaluation or the compulsory regulation of the exchange market. The outstanding feature of foreign exchange control is that initial measures in this respect entail a whole series of successive complementary measures.

For this peculiarity of foreign exchange control, Rumania constitutes an interesting example. The regulation of foreign payments of November 25th 1935, which came into force on December 1st of last year, is the outcome of earlier policy in regard to regulation of international trade which the critical observer is inclined to describe as a series of experiments. This law, which in its essential points suggests the influence of foreign examples, empowers the National Bank to pay exporters an exchange premium which varies according to the standing of the currency in question. The resources required by the National Bank for such payments are constituted partly by a premium on

legal parity obtained from the sale of foreign exchanges to importers. They are also constituted by a 12 % import tax and a tax on the export of oil products. These measures amount to recognition of the fact that the compulsory regulation of foreign exchanges and of the export of foreign exchanges has been insufficient to fulfil its *ad hoc* function, namely the maintenance of the former parities. This conclusion applies to numerous countries which have resorted to foreign exchange control, and is naturally calculated to increase criticism in regard to this monetary experiment.

Further consideration of this system of premiums must in the first place lead to comparison with the German method. In Germany, the necessary funds for the payment of premiums in compensation of loss on exports¹ are constituted by a general tax on German industry, whereas in Rumania these resources are drawn exclusively from firms concerned with external trade. This signifies that the results of the Rumanian regulations have been similar to those which would have been entailed by devaluation, namely, increased export product and dearer imports.

But this system of premiums is not the first attempt made by the Rumanians in this direction. As early as June 10th 1935, export premiums were instituted amounting to 10 to 40 % (of the par rate). This remittance of foreign exchanges was subject to a supplement of 44 %.

The introduction of foreign exchange regulations on the Rumanian market is due, as in other countries, to the evolution of the depression and to special economic conditions prevailing in Rumania.

We will confine ourselves to mentioning the figures of the heavy foreign public debt.

¹ This compensation was necessitated by the sharp fall in prices in other countries, whether due to devaluation or deflation (in the gold countries).

Rumanian Public Debt from 1925 to 1934 (Milliards of Lei)

Year	Total Public Debt	Foreign Debt
1925	162,4	136,3
1926	179,5	153,5
1927	183,7	157,6
1928	160,7	139,3
1929	197,0	174,9
1930	139,0	122,2
1931	175,7	159,1
1932	179,3	162,1
1933	143,9	124,6
1934	148,8	129,4

Communicated by the Statistical Bureau of the Reich.

The Rumanian currency was stabilized at a new legal parity which came into force as from February 8th, 1929. In 1930, an export surplus of 6 milliard lei assured the payment of interests and dividends abroad (2,79 milliard lei for private debts, 2,9 milliard lei for public debts). But it was inevitable that the discontinuance of further inflow of capital and the reduction of the export surplus should give rise to difficulties in connection with international payments. A particularly critical feature was the fall in the export prices of oil products which declined as follows from 1930 to 1933 (compared with indices for 1929) (see following table) :

Rumania : Export and export prices of oil products, total export

Year	Export prices for oil products 1929 = 100	Total exports		Oil and oil products total export	
		Mill. Lei	1929 = 100	Mill. Lei	1929 = 100
1929	100	28 960	100	9 591	100
1930	75	28 522	98	10 409	109
1931	43	22 197	77	6 809	71
1932	42	16 722	58	7 194	75
1933	40	14 171	49	7 833	82
1934	—	13 656	47	7 142	74

Statistical Yearbook of International Trade.

This decline in prices was naturally of far-reaching importance, in so far as the oil export played a decisive, and during the depression years, a still increasing part in Rumanian external trade (see above table).

Neither by the introduction of an import licence system (November 1932), nor by the reduction of international payments in virtue of debt contracts was it possible to achieve complete success. It was inevitable that these measures should be completed by the institution of compulsory foreign exchange regulations.

As above stated, the Rumanian monetary authorities were unable to achieve the object aimed at by the compulsory regulation of international payments. This also was mainly due to economic causes. In this connection, it is necessary to mention the decline of the export surplus from 5,4 to 0,44 Mill. lei in 1930-1934. But, this development would also seem to have been due to a certain hesitation in regard to the institution and organisation of the system of control. In the beginning, the regulations applied only to States which had, on their part, instituted foreign exchange restrictions (February 1932). Shortly after (May 1932), the foreign exchange trade was centralized in the Rumanian National Bank. The actual organization of the foreign exchange control took place in the autumn of 1932. It is impossible here to enter into all details. A noteworthy decision is that of October 1934, in virtue of which the exporter, as soon as his wares cross the frontier, receives from the customs authorities an import certificate authorizing him to import goods up to 60 % of the value of the exported wares. This is to ensure the constitution of an export surplus which can be used for the debt services and other purposes. In this respect, and also in the clandestine traffic in foreign exchanges ("schwarze Börsen") we find somewhat similar conditions in South American States (see below).

2. *Czechoslovakia.*

The monetary policy of Czechoslovakia is generally regarded as an example of devaluation and provisional stabilization. This idea is fallacious as regards the first years of the depression. Originally, Czechoslovakia endeavoured to cope with international payment difficulties by the control and compulsory regulation on the foreign exchange market. What is remarkable is that even

Czechoslovakia : Credit Claim Sheet from 1928 to 1933 (in Mill. Kc.)

	Foreign Debts						Foreign Claims						Total Indebtedness (+ = Credit balance)					
	1928	1929	1930	1931	1932	1933	1928	1929	1930	1931	1932	1933	1928	1929	1930	1931	1932	1933
I) Public																		
State	6 044	5 999	7 322	7 266	8 838	7 452	617	584	569	536	503	465	5 427	5 415	6 753	6 730	8 355	6 987
Communes	506	497	486	412	397	297	—	—	—	—	—	—	506	497	486	412	397	297
Total I)	6 550	6 496	7 808	7 678	9 235	7 749	617	584	569	536	503	465	5 933	5 912	7 239	7 142	8 732	7 284
II) Private																		
Industry and Banks :																		
a) long-term	1 077	971	1 498	1 193	1 275	1 153	1 011	1 477	841	913	732	636	66	+ 506	657	280	513	517
b) short-term	304	656	973	665	323	302	11	20	44	34	107	31	293	636	929	631	216	271
Bank accounts for correspondents abroad	2 776	2 472	2 003	1 178	757	724	4 655	4 331	4 626	1 974	1 960	1 877	+1 879	+1 869	+2 623	+ 796	+1 203	+1 153
Total II)	4 157	4 099	4 474	3 036	2 355	2 179	5 677	5 828	5 511	2 921	2 799	2 544	+1 520	+1 729	+1 037	115	+ 444	+ 365
Total I + II	10 707	10 595	12 282	10 714	11 590	9 928	6 294	6 412	6 080	3 457	3 302	3 009	4 413	4 183	6 202	7 257	8 288	6 919

Note : In the above table we give the figures published by the Petaschek Bank, Prague, in its annual report on Czechoslovakian trade. These figures differ in certain respects from those published by the League of Nations in its balance of payments statistics. E. g. the League gives for 1930 and 1931 higher figures than the Petaschek Bank as regards the public foreign debt and moreover estimates foreign shares and direct investments in Czechoslovakia from 1930 to 1933 at 1 1/4 Mill. Kc. per year.

the devaluation of February 1934 was not sufficient to enable this country to dispense with foreign exchange restrictions. In this connection, it is necessary to point out that Czechoslovakia is not the only country whose monetary policy is a combination of systematically different methods. In not a few countries we find devaluation combined with foreign exchange regulations.

As the effects of the depression began to make themselves felt in the domain of currency and credit, it was currently affirmed that foreign exchange regulations would in the main merely result in capital flight. But it is necessary to go further and to state that the foreign exchange regulations were practically inevitable in countries with an unfavourable foreign debt balance. The case of Czechoslovakia is particularly interesting in so far as her international balance of payments was by no means particularly unfavourable at the beginning of the depression. The fact that Czechoslovakia was nevertheless menaced in this respect is a proof that the extent of the international indebtedness of a country is not a decisive factor. What is more important is the nature of the debt and the possibility of its rapid modification.

From the appended table it will be seen that in 1928, Czechoslovakia's net indebtedness amounted to 4,4 Mill. Kc., in 1929 to 4,18 Mill. Kc. The figures show a constant increase up to 1932. The net debt has been doubled. This increase is due to that of the net public debt by 2,8 Mill. Kc. and to the reduction of net private claims (mainly short-term) by 1,3 Mill. Kc.

What is more important is that private foreign debts decreased from 1930 to 1932 by 2,1 Mill. Kc. This withdrawal of foreign credits was rendered possible by general measures for the taking over of private Czechoslovak claims abroad. During the same year the amount of these foreign claims decreased by 2,7 Mill. Kc. The difference (compared with repayments of foreign debts) may be ascribed to hoarding or to uncontrolled flight of capital.

These developments naturally find their echo in the balance sheet of the Czechoslovak National Bank but not here alone, for the foreign exchange reserves of the private Banks must also be reckoned with. The foreign exchange reserves of the National Bank fell from 2,5 Mill. in 1928 to 0,9 Mill. Kc. in 1933. Even if it is considered that this sharp decline was accompanied by an increase of the gold reserve of 0,5 mill. Kc., there nevertheless

remains a minus in the exchange reserves of more than 1 mill. Kc. The principal decline took place in the course of 1931.

A glance at the evolution of foreign trade completes the picture. The export surplus, which amounted to 1,8 Mill. Kc. in 1930 sank to 1,4 Mill. in 1931 and was replaced by a slight deficit in 1932.

Thus, economic conditions in Czechoslovakia called for urgent decisions in the matter of currency. The Government decided in favour of the foreign exchange regulations and abstained from devaluation. Devaluation would have resulted in an increase of the public foreign debt burden over and above that inherent to the depression years. It moreover seemed doubtful whether devaluation would bring about a revival of the Czechoslovak export trade, a considerable part of which concerned countries which had themselves instituted international payments regulations or quantitative restrictions of imports.

The impartial observer will have to admit that the organization of foreign exchange control and of the measures necessary for its successful functioning have not, in general, failed in Czechoslovakia. What was obviously important in this connection was that Czechoslovakia was able, little by little, to set in motion a machinery the functioning of which had been suspended at a not much earlier date. The first step in the direction of foreign exchange control was a decree of the National Bank on September 26th, 1931, which enabled the latter to supervise all foreign exchange operations in the country. And this decree recalls the law of December 14th, 1923 (still in force) for the protection of Czechoslovak currency, which makes the purchase of foreign exchanges and valuable metals dependent upon economic requirements. A few days later, the currency protection regulations of 1924 were again put into force, and with them, the principal mechanism of the earlier foreign exchange system of the Republic. The trade in foreign exchange is centralized in the banks; all foreign exchanges must be remitted to the Central Bank. In view of the above-mentioned external trade evolution, it is easy to realize that the supply of foreign exchange thus obtained was insufficient for the requirements of Czechoslovak trade. It was therefore necessary to complete these measures by the institution of an obligation for owners of foreign instruments of payment or claims in foreign currencies to offer the latter to the Bank. In December 1934, the National Bank took over interest-bearing

securities, representing an acknowledgment of claims against physical and juridical persons in numerous countries. All these measures were insufficient. The currency protection law of 1923 was amended on July 15th, 1932. In particular, breaches of the law were threatened with heavy penalties. Above all, it is necessary to point out that in Czechoslovakia, as in other countries, strict supervision of the import trade was inevitable. Lists of imports were compiled. The allocation by the National Bank of foreign exchanges for the importation of the wares included in these long lists was subject to express import authorization by a special commission of the Finance Ministry. Czechoslovakia has moreover been unable to dispense with clearings and payment agreements.

Nor, in regard to decisive points, has the Czechoslovakia solution of the foreign exchange problem been satisfactory. As already seen from the above national reports, there is always a risk of not being able to maintain the controlled rates of exchange at what is in certain respects an artificial level. In Czechoslovakia, the conflict between the normal market tendencies and the foreign exchange regulations is characterized not so much by the development of illegal exchange traffic ("schwarze Börsen") or a system of official premiums as by a demand for devaluation which has finally been satisfied. In February 1934, Czechoslovakia devalued the Krone by 1/6, decreasing its gold-content by this fraction. This amounts to the ultimate if not complete victory of those tendencies of the foreign exchange market which foreign exchange regulations were intended to combat.

In numerous countries, the control of the exchange market and foreign exchange regulations constituted the inevitable reaction of the currency authorities to the economic situation as a whole. Even if we are compelled to acknowledge that this system has not fulfilled its immediate purpose, the fact that devaluation has not enabled Czechoslovakia to dispense with foreign exchange regulations must give the critical observer food for reflection. The devaluation had hardly been carried through, when it became necessary to call in interest-bearing securities and to prolong the above mentioned currency protection law.

3. *Germany.*

The example of Czechoslovakia shows that Germany is not the only specifically industrial country which has introduced

foreign exchange control. Although numerous other States besides the two countries have instituted foreign exchange regulations, the attention of the critical observer is mainly engaged by Germany; this is due to two main reasons. First, Germany's position as economically the strongest and most important of the countries applying this system; secondly, the intensity and stringency of wording and substance of the German foreign exchange regulations. It must be granted that Germany has unwaveringly pursued the policy thus inaugurated. The events of autumn 1934 afford striking evidence of the difficulties which had to be surmounted.

A land which undertakes to consolidate and maintain foreign exchange rates menaced by factors tending, under the overwhelming pressure of developments on the foreign exchange market, in a direction contrary to that desired by the currency authorities, is compelled — every economist will agree — to regulate the volume of exchange transactions. Foreign exchange rates may be compared to prices formed in that section of the national money market known as the foreign exchange market. The proceedings are similar to those on other markets: price fluctuations and fundamental modifications of price tendencies can only be held up by regulation of offer and demand (in this case, foreign assets, bills of exchange, cheques on foreign banks and other instruments of payment made out in foreign currencies).

The grounds for Germany's decision, in the summer of 1931, to introduce foreign exchange regulations, are a matter of common knowledge and discussion. Among them figures, in the first place, its enormous short- and long-term indebtedness¹, closely linked up with reparation payments. Further, the increased prices of raw materials, so important for German industry, and — a particularly important factor during the first months of the depression — the experience of the German people during the post-war inflation period. But it must be pointed out that it was also necessary to avoid devaluation, in view of the fact that Germany's foreign debts had been contracted in foreign currency and that devaluation of the Reichsmark would have resulted in an increase of the debt burden. Moreover, devaluation at that moment would have exposed Germany to severe international

¹ Cf. Table on next page.

*Development of German foreign indebtedness
since July 1931 (in milliards of RM)*

	July 1931	Nov. 1931	Febr. 1932	Sept. 1932	Febr. 1933	Sept. 1933
I. Short-term Credits	13,1	10,6	10,1	9,3	8,7	7,4
frozen	(6,3)	(5,4)	(5,0)	(4,3)	(4,1)	(3,0)
II. Long-term Credits	10,7	10,7	10,5	10,2	10,3	7,4
Total (I & II)	23,8 ¹	21,3	20,6	19,5	19,0	14,8

Wirtschaft und Statistik.

criticism. Apart from a few less important States, Germany would at that moment have been the first great power to include the devaluation weapon in its foreign trade arsenal.

It is, of course, impossible to state with certainty what would have happened if Germany had then devalued. But, then and later, it is quite improbable that devaluation would have enabled the country to dispense with the introduction or maintenance of foreign exchange regulations. In view of the powerful factors menacing the equilibrium of the foreign exchange market, it was impossible to avoid quantitative control of the available assets. In the next section of this report, we shall deal with Denmark and thus make acquaintance with a country which, notwithstanding devaluation, was obliged to introduce compulsory regulations for foreign payments. Indeed, it may be said that this development was actually brought about by devaluation.

During the first phase of German exchange control, measures of quantitative control were applied on the German foreign exchange market in such a way as to hold up the further export of capital from Germany. In this connection, we have the decree prohibiting transfer of the product of sales of securities for foreign accounts on the German market; further the standstill moratorium for private and public short-term debts; further again, the compulsory remittance of foreign exchanges and the restriction of the foreign exchanges allocated for import purposes. Economically speaking, the allocation of foreign exchanges proceeded on neutral lines, importers being entitled to receive a certain percentage of their earlier transactions. (Originally

¹ It will be remembered that this figure has been reduced in virtue of the on-call or writing off of important short and long-term credits.

75 %, from May 1932 to February 1934, 50 % of the basic figure. This basic figure was calculated according to monthly average foreign exchange requirements of import firms for the period July, 1, 1930, to June 30, 1931.) The classification of import requirements according to urgency, already envisaged at that moment, was not carried out.

This system worked quite satisfactorily so long as there was sufficient export to cover the foreign exchange requirements of the foreign debt service and the importers. It is a wellknown fact — to the advantage of the German creditors — that the product of the German export was such as not only to satisfy these demands, but to enable Germany, with the assistance of the existing foreign exchange reserves, to repay an important part of its debt.

Serious difficulties arose when trade restrictions and devaluation effects in other countries resulted in a decline of the German export trade which transformed the surplus into a deficit. The surplus which amounted in 1931 to barely 2.9 mill. RM., in 1933 to 0,66 mill. RM. was replaced in 1934 by a deficit of 0,28 mill. RM. This destroyed the material basis of the former foreign exchange organization. The difficulties were all the more serious as certain German firms, on the basis of certain payment agreements, were indebted for wares imported in advance on the strength of future foreign exchange allocations. This was one of the results of the principle of general exchange quotas.

Germany had to take further measures. The restriction of the debt service encountered sharp opposition on the part of the creditors, and the proclamation of a transfer moratorium was met with the threat of a forced clearing, so that Germany was obliged to conclude payment agreements. The whole of the German system of foreign exchange control had to be revised and transformed. These reforms were published in the autumn of 1934 under the name of the New Plan. The system of a general exchange percentage was replaced by the principle of separate authorizations, issued by the Foreign Exchange Control Offices. Under this system, an importer only receives foreign exchanges when in possession of an *ad hoc* authorization before importing his wares. The New Plan is run on the principle only to buy what can be paid for. The greater part of the imports goes through payment agreements, clearings and special foreign accounts for inland payments.

On the whole, the New Plan has functioned satisfactorily. It is the result of a decision to proceed with the regulation of the foreign exchange market notwithstanding the serious difficulties arising from the decline of external trade.

The circumstances described at the beginning of this section have resulted in the development, within the framework of the German foreign exchange regulations, of rates for *Sperrmark* (stopped Marks), which differ from the official mark rate maintained by the German foreign exchange control; this must not be regarded as representing the real value of the German currency, but as a reduction imposed upon a foreign creditor desiring the immediate realization of his frozen mark claim abroad. It was impossible to avoid this development. But taken as a whole, it is due to the indebtedness rather than to the foreign exchange regulations.

4. Denmark.

From two points of view, the Danish foreign exchange measures are particularly interesting: the combination of devaluation and foreign exchange regulations and the Danish foreign exchange strike. The rôle played by foreign exchange control in Denmark since the autumn of 1931 has caused us to include this country in the series of those applying a similar system.

During the post-war period, Denmark had to cope with serious difficulties in the matter of exchange rates. Only in 1926 was it possible to bring them to par. This was done by means of deflationary measures aided by important commercial credits. In 1931, when similar difficulties recurred, Denmark drew the conclusions imposed by its post-war experience.

The Danish Krone was devalued on September 29th, 1931, in order to maintain the considerable export trade in agricultural produce with England. As described in more detail in Part II of this report, the rôle of foreign exchange control in the devaluation countries was to prevent a further sinking of rates. Other devaluation countries have endeavoured to consolidate and equalize the new foreign exchange rates by the creation of an exchange equalization fund. For the creation of such a fund, the country in question must be able to mobilize the necessary liquidities. What should be recalled is that, during the currency crisis of the first post-war years, Denmark already had to resort to foreign loans in order to create a stabilization fund, and in March 1924,

when the fund was exhausted, to consolidate foreign exchange rates on the basis of regulations for the control of the internal foreign exchange market. In 1931, it was obvious that Denmark would no longer be able to rely on foreign credits ; it was therefore obliged, in addition to devaluation, to institute foreign exchange regulations. This decision was probably all the easier, in so far as the earlier experiment with the stabilization fund of 1924 had not been particularly successful. (The fact that it was possible to undertake further stabilization on the basis of a special credit, is explained by the amount of the latter and the relative prosperity of the period in question.)

From 1928, the Danish imports were constantly and increasingly in excess of exports. The difference amounted to 117 and 135 mill. Kr. in 1930 and 1931 respectively. The surplus balance for ocean freight, transit traffic and other small items was not sufficient to make good the deficit, owing to the deficitary character of the balance of interests. This situation resulted, during the critical years, in a rapid decline of the foreign exchange reserves of the Central Bank and other banking establishments. In the Central Bank, they decreased from 106 mill. Kr. in January 1930 to 45 mill. in September 1931. In May 1932, they fell to a minimum of 17 mill. Nor, despite occasional improvement, was there any general recovery during the following years. The balance of payments was also unfavourable to Denmark, although the net foreign indebtedness of barely 1 milliard (January 1930) did not appear to constitute a critical factor.

For these various reasons, a law for the protection of Danish currency was passed in November 1931. According to this law, foreign assets had to be converted into Danish currency. The importation of foreign securities and the exportation of capital were supervised. These judiciously wary measures, accompanied by credit restrictions, were not entirely successful, the less so, as the latter measures were almost immediately repealed. In January 1932, general import restrictions became necessary. Importation was made subject to foreign exchange authorizations. Of the total quantity of goods imported in 1931, more than half was subject to these restrictions. Temporary regulations for the remittance of foreign currencies were imposed. There were later transformed into a mere obligation to convert foreign currencies into Danish. This marked the beginning of the "foreign exchange strike".

The prosperity of the Danish agricultural enterprises, which are heavily indebted, depends upon the rate of exchange received in payment of their exports. The interest of agricultural circles lay in progressive devaluation, the more so as other countries had restricted the amounts of the goods imported from Denmark. Foreign exchange control was, as has been seen, intended to prevent further sinking of the exchange rates. It was but natural that agricultural circles should oppose methods and measures of the Danish foreign exchange control organization. The "foreign exchange strike" broke out after the foreign exchange remittance regulations had been transformed into conversion regulations, just before the autumn elections of the past year. The farmers granted their foreign customers longer delays for payment, endeavoured to use foreign exchanges for inland payments and thus to prevent the centralization of foreign exchanges by the Central Bank, in order to force the latter to higher estimation of the foreign rates. The Central Bank took up the fight immediately by raising the discount rate, with a view to increasing the cost of credit for agricultural debtors. The strike, which for obvious reasons was doomed to a short career, received its deathblow in the form of the re-instatement of the regulations imposing the remittance of foreign exchanges.

This not uninteresting case is in certain respects characteristic of the vicissitudes of a country instituting supervision of international payments. As seen elsewhere in the case of other countries, the functioning of this system is largely dependent upon all-comprehensive and stringent regulations.

In conclusion, it should be pointed out that, in Denmark as in other countries, foreign exchange control proved a stimulus to industrialization tendencies.

5. *South American countries.*

What characterises South-American countries is that several of them — compared with European countries — were at an early date unable to maintain the legal parities. In Brazil, the difficulties began in December 1929, in the Argentine and Paraguay in November, in Uruguay in April 1929, in Venezuela in September 1930, in Bolivia in January 1931, in Chile in the summer of 1931, in Ecuador, Columbia and Peru in the course of 1932. Depreciation has in certain cases assumed extraordinary proportions : the figures for March 1935 are as follows :

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Argentine 55,7 %	Ecuador 50,7 %
Bolivia 59,5 %	Peru 49,1 %
Brazil 59,3 %	Uruguay 54 %
Chile 75,3 %	Venezuela 19,7 %
Colombia 67,1 %	

The rates concern foreign exchange transactions at the Central Banks. As regards the "free rates", the depreciation is still more marked; in March 1935, the figures for the following countries were :

Argentine 64,71 %	Ecuador 71,83 %
Brazil 69,36 %	Uruguay 77,89 %
Chile 79,81 %	

It is important to note that the above information as regards the outbreak of the difficulties in connection with foreign exchange payments is based on *official* rates — except in the case of Chile. On the foreign exchange market, however, premiums were paid at a still earlier date. In Peru, for instance, if we base our estimates on market transactions instead of official rates, we find that the difficulties date from 1930.

We emphasize this fact, in so far as date is an important factor in the study of foreign exchange regulations in the South American States. The regulation of foreign exchange payments was not introduced in Paraguay before the end of 1932 — in the Argentine in October 1931 — despite the fact that in official quarters the official rates had been set aside in November 1929. In Brazil also, the introduction of foreign exchange control followed at some distance the beginning of the decline of the foreign exchange rates (May 1931 compared with December 1929). The situation is similar in Uruguay, and also in Bolivia. In Chile alone, the beginning of the unofficial devaluation coincided with the introduction of foreign exchange control.

As we shall see later, the introduction of foreign exchange regulations was intended in most South American countries to prevent, if possible, further devaluation. It must, however, be admitted that — as seen from the above indices — this aim was not invariably pursued with the utmost energy. Instead of envisaging *universal* supervision and regulation of the foreign exchange market the South American countries concerned themselves mainly with procuring foreign exchanges for the foreign

debt service. This was in so far of vital interest as foreign debts are naturally contracted in foreign currencies. The avoidance of an increase in the debt service by means of exchange remittance regulations based on former official rates would in the main have satisfied public requirements in the debtor countries. Thus, in many cases, it would seem as if the South American countries had from the very beginning only envisaged partial foreign exchange control, with a view to cheap purchases of foreign exchanges for the purposes of the debt service. It is impossible for us to share this opinion, in the first place, because appreciable endeavours were made with a view to the general organization of the exchange market, in the second, because it was owing to already advanced devaluation that the South American countries were obliged to confine themselves to such partial control.

To understand thoroughly the currency developments in South America, it is necessary to bear in mind the position of these countries as exporters of raw materials¹ and their heavy indebtedness. As regards the latter factor, it is reckoned that foreign investments in the Argentine amount to an approximate total of 4 milliard dollars (U.S.A.) (1935). The foreign public and private debt service is estimated at 180-195 mill. gold pesos per annum. Foreign capital invested in Chile is estimated at 1 1/4 milliard dollars (1931), in Brazil at 3 milliard dollars for the same year.

It is a wellknown fact that these three countries were unable to continue the foreign debt service during the depression. The capital influx ceased with the outbreak of the depression and the export surplus had to be reserved for the debt service, the financing of emigrants and other purposes. But the export trade declined enormously, by fully 70 % from 1929 to 1934. In the Argentine, the export surplus sank from 880 mill. RM. in 1928 to 209 mill. RM. in 1934. Brazil's export surplus fell from a 1931 maximum of 450 mill. RM. to 192 mill. RM. in 1934. The Chilian export surplus of 383 mil. RM. in 1928 was replaced by a deficit in 1930; in 1934, the balance was of 76 mill. RM. in Chile's favour.

These difficulties necessitated import restrictions as well as reduction of the foreign debt service. In this respect, the

¹ It is necessary to recall the divergence of the price movements of raw materials (export) and industrial wares (import) at the beginning of the depression.

Argentine is the most favourably situated of the ABC States. Owing to advance repayments, in October 1934, with the aid of the foreign exchange reserves of the conversion fund, it was able to undertake conversion of loans on the London market. This resulted in a considerable economy as regards the debt service and the foreign exchange balance. The Argentine was also extremely successful in the settlement of frozen commercial credits. The situation in Brazil is far less favourable. The amortization of foreign debts ceased altogether in 1931 and was followed by restriction of the debt service on the basis of the Aranha plan. The shortage of foreign exchanges was in 1934 so great, that difficulties also arose in connection with the transfer of the reduced amounts. The most unfavourable circumstances are to be found in Chile, which was obliged in August 1931 to proclaim a complete moratorium. The law of January 31st 1935 resulted in the partial resumption of the service of the long-term foreign debts. The extent of this service depends upon the readiness of other countries to buy Chilean saltpetre and copper.

We will now briefly review the foreign exchange regulations of these countries. For South American countries, it is generally admitted that a free and unofficial market has managed to exist alongside the officially regulated exchange market. This makes it difficult to gain a definite idea of the situation, which is in many respects complex. In addition to centralized foreign exchange trade, we find both a clandestine and a semi-official traffic ("graue oder schwarze Börsen"). The existence of this traffic shows that the currency authorities have not succeeded in entirely carrying out their intentions. This is partly due, at all events as regards the extent of the traffic) to a decision not to pursue centralization of the trade in foreign exchanges with the utmost energy and stringency. The result is that, in various countries, official rates have been gradually adjusted to those formed on these free markets which are tolerated by the authorities. This is particularly evident in Chile where a twofold reduction of official rates led to the approximate assimilation of free and official rates at the beginning of 1935. If the reader refers to the figures given at the beginning of this section, he will be able to appreciate the correctness of this statement. In frequent cases, the difference between official and free rates does not exceed a few points.

All this has an important bearing upon the question which

continually arises in this connection and which is dealt with in Chapter III of this report : Is it possible to abolish foreign exchange control? The South American countries, it has been stated on various occasions, are no longer far distant from this point. This cannot be doubted. On the other hand, it cannot be denied that in the countries in question this result has mainly been achieved owing to the above-mentioned adjustment to the free rates, i.e. by concessions to normal market tendencies. Taken as a whole, therefore, the foreign exchange regulations in the South American countries with which we are concerned have but resulted in the modification and slackening of an inevitable process of devaluation.

From this it is naturally possible to draw the conclusion that the foreign exchange policy of the South American States has produced few or no results. This we consider is due, doubtless in part, to the characteristics peculiar to those countries; but we would also suggest that the principal reason lies in the specific object assigned to foreign exchange control in those countries. This point is mentioned above and considered further in Part II.

On the other hand, it is clear, from this adjustment of official to free exchange rates, i.e. in particular from the extreme depreciation of the South American rates in question that, for heavily indebted countries obliged to make high payments in foreign currencies, the liberation of the foreign exchange market in times of depression must inevitably lead to disproportionate and — in the long run — not particularly successful devaluation.

The opposition between the official exchange market and the unofficial traffic ("schwarze Börsen") did not, as we have already seen, last very long. For the relations which have gradually been established between the two markets, the Brazilian Casadinha-traffic affords easy and suitable modes of settlement. The operations described under this heading take place as follows : foreign exchanges received in payment for exports are remitted as usual to the Banco do Brazil. The Bank, however, does not circulate them in the form of allocations, but authorizes a broker to sell these exchanges at a premium on the free market. There would be nothing particularly unusual in this procedure, if it were not subject to the following restriction : the broker is authorized to sell these foreign exchanges exclusively to purchasers who are in possession of an import or exchange certificate. Casadinha-traffic therefore amounts to circulation on the free

market of exchanges remitted in accordance with the foreign exchange regulation, but their escape from such control is only apparent. For further sale of such exchanges is only authorized in the case of purchasers entitled to receive foreign exchanges. This is one of the methods by which assimilation of the various official and unofficial markets has been achieved. (In the winter of 1932-1933 the share of the semi-official Casadinha-traffic in the foreign exchange market of Brazil was estimated at 20 %).

The space at our disposal permits of a summary review of the exchange regulations of only one country. We will take Brazil as an example. In the light of the above observations, the fact that the initial attempts and measures of foreign exchange control were conceived on stringent lines and — comparatively — rigorously carried through, is hardly a matter for surprise. The fact is that in autumn 1931, the entire trade in foreign exchanges was centralized in the Banco do Brasil. Foreign exchanges could be remitted or bought only through this agency. In any case, foreign exchanges had to be offered to the Bank. Imports were subject to authorization, generally issued by the Bank on presentation of the import documents.

At a later date, those originally stringent regulations were relaxed. During the second phase of Brazilian foreign exchange control (autumn 1934), the whole of the export returns in foreign exchanges was liberated for sale on the free market. Coffee export was, however, subject to remittance of 155 fr per sack. The foreign exchange reserves thus constituted enabled the Bank to meet the requirements of the State and to allocate foreign exchanges to authorized importers. But the latter could only purchase 60 % of their requirements at the official rates. The remainder had to be purchased on the free market. In the allocation of the said 60 %, preference was given to traders importing wares from countries recognized as Brazil's best coffee customers.

January 1935 saw the beginning of a third phase in Brazil's foreign exchange control. Importers were obliged to purchase 65 % of the requisite foreign exchanges on the free market and received only 35 % at official rates. As, however, — as already seen — there is very little difference between these two rates, this is merely a step towards the coming of more or less all important requirements on foreign exchanges at rates governed by those of the free market.

II. *Considerations concerning foreign exchange control.*

Regulation of the foreign exchange market is probably exposed to more criticism than any other form of State economic control. In many quarters, foreign exchange control is considered as the outcome of an exaggerated and — in view of its intensive character — unsound form of State intervention. In our view, it is only possible to endorse this opinion, if it were proved that the countries which have instituted this system could successfully have applied other methods. As shown in the previous chapter, the countries in question were not in a position to do so. The introduction of foreign exchange regulations must therefore be regarded as an unavoidable evil. It remains to be seen whether the system has, to some extent, functioned satisfactorily and what has been the experience of the various countries.

1. *Foreign exchange control and gold exchange standard*

Before dealing with this question, we must revert to a point which we were unable so far to discuss. We have seen that the necessity of foreign exchange regulations arose from the special economic situation and structure of certain countries. In this connection, we have borne especially in mind the question of international indebtedness and balances of payments. But attention must be drawn to the fact that foreign exchange control can also be considered from a higher standpoint — namely as the development, under the pressure of the crisis, of that branch of central banking policy which constitutes a special feature, it may be said, the essential peculiarity of the gold exchange standard. By this is meant the exchange policy of the Central Banks which is one of the most important tasks accomplished by the latter within the framework of the gold exchange standard. The object of the latter standard is to bring about fluctuations of the foreign exchange rates by the purchase and sale of foreign assets and instruments of payment rather than by the export of gold. In certain respects, it is possible to regard the foreign exchange policy of the Central Banks within the framework of the gold exchange standard as the holding and regulation of foreign exchange reserves, the increase or decrease of which constitutes a cheaper and prompter method for prevention or compensation

of exchange fluctuations than actual movements of gold. We are not called upon here to examine the connection between short-term international indebtedness, in so far as determined and produced by the gold exchange standard (indebtedness of Central Banks), and the outbreak and development of the depression. For it is well known that the gold exchange standard and the foreign assets necessary for its functioning constitute a noteworthy factor in the depression and one that has, at all events, contributed to its aggravation. The events of the depression led to the collapse of the gold exchange standard in its earlier form. At the end of 1932, the net exchange reserves of the Central Banks amounted to only a quarter of the exchanges held in spring 1931 before the outbreak of the depression. This decline is a result of the measures taken by creditor countries, which abandoned the earlier foreign exchange policy by reconverting into gold their short-term holdings in the Central Banks. Other countries were not so fortunate as to be able to apply this method. They were unable to convert their reserves and return to the gold standard pure and simple. For, owing to the run of creditors and flight of capital, their reserves dwindled away in the course of a few months. The only course open to them was to transform their earlier foreign exchange organization into an organization designed to cope with shortage of foreign exchanges. The foreign exchange crisis in countries which have instituted foreign exchange control dates, as we have already seen, from further back, and has been caused by indebtedness. On the other hand, the gold exchange standard has too often served to conceal the latent existence of this crisis. Finally, the only road to salvation lay in the transformation of the earlier system into one of foreign exchange control and the monopolistic re-organization of the foreign exchange market.

2. Foreign Exchange Control and Quantitative Regulation

We have seen that the object of both mild and strict forms of foreign exchange control is the maintenance of an earlier parity. Methods to this end take the form of the quantitative regulation of the foreign exchange market. Quantitative control and market regulation in general are by no means new departures in economic life. Their inception is largely due to the initiative of enterprises or to State intervention. But attention must be drawn to the fact that the far-reaching national and international economic effects of the quantitative control of the

foreign exchange market are due to the key-position of the said market. Foreign exchanges are, more than any other economic capital, means to an end. It is therefore natural that the specific effects of foreign exchange control should be felt by vast sections of national and international trade.

The inevitable criticism of foreign exchange control from this point of view may be countered with comparison of the effects of an exchange equalization fund. It has rightly been pointed out, in other quarters, that an equalization fund is also an interruption of inter-State economic relations. The fund serves to prevent rate fluctuations which may be necessary in the interest of economic development. The holding up of long-term fluctuations by this method prevents the adjustment of the economic situation of the country in whose exchange policy the fund plays its part to the economic situation in other countries. The exchange equalization fund, therefore, also leads to a kind of economic isolation and, in a general way, prevents the rapid adjustment of the economic situation in one country to developments in another.

The results of foreign exchange control are, as is known, similar. But the measures applied under this system are of far greater stringency and go deeper. The difference between the two systems is therefore one of "nuances". But something must be added. The exchange equalization fund, with the limited means at its disposal, is unable to hold up fluctuations of a durable character, whereas foreign exchange control, if backed by sufficient power and organizing capacity on the part of the authorities, is in a position to prevent both durable and temporary fluctuations of the exchange rates. Foreign exchange control therefore impedes the free interplay of economic forces; hence its unfortunate effects upon world trade.

3. *Experience in foreign exchange policy*

To form an opinion in regard to experience with the regulation of the foreign market, it is necessary to avoid dwelling on this point to the exclusion of all others. For the fact that countries instituting this system were not in a position to do otherwise obliges the critic to regard this consummation as inevitable. But with this statement, the subject of foreign exchange control is by no means dismissed; on the contrary, it is but the enunciation of the problem. We must then ask whether the measures in-

troduced by countries with foreign exchange control have successfully fulfilled their specific purpose. Secondly, we must raise a question which may be of decisive importance. We have seen how foreign exchange control was intended to neutralize factors rendering impossible further collaboration between certain countries on the old economic basis. Our question is whether the period of foreign exchange control has also been one of preparation for the gradual and complete elimination of those forces which would have destroyed international economic relations on their former basis? In other words: has foreign exchange control tended towards the elimination and final abolition of the factors in question? Generally speaking, we believe that this question can be answered in the affirmative.

But we will now first deal with the former problem and examine results in the strict sense of the word — i.e. whether countries with foreign exchange regulations have succeeded in maintaining the former parities?

It is impossible to give a general answer to this question, which we have already touched upon in the sections of the report dealing with individual countries. We have already recalled that foreign exchange regulations differ considerably in the various countries and that, in many cases, their object is different. Generally speaking, it may be stated that there are three distinct forms of foreign exchange control. Experience differs in each of these cases and this makes it impossible to form a general opinion in regard to the success of this policy in the strict sense of the word.

The immediate object of foreign exchange control is the regulation of foreign rates of exchange. A series of countries introduced this system with a view to preventing depreciation, as soon as maintenance of the earlier rates appeared doubtful. We have, therefore, in the first place, countries which immediately replied to the menace of foreign exchange difficulties with the introduction of foreign exchange control. This group include, in addition to Germany, Hungary, Czechoslovakia and, in certain respects, Chile. Rumania might also be regarded as belonging to this group. In these countries, the purpose of foreign exchange control was from the outset the maintenance of the former rates. In order to succeed, it was necessary from the very beginning to organize control in such a way as to be able to cope with all difficulties. In any case, the foreign ex-

change control in these countries had to be conceived on a comprehensive basis and strictly carried through. With the aggravation of the situation, these countries — in view of the purpose inherent in their regulations — were obliged to apply more stringent methods of supervision and allocation.

Not all countries included in this group were able to achieve the aims they had in view. In this connection, it is possible to refer to Chapter I and also to add that the measure of the success depended upon the capacity of the control authorities and the docility, of enterprises, brokers and bankers.

Apart from the countries considered under the first group, there is another small group, in which the significance of foreign exchange control was from the outset entirely different. In the latter, the first steps in the matter of foreign exchange policy date from the beginning of the depression and took the form of devaluation. This is the case as regards Denmark and Norway. These countries followed the British devaluation lead, in order to maintain their international trade. But what does such devaluation signify? Generally, not that the country which has devalued has definitely gone off gold or merely stable rates. On the contrary, it is necessary to envisage at least a relative consolidation of rates at some new level. As shown in practice, countries require special assistance in order to adjust the rates to such a new level. Among them, Great Britain, the United States and Belgium work on the basis of an exchange equalization fund. Such a fund can, of course, only be constituted by countries with a comparatively liquid money market. Also the critical situation of the foreign exchange market must not last too long, but must be re-equilibrated by the act of devaluation. (For countries which for both or one of these reasons are unable to resort to this method, there remain two alternatives : a foreign loan or foreign exchange control.) Since it was impossible to obtain foreign loans during the first months of the depression, Denmark and Norway resorted to currency devaluation hand in hand with supervision of foreign exchange payments. In this case, foreign exchange control served to consolidate the new rates formed on the basis of devaluation. Here, foreign exchange control is not the primary but the secondary agent of currency policy. The aim in view is regulation of exchange rates, but the principle of further devaluation is not set aside.

As in the first group, the general organization and specific

form of foreign exchange control is determined according to the purpose it is intended to fulfil. With a devalued currency, the regulation of exchange rates can only be successfully carried through if possible to institute a complete control of all the exchanges arriving in the country. On the other hand, it does not call for particularly stringent regulations. In the second group, therefore, we find comprehensive but not especially stringent regulations. This is particularly clear in the case of Norway, where the control is exercised by the banks in an extremely discreet form. In Denmark also, as seen from the section of the report dealing with that country, foreign exchange control is exercised in a relatively mild form. An example of this is the foreign exchange strike, rendered possible by the lack of stringency of the Danish foreign exchange law.

For the regulation of rates on the basis of devalued currencies, foreign exchange control has been extremely useful. At all events, it has ensured the fulfilment of the specific purpose envisaged.

In Spain and the South American States, we find a third type of foreign exchange control. In these countries, the rates had already declined before the currency authorities took effective measures of defence. When, in the further course of the depression, the countries in question envisaged foreign exchange control, the only question commanded by the general situation was to prevent an absolute collapse of the rates. Here the object of foreign exchange was not the maintenance of earlier rates; nor can it be regarded as an auxiliary of foreign exchange policy; its purpose was rather to act as a brake. It was not intended to reverse natural developments, but rather to mitigate them and, as stated above, to prevent an increase of international debt charges by organizing a section of the foreign exchange market on the basis of the former parities. The result was that, within this third group of countries, a new form of foreign exchange control developed in accordance with a different purpose. All-comprehensive control of the market is not a *sine qua non*. But within the scope of the control or within the section subject to regulations, the latter are applied with great stringency.

As regards the experiences of countries of the third group, there is not much to be added to what we have already said in Chapter I. In these countries, foreign exchange control has, in practice, merely resulted in a less prompt and cheaper public

debt service. The fact that the Spanish experiences appear to be more favourable — it was possible to secure the stabilization of rates of exchange at a not too low level — is due less to foreign exchange control than to a loan obtained in France secured by a lien on Spanish gold.

4. *Foreign Exchange Control and World Trade Recovery*

It is therefore impossible to form a general and comprehensive opinion as to the services which foreign exchange control has rendered to foreign exchange policy; this question can only be considered in relation to the different groups applying different types of foreign exchange regulations, as has been done in the previous sections. But we realized that the question of services in the strict sense of the word is not the only and the decisive aspect of the problem. We must now consider whether the period of foreign exchange control is to be regarded as a partial basis and as a period of preparation for the clarification of the situation which led to the institution of the control. We have already pointed out that this question should, to our mind, be answered in the affirmative.

As already seen, various countries were, at the beginning of the depression or in the course of its development, unable entirely to fulfil the obligations arising out of their international indebtedness, but nevertheless hesitated to resort to devaluation. Countries which — like the South American States — nevertheless resorted to devaluation have not been particularly successful. Foreign exchange control was therefore inevitable. Its institution made it possible to gain a clear and comprehensive view of the difficulties of the situation in which various countries were placed. Foreign exchange control has brought into the foreground the already existing problem of international indebtedness and with it that of its settlement, an extremely important and serious question for all nations. Foreign exchange control which in view of the export shrinkage could not provide a guarantee for the full debt service, has at any rate led to a more serious discussion than in the past of the difficult problem of international indebtedness. Foreign exchange control has thrown the debt question into sharp relief. And once a problem has been clearly and correctly enunciated, its solution is not far off.

A similar statement — partly in connection with the above

— may be made in regard to external trade. It remained for foreign exchange control to show with the greatest of clarity that countries which cannot expect a regular influx of foreign exchanges from important foreign assets, must have an export surplus or, at the very least, an equilibrated trade balance. It is impossible to shirk this problem if all countries are to receive durable and relatively certain guarantees for stable exchange rates. Here we touch upon a point that has been severally discussed in other connections. The export of industrial wares by States which have no foreign capital should not be hampered by restrictive measures on the part of other countries. (This argument is naturally still stronger when applied to countries which at the same time require foreign exchanges for their international debt service.)

The stressing of these interdependent circumstances under the pressure of foreign exchange control was inevitable owing to the fact that in many cases it became necessary to institute bilateral clearings in the stead of the former multilateral clearings. We have in mind the example of the Germano-American economic relations as well as that of the German and Brazilian exchange of wares. The cultivation of cotton has increased considerably in Brazil, and, on account of the foreign exchange situation, Germany purchases more cotton in Brazil and less in America.

It will be remembered that these developments have in the first place been facilitated by the payment agreements. We have already mentioned this point and we propose to say a few words in conclusion. In order to form a judgment on the essential characteristics and results of foreign exchange, it is necessary to envisage its subsequent development and not to confine oneself to the initial conception. This later development has been influenced by clearing and payment agreements — above all, by the latter. This development can be briefly summarized in general economic terms. In the beginning, foreign exchange control was an *autonomous* act of individual states. Later, owing to the payment agreements — it became to some extent a *treaty obligation*. That is, rates, or in any case fluctuations of rates of exchange are during the period of the validity of the payment agreements no longer determined by one State alone.

It should be pointed out that a very considerable part of the external trade of a country goes through such payment agreements. In the Argentine, imports on the basis of payment agree-

ments are estimated at 44,5 % of the import total of 1935, exports at 56,9 % of the export total. For Germany, external trade on a free rate basis is estimated at 20 %; the share, passed through special foreign accounts (ASKI), at 20 %; the remaining 60 % is settled through the payment agreements.

This shows that the relation between, as it were artificial, foreign control and the processes and requirements of economic development is closer than may appear to the uninformed observer.

III. *Gradual abolition of foreign exchange control*

The reader may have wondered why Austria was not dealt with in the section reviewing the situation in certain countries (Chapter I). It is true that, but a short time ago, Austrian foreign exchange control would have headed the list for historical reasons. Austria was one of the first countries to institute this system. But to-day, it is necessary to deal with Austria under the heading « gradual abolition of foreign exchange control ». Owing to foreign aid, Austria has been able to alleviate and relax the extremely strict regulations formerly imposed on the foreign exchange market. From this point of view, the case of Austria is of special interest. What circumstances made it possible for Austria to proceed with the relaxation and gradual abolition of the foreign exchange regulations?

A closer examination shows that Austria was able to achieve partial order in certain economic circumstances which we described above as disturbing factors. We regard this example as the endorsement of those observations.

The alleviation of the foreign exchange situation in Austria results from a series of events, which may be briefly summarized. First, the 1933 loan; secondly, and most important, the 1934/35 conversion of the League of Nations loan; thirdly, strict import restrictions, and, finally, the lowering of the exchange rate of the Austrian schilling. The institution of the private clearing played an important part in the successful issue of the devaluation. A final point, which should also be borne in mind, is the improvement of the balance of the tourist and hotel industry.

Austria's example shows that the indispensable conditions for the gradual abolition of foreign exchange regulations are not impossible to realize. The general and durable application of the

new order depends upon the decisive character of the measures of reconstruction. That is : it must not come from outside, but must be based on the innermost forces of a country. Envisaged from a more general standpoint, it is certain that at least the principle of such reconstruction could be admitted in the case of several countries.

If, as we suggested above, foreign exchange control has in itself been one of those factors which have prepared and promoted such reconstruction, it has indeed rendered its greatest services. What remains is to abolish as rapidly as possible a general system which, under pressure of circumstances, has admittedly caused so many and varied disturbances in international trade.

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February 1936.

(Signed): Andreas PREDÖHL.
Harald FICK.

**Memorandum
on the
possibilities of the sterling area**

by

Professor T. E. GREGORY,
Professor of Economics, University of London

- I. Can a repetition of the situation of 1931 be prevented in the case of Great Britain ?
 - II. The case for a universal "pegging" to sterling.
 - III. What would be the rôle of gold given a permanent continuance of three or more groups of countries with different standards ?
 - IV. To what extent are the countries of the British Empire, Scandinavia and the "unofficial" members of the sterling group likely to hold together ?
- I. *Can a repetition of the situation of 1931 be prevented in the case of Great Britain?*

It appears to me that the situation of the autumn of 1931 was a combination of the very special adverse circumstances I enumerate below :

- a) Firstly, a generally unfavourable cost-price situation due to the depression;
- b) A rate of exchange which was unsuitable to the circumstances of Great Britain even before the depression began;
- c) A world situation in which London had to receive too large "refugee" monies and which therefore exposed the London money market to the danger of a sudden withdrawal of funds whenever the outlook of Great Britain became unfavourable;
- d) A political situation considered to be unfavourable by foreigners. There was a general feeling that the Government in power at the time was unwilling to face the special budgetary difficulties at the moment, as well as unwilling to face the generally unfavourable situation created from the standpoint of Great Britain, by the rigidity of the British costs;

e) There was, in Great Britain, a growing malaise due to the unbalanced international situation elsewhere. Not only did this unbalanced international situation lead to an influx of funds to London — it created a general psychological atmosphere of depression;

f) It is quite impossible to guarantee that there will not be at some time in the future a repetition of this particular combination of circumstances, but it is improbable that the special historical circumstances of 1931 will repeat themselves in detail. It must be remembered that if the world chooses to peg permanently to sterling, the "rules of the game" will be in Britain's hand, and if, on the other hand, there is to be a return to the gold standard, the factor which was particularly unfavourable to Great Britain in the course of 1931, namely: an unsuitable rate of exchange, can be avoided in the future. A return to the gold standard would involve the revaluation of the gold stocks of the Bank of England at the rate of 140 shillings per ounce, which would result in a continuation of the cheap money policy hitherto pursued by the Government and the Bank of England. It is true that, in the absence of exchange control, nothing could prevent an influx of funds into London if the situation elsewhere were unfavourable. On the other hand, the technique practised by exchange equalization funds has given the central authorities in England a sense of confidence which they probably did not possess 5 years ago. On balance, therefore, it may be suggested that the very peculiar circumstances of 1931 are not likely to be repeated.

II. *The case for a universal pegging to sterling*

The argument for a retention of the system by which a considerable proportion of the overseas world is at present linked to currencies bound to sterling, can be stated as follows:

a) Whatever the extension of quotas and tariff legislation in Great Britain may be, Great Britain shares with the U.S.A. the position of being the market for a large part of the overseas raw material producing world. From the standpoint of countries like Argentine, Australasia, Canada, etc., the necessity for retaining a proportionate share of the British market is almost overwhelming and from this point of view, this particular consideration probably outweighs all others;

b) Currency and political instability elsewhere has made London the world's reserve centre, not only for the Central Banks but also for the commercial banks. It is quite clear that serious losses would ensue for many countries if their currencies were allowed to appreciate in terms of sterling. This is the same thing as saying that from the strictly financial standpoint, it pays to maintain the sterling basis for local currencies;

c) It is impossible to predict in detail what the future of international lending is likely to be. It is at any rate certain that some countries (e.g. China and South America) have not yet been presented with the complete apparatus of public works, etc. which they require if the standard of life of their populations is to go up. In view of the psychological difficulties in New York and in Paris, and the inability of other centres which might in the past have furnished some of the necessary funds (e.g. Berlin), it is certain that the only centre to which the world can look for any free flow of capital, is London. Since capital issues in London are bound to be made in terms of sterling, it is clear that it is to the advantage of the borrowers to maintain the local currency at par with sterling, since it eases the transfer problem;

d) From the standpoint of the countries at present forming part of the sterling club, the predominant question apart from the economic issues just mentioned, concerns the powers and capacities of the Central Banks and the Treasury. From this point of view, Great Britain is in an extremely favourable situation. The Bank of England has, for generations, commanded the confidence of the world. There is no belief that the Bank of England manages the pound sterling from any other angle except that of the public good. Nor is there any belief that the authorities of the Bank are mere creatures of the political changes which may occur from time to time. Nor does Great Britain suffer from a Treasury which is the subject of political domination. The British Treasury is not likely to pursue a policy of budgetary disequilibrium because it does not possess the necessary fiscal courage. It is, of course, not possible to guarantee that in the future public opinion may not undergo a drastic change, but things being what they are, it is possible to look forward to a moderate policy being pursued both by Central Banks and by the Treasury authorities. This being so, reserve balances kept in London, and currencies pegged to sterling, are not likely to suffer any appreciable reduction of their internal purchasing power;

f) Nor is it probable that any alternative Government coming into office in Great Britain, is likely to pursue any violent policy of changing the internal purchasing power of the pound. The truth appears to be that any alternative Government to the present one is likely to pursue very much the same policy that has been successfully pursued in the last 3 or 4 years. No one, of course, can guarantee the outlook in so unsettled a world as this, for more than a limited period of time, but, on balance, there appears to be nothing in the movements of British public opinion to lead one to suppose that any very violent change is in prospect. Under these circumstances, the various countries pegging themselves to sterling have not to run the risk of any revolutionary change.

III. *What would be the rôle of gold given permanent continuance of 3 or more groups of countries with different standards?*

In dealing with this subject, I assume that there might be for some years to come :

- a) A sterling group;
- b) A gold standard group, including France and the U.S.A.;
- c) A group (including Germany and Italy) nominally on the gold standard but actually pursuing a mixed policy of currency depreciation and exchange control.

Under these circumstances, the rôle of gold might remain more important than appears at first sight, for the following reasons :

a) A continuous régime of tripartite division of standards would assure the continuance of uncertainty. Events in the last few years have shown that every increase in the degree of uncertainty with regard to the future of currency standards involves an increase in the amount of gold hoarding. Consequently, the probability is that if the world were to be permanently divided into three or more groups of currency standards the amount of gold hoarded in public and private accounts would increase. In other words, the significance of gold as a store of value would continue to be accentuated;

b) Secondly, every contraction of the areas upon an orthodox gold standard would diminish the fear that there is an insufficiency of gold. Further, the central banks of countries with depreciating currencies are in effect adding to the "invisible"

supply of gold due to the circumstance that if they ever chose to revalue, their reserves would be immensely increased;

c) Even if the world continues to be divided up into separate currency areas, the function of gold as a balancing item would continue to be very significant. Let us suppose that Great Britain were effectively to go off the gold standard. That would mean that the British pound could no longer be purchased by the presentation to the Bank of England of a fixed amount of gold. Nevertheless, this would not prevent the Bank of England from hoarding gold as an asset in very much the same way as some central banks hold e.g. dollars or sterling at the present time. In other words, it does not follow that even if no general return to the gold standard takes place, gold would not lose its function either as a store of value or as an asset among the other assets held by central banks.

IV. *Permanency of the sterling group*

No public declaration on the part of the Government of Great Britain has ever been issued pledging the Government to any definite future value of sterling. It is known that the British Government desires a rise of wholesale prices and it is known that it has actually practised a policy of "cheap money": but no pledges have been given, so far as I am aware, to any of the constituent members of the sterling group, on any other detail of currency policy.

The danger of a disruption of the sterling area can come in one or other of the following directions :

(1) Firstly, there may be local pressure for further devaluation. It is useless to conceal that there may be temporary disequilibria of the balances of payments which may make it worth while for a particular local area to reduce the sterling value of its currency. If e.g. Australia, finds that it cannot maintain the normal post-depression volume of its London balance, it may be tempted to resort to a further devaluation of the local Australian pounds. This would almost certainly be followed by a further depreciation in the sterling value of the Scandinavian currencies. There is, in other words, the danger of a break-up of the sterling area, not in consequence of a policy pursued by Great Britain, but in consequence of local pressure exerted in other parts of the world.

(2) The other danger is of the political or economic situation

of Great Britain itself deteriorating. It is not possible to state in detail what this danger is, but of course it is possible to envisage Great Britain being caught up in a European war or being engaged in military activities against other powers. It is fairly certain that in the modern world, the first resort of any Government under those circumstances would be towards inflation, and the countries who have been in the habit of maintaining their reserve balance in sterling, would, under those circumstances, be driven to transfer their balance elsewhere and allow their local currency to vary in terms of sterling. It is not for one moment suggested that difficulties of this kind are at all impending or probable, but in weighing the advantages of the coherence of the sterling area, they must obviously be taken into account. It is also possible to imagine a sudden and quite unforeseen check to the process of internal recovery in Great Britain itself. This might lead to the development of extreme policies, either by the right or by the left, which would have the effect of driving away a large proportion of the refugee money at present maintained in Great Britain, and, further, might make sterling an unsettled currency to hold by foreign central banks. In other words, an intensification of the political difficulties of Europe, or a sudden reversal of the tide of economic recovery in Great Britain, might very probably alter the currency situation of the country. If such major changes in the political or economic situation were to take place, it might prove to be impossible for the responsible organs of the Government to make their will felt against public opinion, face to face with the startling changes in the situation.

(3) It must be remembered that part of the attractiveness of the sterling area to new entrants has been due to the difficulties shown in exchanges elsewhere, and the future of the sterling area might be made very much more difficult if e.g. the outlook for the French franc were to become more certain than it is at the moment of writing this. Part of the attractiveness of joining the sterling area at the present time consists in the circumstances that although no currency is certain, nevertheless the totality of conditions in Great Britain and the sterling area is more favourable than elsewhere. If conditions outside the sterling area were to be improved, while conditions inside the sterling area were to deteriorate, the attractiveness of adhering to the sterling bloc might undergo a sudden change.

May 1936.

(Signed): T. E. GREGORY.

**Memorandum
on the
technique of the forward exchange market
and the elimination of uncertainty**

by

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Scope of the memorandum and general remarks

The questions the present memorandum is to answer are not limited to the possibilities of eliminating the risks of fluctuating exchanges by way of the forward exchange market, but also cover the elimination of the consequences of the fluctuations of the exchanges under the present circumstances, by way of the forward exchange market. The distinction is material, for a fluctuating exchange rate is not only a phenomenon which has direct repercussions on the calculations of those engaged in foreign trade, but is also a cause of all kinds of changes in economic life, which might be of even more importance than the exchange fluctuations proper.

One could go even further and consider the exchange fluctuations themselves as symptoms of underlying changes taking place in economic society, which changes of a manifold character manifest themselves in the fluctuations of the exchange rates. Of these forces which form the essentials of the dynamics of economic life, the exchange fluctuations might be as well the effects, as the causes. It is open to question whether the economic changes of which the exchange fluctuations are commonly considered to be the causes, are not in reality *soi-disant* a continuation of those dynamical phenomena, of which the exchange fluctuations are often thought to be the effects. Under this assumption, the exchange fluctuations should even be a symptom of those economic changes, of which they are generally considered to be the moving forces.

An example might illustrate this line of thought. An inflation will lead to an upward movement of prices; and under normal circumstances the advance of prices will cause an increase of imports and a decrease of exports, i.e. a so-called unfavourable balance of trade and consequently a decline of the value of the currency of the country in question. But the inflation also leads to a direct flight of capital which also makes the currency go down. (Here the exchange fluctuation is but a symptom and moreover of more than one direct factor.) The upward movement of prices often makes a continuation of the inflation almost inevitable. The consequences are a further deterioration in the balance of trade, a further flight of capital and a renewed decline of the purchasing power of the currency. But when this process is well under way, the downward movement of the currency will not seldom be considered as the real cause of the further deterioration in the balance of payments and of the further increase of prices. That this interpretation of the phenomena as they present themselves is apt to be incorrect, becomes evident, if, by action of the State, the rise of the foreign exchange rates is counteracted by an exchange control by way of a manipulation of the exchange market. If effective, the result will be that the symptom does not manifest itself. But even then the inflation (caused by an irresponsible financial policy), as a continuous process with the usual consequences, a rise of the price level and a deterioration of the real balance of payments, will be in progress.

The foregoing might lead to the conclusion that the instability of the exchanges is always only a symptom or rather one of the symptoms of dynamic changes of a general character in economic life. But for all that, to those engaged in international trade or international lending these exchange fluctuations are not merely abstract symptoms but a reality of vital importance. Foreign trade reacts promptly on these exchange fluctuations and this often psychological reaction has a direct and important influence on the essential changes which manifest themselves in the economic field. Practically therefore it is not incorrect to consider these further economic changes as caused by the exchange fluctuations although this might not be in accordance with the results a thorough theoretical analysis may lead to.

Moreover it should be recognised that these exchange fluctuations whatever their true character may be, are a real and sometimes even a decisive factor in the calculations of interna-

tional finance and international commerce. And it is this factor, the exchange risk proper, which requires attention first of all.

Different means of elimination of exchange risks

The fluctuations of the rates of exchange are a factor of uncertainty for all affairs and transactions which make necessary a transfer into another currency. In most cases this basic currency will be the currency of the State in which the trader or company concerned is established or the currency on which the trader or company bases their affairs. Many firms established in the Far East, South America, etc. will base their calculations on the currency of their home country or on one of the most important currencies, Pound sterling or Dollar.

The risks connected with the fluctuations of certain currencies in comparison with the basic currency, could, when a bill market exists in the country with the unstable currency, be eliminated by a drawing of bills on that country whose currency is unstable and a discounting of these bills, ultimately in the country with the fluctuating currency. Thus a future claim fixed in an unstable currency can be transferred into a claim payable on demand which can be sold in the ordinary exchange market, by a switching into the basic currency. If no bill market exists in the country with the unstable currency, or if the commercial or financial transaction involved does not allow of the drawing of a bill, the merchant could perhaps sell his future claim in blank, but in many cases it will not be possible to find a counterparty.

A future obligation made out in an unstable currency can be fixed in terms of the basic currency, by a direct purchase in the spot market of the currency to be paid on a future date, but this involves an immobilisation of liquid funds or necessitates a raising of credits on the currency purchased as collateral or otherwise. This is an inconvenience and moreover it involves further risks for the merchant or company who have to keep the currency bought until their obligation is due.

Generally speaking, trade and industry will not switch into the basic currency those claims and obligations which are counter-balanced by future obligations and claims in the same, or even another, fluctuating currency. An industrial firm, who buys his raw material in an unstable currency but who sells his products

in the same currency, will only switch the balance into the basic currency.

In both cases, the covering of future claims and the covering of future obligations, the forward exchange market proves to be a convenient medium. And nearly always it is not relevant whether the future claims are by way of acceptances or debits in account.

The forward exchange market, past and present

Before the world war, an international forward exchange market could not be spoken of. After the Crimean war an irregular market in forward rubels developed in Berlin, as a consequence of Russia's departure from the gold standard. This market remained more or less active for several decades. In Vienna and Triest now and then forward contracts in Pounds sterling and French francs against Austrian Kronen were dealt in. The often very sharp fluctuations of the South American currencies gave rise to a forward trade in these currencies. The autumn requirements of Dollars in the London market were often covered forward, but more often the seasonal weakness of sterling was anticipated by the drawing of finance bills on London in summer, in such a way that their due dates coincided with the more abundant supply of sterling in the autumn.

The forward exchange market was never more active than in the years after the world war, before the period of restabilization of the principal currencies (1925-1928). The most important factor working in the market was speculation, which brought about such an extension of the market, that its significance not infrequently equalled that of the spot market. After the stabilization of the exchanges the activity in the forward exchange market greatly diminished, and even the monetary events of recent years have not brought about a revival of the forward market to an extent comparable with that of the years just after the war.

At first sight it seems self-evident that all transactions in the forward exchange market should find their direct counterparty there, and that a firm who wants to sell a forward claim in a certain currency, due let us say two months hence, has to find a firm who wants to cover forward a commercial obligation in the same currency for the same amount and per the same date. Or perhaps that there must be a speculator ready to buy this claim.

outright in the forward market, as a bull speculation. Now the operations in the forward market very seldom take place in this way.

Nearly always the transactions are closed by way of the spot market, by means of swaps, transactions by which an interchange takes place between spot and forward claims in two currencies. If mention is made of the forward exchange market, nearly always the market in which these swap transactions are closed is meant.

This switching of the forward transaction to the spot market relieves the merchant or his banker acting as his agent from the necessity of immediately finding a counterparty for the forward currency. The bank who buys a certain amount forward from his client covers himself by selling an equal amount of cash in the spot market. The client has eliminated his exchange risk and even the bank has, by selling spot, eliminated the main risk. The Bank does not run an exchange risk proper, but it is not quite safe yet, for by having bought forward and having sold spot it still runs the risk of a widening or narrowing of the margin between the spot rate and the forward rate. Therefore the bank has still to interchange its forward purchase and its spot sale in the swap market. If the bank does not make this swap, it is speculating during the period covered by the forward transaction on the margin between spot and forward. Moreover selling spot of a certain currency is only possible if the bank has a sufficient balance of this currency on its *nostro* account abroad.

By interchanging spot and forward, in the first instance sold and bought separately, the bank balances the transaction by closing it. At a counterparty for this swap transaction another bank may come forward which on its part concluded a similar transaction for one of its clients in the opposite direction. But this means that there must be a demand for the forward currency, either from the side of trade, or from a speculator. But it happens to be that here a third factor working in the forward market or rather in the swap market, comes, in, i.e. the interest arbitrage.

Buying cash of a currency and selling it forward very often takes place as a separate transaction, as an investment in the currency concerned during the period covered by this swap transaction, whereby the exchange risk proper is eliminated by the forward sale. Each transfer of liquid funds for a limited period can be considered as an interest arbitrage, the profit equalling

the difference in the rate of interest in the two centres. If an interest arbitrage is connected with a swap transaction in the forward exchange market, the interest margin decreases or increases *pari passu* with the forward margin of the swap, i.e. with the discount or premium of the forward rate in comparison with the spot rate. The bank concluding this kind of swap should not ignore that if, during the period covered by the swap it wants to liquidate this transaction it will have to reckon with the widening or narrowing of the swap margin in the meantime.

Factors determining the forward margin and the limitation of the forward market

The forward market is influenced by three factors, the supply and demand for commercial purposes, speculation and interest arbitrage. The activity of these factors determines the scope of the forward market and the trend of the forward exchange rates, manifested mainly in the margin between the spot rate and the forward rate.

The interest arbitrage has a tendency to make the forward margin equal the net difference of interest between one money centre and another.

If, for instance, the rate of interest for three months treasury bills or other bills in the London market is 2 % and private discount in the Amsterdam market is 3 1/2%, a transfer of funds from London to Amsterdam, under elimination of the exchange risk by way of the swap market, may be expected as long as the discount for forward guilders in the London market for a period of three months is smaller than 1 % per annum, that is 1 13/16 cent per pound, if the exchange rate is taken at 7.25.

If speculation is not active, for instance when in both centres concerned the gold standard is maintained, the forward margin will show a tendency to equal the interest margin in the money market in the two centres. But even then this is not more than a tendency. There can never be said to exist an absolute correlation between forward margins and interest margins, because if for instance the rate of interest in Amsterdam is relatively high and the guilder is weak and the rate of the guilder is near the gold-point for export, the interest arbitrage will transfer funds to Amsterdam without covering this transaction in the forward exchange market, because one can be sure that, provided the gold standard is maintained, the guilder can hardly go down further.

Consequently, a forward sale of guilders at a discount will be senseless. Moreover, forward guilders thus offered would be taken up immediately by speculators so that the discount of forward guilders would not increase under these circumstances, notwithstanding the forward sales by the interest arbitrage.

This shows that the influence of interest arbitrage in the forward exchange market diminishes in proportion as the outright forward rate approaches the gold-points, or in the case of a pegged currency in proportion as the outright forward rate approaches the rates between which the currency fluctuates.

It should further be borne in mind that the deviation between the forward margin and the interest margin, i.e. the net interest profit, after elimination of the exchange risk, will be bigger if the interest arbitrage is preponderately one-sided. For the possibility of a transfer of funds to a certain money centre will always be limited, as the banks making this investment must take into account the risks they are thus running and cannot go on transferring funds abroad without endangering their liquidity in their own currency.

The conclusion must be that even under normal circumstances the interest arbitrage has only a limited influence on the forward exchange market, in the first place on account of the requirements as to the liquidity of the banks and in the second place, because the interest arbitrage becomes less active when the exchange rates move in the neighbourhood of the gold-points or the pegged rates between which the currency is supposed to fluctuate.

Speculators have a much less limited influence in the forward exchange market. They act ultimately as outright buyers or sellers of the forward currency and of course are most active when large exchange fluctuations are expected.

Speculation tends to drive the forward rate of exchange up or down to the level corresponding to the rate which is expected to be the future basis of the exchange rate. As to the influence of speculation on the forward margin, a bull speculation will narrow a discount for forward delivery (which might be caused by the activity of the interest arbitrage) or widen the margin between spot and forward if forward exchange is dealt in at a premium. If the speculation has a bearing tendency, a discount for forward exchange will increase or a forward premium will diminish. The force of the speculation will abate when the out-

right forward rate approaches nearer to the rate of exchange expected in the future by speculators.

A bear speculation in exchanges has always been a more common phenomenon than a bull speculation, but looked at from another angle a bear speculation in a certain currency might at the same time be considered as a bull speculation in another currency.

A bear speculation will drive down the forward rate of exchange on the country whose currency is supposed to weaken and in most cases the forward discount will increase considerably. Here the interest arbitrage may come in, by selling this particular currency for spot and buying it back forward at a considerable discount, thus making a nice interest profit. The forward discount may be so big, that even when the rate of interest in this particular country is higher than elsewhere, this kind of transaction is profitable.

It is often thought that the interest arbitrage, which only makes use of an existing forward margin, can never endanger the exchange position of the country, because it operates by way of a harmless swap transaction. But it should be kept in mind that it is the interest arbitrage, which by offering itself as a counter-party for the bear speculator, makes possible this bear speculation. And just because the interest arbitrage operates by selling spot besides buying forward, still a downward pressure is exercised on the cash position of the currency. Speculation drives down the currency in the forward market only; but as a consequence of the activity of the interest arbitrage this pressure is transferred from the forward market to the spot market, thus causing a loss of gold if the country is one adhering to the gold standard.

The forward margin diminished at the cost of a greater pressure on the spot rate.

If the interest arbitrage is not active, for instance, because the rate of interest in the country in question is extremely high and money is tight, so that the profit resulting from the swap does not outbalance the loss of interest, or because the transfer of funds outwards is not possible, because this transfer is prohibited or this transfer is not deemed safe on account of impending moratoria in other countries, the speculation will drive the out-right forward rate down further, the forward margin will increase further, but the switching of this pressure to the spot mar-

ket will not take place. And a very large discount in the forward market may discourage the bear speculation and even bring about a bullish tendency if it is clear that the country in question does not think of giving up the gold standard, or the pegging of the exchange.

Without interest arbitrage and without speculation the forward exchange market would only work very defectively. Each supply from the side of commerce would have to be absorbed by a demand likewise originating from a commercial quarter. Not only the amounts would have to be equal but also the period would have to coincide. An offer for delivery at one month after date would not be acceptable to a firm interested in a purchase for delivery three months thence.

Interest arbitrage and speculation mix in with supply and demand from the side of trade, bridging over differences as to the amounts and as to the period to be covered.

But in order to enable the interest arbitrage to be an active factor, this kind of investment must be profitable and the covering forward must be reasonable which it is not if risks one is running do not warrant a forward transaction. But even then the working of this factor is limited because other features have to be considered when funds are transferred from one centre to another.

An active speculation presupposes a fluctuating exchange market and the possibility to make use of these fluctuations. A pegging of the exchanges makes speculation almost disappear if the pegging is very rigid.

Exchange restrictions make speculation and interest arbitrage very nearly impossible. Even if on certain conditions a free transfer of funds is still allowed, the possibility of restrictions being introduced sooner or later, will make both very reluctant.

Further we have to reckon with the fact that almost without exception, dealing in forward exchange is only possible for periods of limited duration. For periods longer than six months a counterparty will practically not be found. One month and three months are the usual periods. This has nearly always been so, also in the years following the world war, when the market was very active and the movement of the exchanges was hardly ever checked by exchange restrictions. The main reason is that the interest arbitrage operates through the bill market or the market for fixed deposits for the usual periods, i.e. mostly one months or three months.

After this general introduction we may proceed with the answers to the specific questions, as they have been formulated by the Committee. The introductory remarks might prove to be of some help there.

- 1) *To what extent is it really true that the forward market protects the lender, the borrower and the trader?*

A forward exchange transaction does not and cannot do more than make possible a transfer of certain claims or obligations from one currency into another. Only the elimination of a nominal exchange risk can thus be attained. In most cases transfer will be made into the currency of the country in which the firm in question is established or the currency of its home country, in case of firms situated abroad. But under certain circumstances it may also be the currency which is supposed to show the greatest relative stability in future, in terms of goods. In specific cases, it may be the currency in which at some future date settlements in an opposite direction will have to take place.

Strictly speaking, a nominal exchange risk only is eliminated. The transfer into a certain currency involves in fact that the fluctuation in the purchasing power of the chosen currency is freely accepted. In case of violent price fluctuations in the country of the chosen currency a transfer into this currency may mean that heavy losses will be incurred. In the era of the inflation in Germany a German firm would certainly not have transferred her future claims in another currency into Marks. For by the time the Marks bought for future delivery were due, the purchasing power of the German currency would have diminished greatly. By elimination of the nominal exchange risk a far greater risk was assumed. And if in these days in the United States the price of a certain article is rising strongly, although it might, from a technical or bookkeeping point of view, be advisable for a firm abroad, who will have to buy this article at some future time, to cover the Dollars forward, it is evident that by doing so, the loss caused by a further rise of price in America will not be eliminated.

In many cases the desirability for trade to cover its obligations and claims in the forward market diminishes *pari passu* with the extension of the forward margin, mainly brought about by speculation. For it may be that the price so paid for this

forward covering is so high that the trader can as well run the exchange risk himself.

Generally speaking, all that has been said about trade holds good just as well for lenders and borrowers. But the difference is this, that in most cases lenders and borrowers are less concerned with the internal fluctuations of the price level in terms of the currency into which they transferred their claims or obligations, which will nearly always be their own currency. Lenders and borrowers therefore will be satisfied in general by an elimination of the nominal exchange risk.

On account of the fact that very rarely items with a usance of more than six months can be covered in the forward exchange market, long term loans and obligations practically cannot be covered forward.

2) *What currencies are covered forward adequately?*

As set out above, traders, lenders and borrowers can only be sure of finding cover in an active and real forward market, for supply and demand from the part of commerce cannot be supposed to coincide. And real market cannot exist when interest arbitrage and speculation cannot work. Speculation is not active if exchange fluctuations are not likely, either because the rate of exchange is pegged, or because the fluctuation that was expected has already more or less been realised. Interest arbitrage needs a money market in both centres concerned and an interest margin which warrants a transfer of funds and leaves a profit even after a forward exchange margin has been paid. The possibilities of transferring funds from one centre to another are limited, because the banks have to watch their liquidity.

A stringent pegging of the exchanges will, if the people are confident that this pegging will be maintained effectively, cause a shrivelling up of the forward exchange market and under these circumstances there is no use for a forward market. If a pegged currency is dealt in forward, it often proves that belief is lacking that this pegging will be adhered to.

Exchange restrictions lead to a situation in which the exchange market, spot as well as forward, is purely imaginary. If these restrictions apply only to certain transactions, e.g. the transfer of capital, the exchange market is not closed to other transactions, but it becomes very difficult to find a counter-party.

The same applies to the forward exchange market. Restric-

tions regarding the transfer of capital will make interest arbitrage impossible and consequently this factor disappears from the swap market, which operates by switching of spot exchange against forward exchange, or rather by a double switching of spot exchange. A against spot exchange B and forward exchange B against forward exchange A. Thus interest arbitrage also ceases to be a working factor in the outright forward exchange market.

Partial or even complete exchange restrictions do not *ipso facto* make speculation in future impossible. For a forward contract proper is but an agreement to deliver or to receive on a certain date a certain amount of currency for settlement in another currency at a fixed rate of exchange. If exchange restrictions are effective in country A nothing prohibits a resident of country B to make such an agreement based on the currency of country A. But it is very likely that delivery cannot be made when the contract is due and then speculators are doomed to inactivity.

Restrictions as to the transfer of capital are also prohibitive to *bona fide* lenders and borrowers desirous of covering their exchange risks in the forward market. If the market is still open to real commercial needs, traders, will be free to cover themselves in the forward market, but as speculation and interest arbitrage are practically banished from the market, a counter-party will only be found accidentally.

It should also be kept in mind that in order to contract a deal in the forward market it will of course be necessary that both currencies which are switched against one another can be dealt in forward. If for instance London is the only free money market, this means that there is no free exchange market at all, not even in London.

At the end of 1935 the only currencies which could still be adequately covered forward were :

Pounds Sterling	Dutch guilders
U. S. Dollars	Swiss francs
French francs	Belgian francs
	Canadian Dollars

and the following currencies could be covered forward occasionally in a market which could hardly be worthy of the name :

German Marks (Free Marks)	Polish Zlotys
Norwegian Kronen	Tsecho Kronen
Swedish Kronen	Spanish pesetas
Danish Kronen	Finnish Marks

If a certain currency A is pegged to another currency B and if currency A cannot be covered forward, one can protect oneself by hedging in currency B. Up to a certain degree the same holds good if currency A is not pegged to currency B, but if a tendency is manifest for currency A to fluctuate in conformity with currency B.

3) *What types of contracts are covered?*

If no exchange restrictions exist, all kinds of obligations or claims in a foreign currency falling due within the limits stated can be covered forward. For they are the abstract claims or obligations in a certain currency which are covered by a forward transaction, and not the underlying commercial or financial contracts.

If exchange restrictions exist, the underlying transactions will begin to play a rôle. For then only those transactions can be covered forward which, when falling due, are not affected by the restrictionist measures.

4) *What is the net cost of such protection, even if cover is available?*

The net cost is the forward margin, i.e. the premium or discount of the forward rate compared with the spot rate. The factors which determine this margin have been set forth in detail before.

Owing to speculative movements and repeated attacks on the gold currencies, the forward margins have fluctuated wildly. In the course of the year 1935 these margins for three months delivery of the principal currencies, regularly dealt in in the market, have fluctuated as follows :

<i>Forward quotation (three months) range during 1935</i>	<i>Percentages (yearly basis)</i>
<i>U. S. Dollars from 1/4 ct over spot to 2 cts under spot.</i>	<i>from 0,2 pct disc. to 1,6 pct premium</i>
<i>French francs from 10 cts over spot to 5 frs over spot.</i>	<i>from 0,5 pct to 27 pct discount</i>
<i>Dutch guilders from par to 40 cents over spot.</i>	<i>from par to 22 pct discount</i>
<i>Swiss francs from par to 1 fr. 10 cts over spot.</i>	<i>from par to 29 pct discount</i>
<i>Belgas from 2 1/2 frs over spot to 16 cts under spot.</i>	<i>from 40 pct discount to 2,1/4 pct premium</i>
<i>Canadian Dollars from 1 1/2 cts over spot to 1 ct under spot.</i>	<i>from 1,1/4 pct discount to 0,8 pct premium</i>

A cross rate forward, e.g. U.S. dollar-Dutch guilder can be found by combining the two forward rates U.S. dollar-Pound sterling and Dutch guilder-Pound sterling; and so on, for each set of two currencies.

These large margins as well as the sudden changes in the forward quotations must be prohibitive to foreign trade. Moreover, when speculation was most active, *bona fide* sellers of these currencies could practically not find cover at all in the forward market.

Under an effective international gold standard, as a rule the forward margin would never surpass the range between the lower and the upper gold points, consequently about 1 pct as a maximum, or 4 pct on a yearly basis.

It goes without saying that one can only speak of costs if a buyer has to pay a premium or a seller has to take a discount. Otherwise the covering forward may even prove to be a profitable business for those concerned. Moreover it should be borne in mind that in the majority of cases trade only has to find cover for a period of a few months, so that the percentages quoted above have only to be paid for a limited time. Be it as it may, even a margin of a few percentages can in many instances be prohibitive to trade.

5) *What conditions are necessary for a perfection of forward exchange?*

One should differentiate between factors which tend to make the necessity for traders to seek cover in the forward market less pressing and those measures which can be expected to improve conditions of the forward market.

There will be less need for a forward market when exchange rates are stabilised, either by pegging, or by a return to the gold standard, internationally. That when the exchanges are rigidly pegged, covering forward is not needed, goes without saying, but even a return to an international gold standard will greatly diminish the importance of the forward market. But although a return to the gold standard is of paramount importance and the ultimate goal of every wise monetary policy, this question has very little to do with the subject of this memorandum. For it deals only with measures which, given the rather strong fluctuations of the exchange rates at present, can facilitate the covering of exchange risks by way of the forward market.

The main obstacle to a smooth functioning of the forward market is the existence of exchange restrictions. It does not seem likely that the governments can be brought to abolish these obstacles to trade. Perhaps the governments could be induced to abolish these restrictions as far as commercial transactions are concerned, but this would be of little help to the forward market proper. For it has been said already that as long as these exchange restrictions are maintained in the field of capital transfers, speculation as well as interest arbitrage cannot play an active role. Therefore a revival of the forward market cannot be expected so long as the exchange restrictions are not removed all along the line.

If the exchange market was freed of all restrictions, trade would again be in a position to cover its claims and obligations in the forward exchange market, but under the present circumstances this would often be possible only against payment of a prohibitive forward margin. For the uncertainty as to the future basis of some currencies must bring about a downward pressure on the forward rates of exchanges, first by the activity of speculators and secondly by the attitude assumed of late by international trade itself, which in anticipation of monetary events supposed to materialize sooner or later, refrains from covering its requirements of the currency concerned. Consequently the forward market becomes extremely one-sided at times, as is clearly illustrated at present by the Scandinavian currencies and the currencies of the countries of the so-called gold bloc.

When exchange restrictions are applied, the forward market becomes unbalanced because traders can only find cover with fellow traders dealing in the opposite direction; and if no restrictions are applied the same holds true up to a certain degree because speculators and trade itself are often inclined to operate in one direction only.

In order to counterbalance this onesidedness it might be advisable to have the central banks intervene in the forward market. And here we are led up to the last question put by the Committee, viz. :

- 6) *Can the Central Banks assume universally the covering of exchange risks over any period?*

It behoves us to consider the question of intervention in the forward exchange market by the Central Banks in a somewhat

broader sense. Such intervention would be beneficial to foreign trade on two grounds. First this may lead to an extension of the market, making it easier to find a counterparty; and secondly this may bring about a narrowing of the forward margins, thus diminishing the cost of forward covering.

But an intervention in the forward exchange market has some consequences of no small importance for the Central Banks themselves. It means that the Central Banks become jobbers in foreign exchange. Now this kind of activity is not quite unusual of late, specially in those cases where the currency is not linked to gold. And after all, the gold exchange standard which before September 1931 played such an important role in monetary policy was based on the same principle. This intervention has nearly always been limited to the spot market, but not unfrequently this also brought about in extension of the forward market. For by way of swap transactions this action of the Central Banks can be transferred to the forward market and this will have the same effect as a direct activity of the Central Banks in the forward market. But if for one reason or another interest arbitrage, which has to make these exchange swaps, cannot work, a direct intervention by the Central Banks in the forward markets might be useful and the more so when, as a result of the activity of speculators, the forward margin widens out of proportion.

In countries where the gold standard is maintained under normal conditions, such intervention would not be much use, provided the rules of the game are strictly adhered to and gold is sold freely when the foreign exchanges reach the upper gold-points and the exchange market is not manipulated in any way. Under these conditions the exchange market will work smoothly and the activity of interest arbitrage, granted the existence of a money market, will also guarantee a good functioning of the forward exchange market. But then of course interest arbitrage must be allowed to act as counterparty to traders in the forward market.

But in present times even in those countries strictly adhering to the gold standard, the forward market has rather a one-sided character, because speculators, arguing that the gold standard will perhaps be abandoned sooner or later, drive down the forward quotation of the currency in question to a level well under the lower gold-point.

Without doubt a free and extensive spot market provides for

a possibility of a sufficiently extensive forward market (whereby the nature of the ruling monetary system, either a "free currency", managed by exchange funds, or an old fashioned gold standard, is of secondary importance) but when interest arbitrage does not function smoothly or speculation is very active and one-sided, forward margins will often become very wide, much to the disadvantage of trade and industry.

Now experience has proved that it is scarcely possible to discard speculation altogether. One may try to paralyse speculation by law or by way of a gentlemen's agreement between the Central Bank and the commercial banks, but trade itself can hardly be forced to transfer its claims into its own currency, if the monetary position of this currency, rightly or wrongly, is not deemed too strong. Such behaviour has the same effect on the forward exchange market as a bear speculation.

By operating in the forward market, the Central Bank of gold standard countries and of those countries whose currencies are not linked to gold, might indeed bring about an extension of the forward market and a narrowing of the forward margin. On the other hand it should be clear that by thus facilitating the forward market, the Central Banks make matters easier for bear speculators, professionals as well as traders. By not intervening in the forward market and by letting the forward margin grow larger, speculators might even be discouraged more effectively. It seems likely that in gold standard countries the Central Bank would not easily be persuaded to intervene in the forward exchange market, the more so if this should be a deviation from the principle, established in 1931 or perhaps long before, not to operate in the exchange market. The Central Bank in question might by preference leave it to the private banks, to satisfy the needs of trade in the forward exchange market. Under the present circumstances, when the forward market is far from balanced, this will often mean that the private banks are not able to cover their forward sales to customers in the forward market and are obliged to close the transaction by repurchasing the exchange in the spot market. And they certainly will be willing and able to do so, provided they can be absolutely sure that their own Central Bank will back them by selling gold freely, if the upper gold-points of the foreign exchanges are reached. Besides, the banks must be in a position to finance these swap transactions, and if they cannot do so out of their own liquid funds, they must

be sure that the Central Bank will help them out in the usual way, by discounting bills or granting advances against collateral.

Perhaps the Central Bank would rather not see gold flow out of the country as a consequence of this kind of operations. But the Central Bank will be aware that if, alternatively, it operates directly in the forward market by meeting the demand for "devises" this outflow of gold will take place as well, either immediately, because these forward sales from the part of the Central Bank are transferred to the spot market by interest arbitrage, or later on when delivery of these "devises" must be made.

When the currency is a so-called free currency, held in check by exchange funds or otherwise, there will be less objection to an intervention in the forward market, as in most cases this principle of non-intervention has already been abandoned. But in these instances an effective manipulation of the spot market, which substitutes the automatic regulation of the exchange market by a gold standard, will equally bring about an extension of the forward market and a narrowing of the forward margins.

Whatever course is followed, an intervention in the forward market cannot be carried through either if exchange restrictions of a more or less stringent character are existent in even one of the countries concerned, although these legal restrictions be not applied to forward operations of the Central Banks themselves. For in most cases this will prevent industry and trade from making or taking delivery of the "devises" when contracts are due.

The exchange risk itself cannot be an argument for the Central Bank to abstain from intervention in the forward market, for with or without the gold standard, the Central Bank, above all others, must of course start from the axiom, that it will be able to hold the currency. And on the ground of this assumption the Central Bank must be able, in theory, to cover the exchange risk over any period of time. But if it cannot be assumed that the currency can be held, even an intervention from the part of the Central Bank will not hold the forward margin down.

Generally speaking, a direct intervention in the forward exchange market from the part of the Central Banks will be of little use. And this stands to reason. For if forward margins are large, this proves, in nine cases out of ten, that confidence as to the stability of the currency is failing. A wide margin between

spot and forward exchange rates is a symptom that confidence is lacking. A manipulation of the forward market might perhaps prevent this symptom from manifesting itself, but it cannot be denied that it is far better to think of means to strengthen confidence in the fundamental stability of the currency, under present conditions, either by working the gold standard along orthodox lines (unlimited sale of gold at the upper gold-points) or — in case of a free currency — by a liberal and not a restrictive exchange control in the spot market.

The main obstacle to a smooth functioning of the forward exchange market is the system of exchange restrictions. Therefore monetary policy should be directed first of all to an abolition of these hindrances to trade.

February 1936.

(Signed): A. A. VAN SANDICK.

PART II

The technique and nature of re-stabilization

**Memorandum
on the
problem of price-levels and the actual relationships
between costs and prices**

by

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How far is the plea that we must go back to some previous existing price level, or relation of price-levels, justified? In view of the progress of technology, what is the justifiable empirical relationship between costs and prices?

I. In the modern world, the most obvious point in the past which impinges on the present is the burden of indebtedness, public and private. A period of depression, by the mere fact of the accumulation of income over expenditure, leads to a lowering of the rates of interest and therefore to the possibility of the conversions which have been taking place everywhere on a very large scale. Nevertheless, it must be recognized that the empirical justification for a retention of a given price-level consists in the fact that at any moment of time, an enormous mass of indebtedness contracted in the past cannot be suddenly adjusted to the necessities of the present.

II. In addition, a second factor has been super-added to those mentioned above. This modern factor is the significance of "rigid costs". From the standpoint of this memorandum, this is an issue which can only be stated and cannot be discussed. It is clear that, with the growing accretion of labour to industries in which salary scales are fixed, and with the growing reluctance of large masses of contractual labour to suffer any reduction in money incomes, rigid costs play a rôle quite disproportionate to that which they played in the 19th century. It follows from the

two considerations urged above that the general stability of price-levels is a matter of much greater significance both from the standpoint of economic stability and from the standpoint of political pacification, than it was 30 or 40 years ago.

III. It must, however, be recognized that both these considerations have a diminishing significance as time goes on, for the simple reason that *new* contracts and *new* price-levels are an equally growing proportion of the total mass, both of long-term debts and of wages and other contracts entered into at a particular moment of time. It would require a much more detailed investigation than it is possible under the circumstances of this inquiry, to prove this point, but the *a priori* relevance of the considerations just urged is obvious. I take it therefore that it requires no further argumentation at this point.

IV. Apart from the significance of the seasonal and cyclical variations in prices, there is one other point which is in itself obvious: The progress of technique did not cease with the depression of 1929. On the contrary, it is notorious that every period of depression brings with it new technical discoveries induced by the mere fact that individuals are desirous of conserving their own profit levels. It is therefore fairly clear that a price-level appropriate to the circumstances of 1929 is no longer necessarily appropriate to the circumstances of 1936. It would require a new technique of statistical investigation to assess the degree to which, in effect, costs have been adjusted to the level of prices. But that some such adjustment has taken place is shown by the fact:

V. That there has been a very considerable recovery in a wide range of countries. If the depression is characterized by a maladjustment of costs to prices, it follows that recovery is characterized by an adjustment of prices to costs. There is agreement that in every country (apart from foreign trade, which can be explained on special grounds) there has been a considerable improvement in the volume of employment and in the growth of the aggregate national income. This in itself seems to show that the *de facto* level of prices is not so out of line with the level of costs as to make permanent depression at all a reasonable proposition.

VI. It must be confessed, of course, that the position varies from country to country, according to the significance of foreign and domestic trade in each particular case. The sacrifices involved on the part of raw material producing countries such as Australasia, have undoubtedly been much greater than those imposed on a creditor country like Great Britain. Furthermore, countries in which the proportion of foreign to domestic trade is large, must necessarily go through a period of violent adjustment (as far as exporting is concerned) if the markets to which they habitually sell have to adjust themselves to a new technological situation produced, e.g. by a change in the economy of agricultural production. But, on the whole, the mere fact that the world is slowly climbing out of the depression seems to indicate that the most acute phase of the crisis of prices has been overcome.

VII. It is now practically 8 years since the maximum of post-war prosperity and post-war prices was achieved. A large mass of indebtedness has been incurred since. It appears to me that to go back, as some authorities have urged, to a price-level which is now 8 years old, would be to create a new series of disequilibria almost as serious as the disequilibria which were produced in the course of the pre-depression boom, and from the consequences of which we have been suffering. On balance, effective recovery appears to point to the fact that the pre-depression era is now matter of "ancient history" and that technological progress on the one hand and financial conversions and readjustments on the other, have solved what are undoubtedly the causes of the troubles of the period 1930-1932.

May 1936.

(Signed): T. E. GREGORY.

**Memorandum
on the
production and distribution of gold**

by

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The economic reconstruction after the world war proceeded under the prevailing influence of principles recommended by the international conference of Brussels and Genoa. Regarding the structure and the functioning of the gold standard the above conferences presupposed that world economy will face very soon a shortage of gold for monetary purposes and that, therefore, a greater economy that heretofore in the use of gold should be necessary.

The monetary policy of the pre-crisis period followed, however, a different path. In theory, fear of the gold shortage prevailed. In practice, return to the gold standard disregarded the spirit of greater economy in the use of gold. New by-laws imposed on central banks more rigid requirements than before the war, when there had not been much concern about a possible decline in the production of gold.

First of all, the principle of minimum reserve was applied in a more rigid way. The legal cover of notes was raised from the pre-war 33 % to 40 %, in some cases more, up to 60 % in one South American country. Simultaneously new by-laws put central banks under the obligation to calculate this cover not only against the outstanding notes but also against the total of sight liabilities. Before the great war such a system of calculation was employed rather exceptionally. Moreover, silver was excluded from the reserves. As result of these more rigid reserve requirements the demand of gold for monetary purposes increased

instead of declining. Thus, practice had thwarted theory. The inconsistency was obvious.

The contradiction between theory and practice was engendered by two illusions which had been generally adopted together with concern about the future of gold production.

One of them was the readiness of Federal Reserve Banks to adopt a liberal credit policy in order to help the outflow of gold to Europe, thus reducing excessive American stocks. It was expected that the more rigid reserve requirements adopted by the European central banks would tend to increase the demand of gold, draining it back from America. At the same time, long term loans were to be issued in America to serve reconstruction of Europe. Again it was expected that a large portion of these loans would be converted into gold, facilitating the repatriation of gold to Europe.

The second illusion consisted in the very optimistic judgment of the gold exchange standard as a method of economising gold. It was generally hoped that with the help of this system it would be possible to neutralize the increased demand of gold resulting from a more rigid system of reserve requirements.

Experience proved that both repatriation of gold from America and the gold exchange standard failed to fulfil expectations. America inflated the world with credits, but at the same time gradually raised her tariff walls in spite of her steadily active trade balance. Under these conditions gold could not be repatriated, because new debts were incurred in order to pay capital and interests on old ones, or to cover the import surpluses. Instead of repatriation of gold, we had inflation of credit on an international scale. On the other hand, the gold exchange standard contributed to this inflationary process, because accumulation of foreign exchange rose year after year and migrated in the shape of short-term money from market to market, constituting an additional source of international credit. The final results are well known from the development of the present depression. The too rigid reserve requirements proved unreal as soon as the international credit inflation stopped. It could not be otherwise since gold could not be repatriated owing to the American trade policy and since the gold exchange standard revealed in practice more defects than merits.

Leaving the past and turning to the future, it is necessary to re-examine the problem which faced the world at the beginning of the past-war period. This applies in the first line to the

fear of gold shortage and the inadequate distribution of gold. These fears gave birth to the pre-crisis trend of thought and, therefore, a critical analysis of these fears must also form the basis for the post-crisis attitude.

1. *The adequacy of gold*

Post-war apprehensions regarding the probable shortage of gold increased especially under the influence of the great popularity gained all over the world by Cassel's theory. According to this theory economic progress showed during the whole nineteenth century an annual increase of about 3 %. Consequently gold production should also increase annually by about 3 % in proportion to the gold stocks already existing in the world. Otherwise the purchasing power of gold would have to fluctuate showing long-term secular upward or downward tendencies in dependence on larger or smaller gold production. To support this thesis Cassel quoted interesting and well-known statistical data.

Cassel's formula constituted a first attempt at mathematical expression of the problem of the gold adequacy. The necessity of a 3 % annual increase seemed to represent an economic law governing the world economy. Apprehensions of a gold shortage had necessarily to increase, as it could not be expected that gold production would be able to keep pace with the requirements of a regular annual increase of 3 %. The larger the existing gold stocks, the greater the producing capacity of the gold mines would have to be. This could not be maintained in the long run. Cassel himself called this necessity of a continual and regular increase "the paradox of the gold standard". And, therefore, he not less emphatically recommended better economy in the use of gold for monetary purposes in order to balance the decreasing supply by a decreasing demand.

Fortunately Cassel's estimates, supported later by Kitchin, were too pessimistic and exaggerated. Not statistical errors, however, supply the strongest argument against the 3 % formula. The question whether such a formula is at all possible as a law ruling in the world economy is of far greater importance.

The price level depends not only on the supply of new gold, but also on technical improvements in the demand of gold for monetary purposes. It is easy to calculate the supply of new

production. Whereas it is impossible to calculate changes in the demand of gold as to obtain exact figures comparable with supply figures. If, therefore, the reduction in demand of gold exercises the same influence on its purchasing power as the supply of new gold from the mines — it being impossible, however, to express this reduction of demand in figures as exact as those of supply — we must come to the conclusion that there is a scientific impossibility of finding an exact mathematical formula.

The impossibility of finding an exact mathematical formula indicating the amount of minimum influx of new gold needed yearly in order to maintain the purchasing power of gold at a relatively stable level, does not yet cancel the problem itself of gold adequacy. Gold is a commodity and as such is subject to the law of supply and demand. In proportion, therefore, to economic progress and growing prosperity, the demand of gold increases independently of rules governing the functioning of the gold standard. In the period 1913-1928 the production of gold yielded to the world 5,882 millions of old dollars. This represented a sum practically equal to the total world stock of monetary gold in 1880, representing the result of accumulation over hundreds of years. In spite of this record influx of gold, the gold cover of the total volume of bank deposits in the world, representing the increase in production and average prosperity, fell by about one half within fifteen years only. What would the position of world economy have been had there been no influx at all in the course of these fifteen years? No more needs to be said to prove that theoretical negation of the problem of gold adequacy would amount to unconscious negation of the law of supply and demand which constitutes the most important basis of the classical doctrine.

The theoretical importance of the problem of gold adequacy can be also emphasised by the special character of the gold demand. The subjective demand is insatiable. Fortunately, the objective capacity to purchase gold is limited. This capacity depends in the first line on economic progress and growing general prosperity. It applies as well to the demand for industrial, artistic and hoarding purposes, as to the demand for monetary purposes in both domestic and international employment. Wars or elemental catastrophes, such as failure in crops for instance, hamper the demand of gold, entailing temporary

periods of pauperisation. A parallel influence is exercised by changes in gold production depending on discovery of new gold-fields or technical inventions increasing efficiency. Owing to the above changes in demand and supply, the purchasing power of gold is subject to greater or lesser and shorter or longer fluctuations. Independently, however, of such annual fluctuations or secular trends there is a special phenomenon of great importance. I have in mind the general tendency towards an excess of demand over supply of monetary metals if considered in the perspective of centuries. It is the natural result of the simple fact that demand depends on man, while supply depends not only on man but also on nature, offering limited possibilities of extraction of metal under a subjectively insatiable demand.

The historical tendency of the purchasing power of monetary metals is the tendency to increase regardless of annual fluctuations or secular trends. The purchasing power is, however, only a synonym of the exchange value of monetary metals. The latter are first of all commodities. The tendency of the purchasing power of a monetary metal towards an increase is equivalent to the tendency of the exchange value to increase. This fact cannot be disregarded as far as prices paid for monetary metals are concerned. With the increase of the exchange value prices should rise. Meanwhile prices paid per kilo of metal either by mints in coins or by central banks in notes have to remain stable, because every monetary system consists in the first line in the stability of this price. Here we discover a problem of cardinal importance to the economic history of the world. It is obvious that in the long run the real exchange value must win and prices must change. The increase in the exchange value must be followed, sooner or later, by an increase in price.

To-day's pound sterling is a fraction of the pound as unit of weight. Similarly to-day's franc is a fraction of the livre and to-day's mark a fraction of the original mark of silver as unit of weight. The same can be said about the Roman as of copper. The history of money reveals a tendency towards continual and gradual devaluation, i.e. towards raising the price paid in coins or notes per kilo of the respective metal. This history is governed neither by Cassel's formula of the 3 % increase in stock, nor by any other mathematical formula, but by *the law of fundamental contradiction between the tendency of monetary metals towards gradual increase and the tendency of prices paid for these*

metals to remain stable. The annual cycles and secular trends are but episodes filling out longer or shorter periods of contest between both contradictory tendencies. Victory goes, however, sooner or later, to the exchange value or real purchasing power, not to the price. And therefore the historic evolution of money is characterised by a process of gradual devaluation, a process of reduction of the amount of metal in the respective monetary units, which means a gradual increase in the price paid per kilo of the respective metal.

In the light of the law of contradictory tendencies as outlined above, the part played by gold production in the world economy finds its additional theoretical justification. If the productive capacity of mines keeps pace with economic progress, we avoid the deepening of contradiction between exchange value of gold and its price at the given moment. If the inflow of new gold lags behind and the deficit is not balanced by a greater economy in the use of gold, the contradiction between the exchange value and the price of gold deepens. World economy enters then a period of protracted depression, which frequently is followed by a process of devaluation. The problem of gold adequacy therefore not only exists both on theory and in practice, but deserves continual observation. Transitory annual cycles do not remove the necessity of this continual observation. From this point of view the Gold Delegation of the League of Nations was perfectly right in not hesitating before a further study of the problem of shortage of gold, although their work coincided with the beginning of the present crisis which, like all depressions, favoured the production of gold and permitted to anticipate an increase in this production.

Coming now to the estimates of the Gold Delegation concerning gold production and comparing the theoretical figures with effective results obtained during the crisis, we can draw up the following table :

Estimates and actual results
(in millions of old dollars)

Year	South Africa (estimates)	Total	Kitchin (estimates)	Actual South Africa	Actual Total	Plus U. S. & R. (estimates)
1930	211,7	405	404	221,5	400,7	+ 22-29
1931	207,3	401	402	224,9	426,0	+ 21-29
1932	213,2	407	410	238,9	463,0	+ 25-39
1933	206,8	399	407	227,7	469,9	+ 51-59
1934	198,1	390	403	216,6	481,8	+ 73-83

A glance at the above table sets out in the first line a remarkable increase of gold production during the present depression. Respective figures are so largely in excess of the estimates of the Gold Delegation that the latter has been often accused of an unfounded pessimism and drastic errors. There is no doubt that the Gold Delegation did overestimate Canada's productive capacity, underestimating Russian production. Nevertheless predictions regarding the probable exhaustion of the South African mines seem to be coming true. In spite of an exceptionally good payability enjoyed to-day by gold production owing to reduction in costs with a simultaneous rise in price due to monetary devaluation, South African production shows signs of a relative decline. Returns for 1933 and 1934 indicate this fact. As until lately South Africa used to supply more than one half of the total yearly influx of new gold, the decrease of production in this important area will be more and more difficult to compensate.

However, the principal argument in favour of the Gold Delegation lies with the fact that in 1930, when the Delegation was at work, no one anticipated so drastic a fall in prices and so deep a depression. Even if some economists did realize the danger, the Delegation could not set the world on alarm in a document intended for publication. The Delegation had no other issue but to base their estimates on the anticipation of "moderate changes in the price level" and such changes do not yet bring about records in the gold production. Such records came as a result of the catastrophe. What is their influence? In spite of a record inflow of new gold and in spite of an unprecedented dis-boarding of gold from Indian stocks, the crisis followed its course and still follows it. This fact fully confirms the Gold Delega-

tions's point of view that, as far as the problem of the shortage of gold is concerned one cannot rely too much on the fall in prices as remedial measure.

The problem of gold adequacy, as a theoretical problem, existed in 1930 regardless of better prospects for the gold production owing to the beginning of the depression. This problem did not lose its importance in spite of an unprecedented increase of production and dishoarding of gold in the years 1930-1935. Besides theoretical considerations, a few facts seem also to justify our view.

First, too active extraction of gold during the crisis will reduce the productive capacity when the crisis is over and the increase in costs of production begins to reduce the present high degree of profitableness of this production. Second, taxation of the gold production has been increased during the depression and, once adopted, it will not be easily reduced, thus constituting a drawback for future production. Third, there is a lack of proper international co-operation in this domain, whilst the problem of gold adequacy is essentially an international problem and in the twentieth century it is more and more difficult to solve it by local measures.

A classic example of the last question is furnished by the present problem of devaluation with divergent endeavours to settle it from one local case to another and to the detriment of the world economy as a whole. May be that the present monetary crisis is likewise one of those historical periods when excessive disequilibrium between the exchange value of gold and its price has to be met, although the actual volume of the present disequilibrium was the result not so much of changes in the gold supply, as of other factors, of general economic and fiscal nature, as well.

2. *Distribution of Gold*

Apprehensions of a shortage of gold were in the first post-war decade accompanied by complaints of a faulty repartition of the monetary gold reserves. The neutral states inherited from the war period excessive reserves, which they were not inclined to reduce for the benefit of others. Moreover, America beat all records as a magnet attracting gold. At the end of the first decade France joined the United States as a centre of excessive accumulation. The exact facts and figures are well known and do not

need to be quoted here. What is required, is to recall the main causes of this faulty repartition, for such a reminder may facilitate an answer to the question whether any chances for improvement exist at present.

The change in views on the role of gold under the gold standard may be quoted as the first cause — one of a general character. Before the world war, according to the traditional doctrine of the functioning of the gold standard as an international system, the outflow of gold from a given country was regarded as a natural phenomenon, which in its turn, sooner or later, would be made good by a return of gold. Gold included in the reserves of central banks was expected to move from one country to another and vice versa. There were periods when the Bank of England¹ lost about 30 per cent of its gold reserves (besides the outflow of gold coins from private circulation on the market), yet in spite of this it was the cause of this outflow that give rise to concern, not the very fact that gold was flowing out.

The post-war change in the psychology of the market ought to be in first place ascribed to the Report of the Cunliffe Committee, in which the idea of a minimal reserve for the Bank of England of 150 million pounds appeared for the first time. It was a theory incompatible with Ricardo's classical doctrine. It fell, however, upon a ready soil. The withdrawal of gold coins from circulation and the concentration of gold in central banks presented advantages as regards the credit policy and the control of the money market. However, as regards the relation of public opinion to gold the situation was less favourable. With the pre-war gold standard the deficit of the foreign balance of payments was covered not only by central banks but also by the market reducing the circulation of coins. After the abolition of the circulation of gold coins the burden of a deficit began to fall exclusively upon the shoulders of central banks. The balance-sheets of the latter, published every week, immediately revealed the status of the balance of foreign payments and gave rise to apprehensions at an earlier date than formerly. The theory of a minimal reserve, recommended under such circumstances by the Cunliffe Committee, was bound to find a favourable reception.

As regards the role of gold movements in the world economy,

¹ W. E. BEACE, *British International Gold Movements and Banking Policy 1881-1913*, Harvard University Press, 1935.

the spirit of safeguarding gold reserves and of regulating their movements gained the upper hand over the spirit of freedom and liberalism. This tendency commenced with restrictive measures in foreign trade and later was also applied to trade in gold. As soon, however, as protectionism began to dominate the policy of central banks in the domain of gold, the return to trade liberalism was rendered more difficult. All countries began to aim at a favourable balance of trade in order to protect their gold reserves. Thus, to the protection of the home industry (for the sake of economic self-sufficiency) another argument was added: the alleged necessity of eliminating the danger of the outflow of gold.

Excessive and defective employment of the gold exchange standard may be quoted as the second cause of a faulty repartition of gold. The central banks which had adopted this system converted from time to time a part of their foreign exchange reserves into gold, being forced to do so by the requirements of a minimal gold reserve existing in all large central banks of this kind. Only two banks, viz. the Bank of Danzig and the Bank of Estonia (which did not play any important part) were free from this obligation. With the system of the gold exchange standard, however, central banks of this kind did not sell gold, for they regulated the rate of exchange of the given currency by means of unlimited sale of foreign exchange and never by the sale of gold. If, therefore, they purchased gold, it was hoarded at the bottom of their reserves, as a portion of their minimal gold reserves. Under such circumstances gold flowed in fairly often and flowed out only in exceptional cases when the foreign exchange reserves became exhausted. This meant a hoarding of that part of gold which was acquired by central banks applying the gold exchange standard.

At the same time the so-called gold centres, where the banks of the above mentioned category held deposits in foreign exchange, were obliged to take into account the possibility of these deposits (which were claims to receive gold) being sooner or later converted into that metal. This was the case particularly in the United States where the Federal Reserve banks, not without reason, contended that a considerable part of their gold reserves, which formally belonged to them, economically belonged to the foreign central banks which disposed of a large amount of dollar exchange. Under the influence of such fears America embarked

upon the policy of the so-called sterilisation of gold, i.e. she deliberately maintained the cover of notes at an excessively high level. Therefore, both the hoarding of gold practised by banks applying the gold exchange standard and the sterilisation of gold by the Federal Reserve banks in connection with this, supplemented each other in their disturbing influence on the distribution of gold.

The situation deteriorated further owing to another defect of the gold exchange standard. The new system had a disastrous effect on private gold arbitrage transactions, which before the world war had played an important part as one of the factors regulating the distribution of gold. It could not be otherwise, for a central bank working under the gold exchange standard could take advantage, for instance, of a prolonged and abundant inflow of gold from London derived from arbitrage transactions, while an outflow of gold due to private arbitrage was never possible, because banks of such type could sell sterling cheques and bills at a stable rate of exchange, thus eliminating such fluctuations as would justify arbitrage transactions. From this point of view the central banks which had adopted the classical gold standard and which did not buy and sell foreign exchange found themselves in a less advantageous position. As a result of these differences in opportunities the distribution of gold became complicated because one of its regulators, i.e. private arbitrage transactions, became one-sided.

The unusual increase of the accumulation of short-term funds in the gold centres, i.e. in countries with strong currencies, may be quoted as the third cause of a faulty repartition of gold. Already before the world war, during the second half of the nineteenth century, the role of short-term foreign deposits (as a factor exercising influence on the functioning of the gold standard) was gradually increasing in importance. Whitaker, Laughlin and others drew attention to this phenomenon under the impression of the first disturbances caused by sudden large scale transfers of short-term funds from one market to another. This tendency was encouraged by the development of banking in general, and particularly of banking technique, supported by the invention of the telegraph, telephone, accounting machines and finally by the wireless facilities. After the world war, the role of liquid funds gained immensely in importance both on account of the increase

in their volume and on account of the development of forward foreign exchange transactions.

The classical doctrine of Ricardo was based chiefly on observations of the international commodity exchange. The changes in the volume of trade require time as they occur slowly and gradually. Central banks were able to exercise by means of their discount policy a levelling influence on the divergencies in price levels. The situation became, however, considerably more difficult when liquid funds entered into play on an increasingly large scale and showing greater and greater liveliness in moving from one country to another. The changes in the volume of deposits could occur from day to day and involve such large sums that the gold reserves, being the guarantee for transfer operations, proved relatively insufficient. The general situation was, moreover, made still worse by the feeling of uneasiness prevailing in the post-war period. The traditional doctrine of Ricardo in the face of these new problems was deprived of its former significance. The doctrine of the freedom of gold movements was bound to give way under the pressure of the new factor.

The fourth and most important cause of a faulty distribution of gold originates in the changes in the fundamental world monetary structure.

Before the world war the strongest currency, to which all other currencies gravitated, was the pound sterling. England was then a country of free trade. The balance of her commodity exchange with foreign countries used to be adverse. Under such circumstances the debtor countries were able to pay interest and amortisation annuities by means of their excess of exports to England, the creditor country. An additional advantage was the relatively slow rate of increase of England's overseas investments which did not bear any inflationary character. As a result of these conditions England was never a country marked by excessive accumulation of gold. The repartition of gold was carried through relatively smoothly, provided the economic and financial policy of the given countries was based on sound principles.

The world war changed this state of affairs. The United States from a debtor country became a creditor country. In addition, the rate of growth of the new American overseas investments became from the outset an abnormal one. At the end of 1928 the total amount of American investments abroad (including war debts) almost equalled the total sum of English overseas

investments. In other words, during the period of ten years America attained the same level of foreign investments as England had after the lapse of a century. Such an abnormal and clearly inflationary speed of investments was the outcome not only of a faulty credit policy, but also of vital necessity. For the United States were steadily carrying on an anti-liberal commercial policy. Immediately after the war they closed the door to further immigration. Moreover, during the whole first decade they gradually raised the tariff barrier. America as a new centre of world economy became a creditor country not only by reason of loans granted, but also on account of a steady excess of exports over imports. Not being able to pay the interest and amortisation annuities by means of the excess of exports the debtor countries were compelled to incur new debts in order to pay off the old ones and to cover the costs of their excess of imports from the United States.

The structural changes consisted not only in that the pre-war pound sterling standard was replaced by a dollar standard, but, which is more important, that the new centre did not apply the pre-war English liberalism in trade and in addition embarked upon a policy of credit inflation on a world scale.

The significance of such a radical change was strengthened by the fact that the United States is a country controlling at least half of the world production of some important raw materials as : copper, tobacco, cotton, crude oil, not to speak of wheat, maize, etc. The rest of the world was under such circumstances compelled to buy in America regardless of prices, at the best only limiting the quantities purchased. It is only natural, therefore, that the United States steadily showed an active balance of trade and that they became a particularly strong magnet attracting more and more gold. The inflow of short-term funds from Europe looking for profitable investments in the country of the strongest currency and the most lively rhythm of economic life (though speculative at times) played the role of additional ally of the accumulation of gold.

Credit inflation protected by tariff barriers could not last indefinitely. The vicious circles of extending loans without assuring the possibility of repaying them by the exports of goods was bound to break up. The present economic depression began by such an explosion and the ruins crushed both the creditor and the debtor, i.e. the United States and the rest of the world. The

extraordinary importance of the American policy to the post-war gold standard is best reflected in the fact that at present, in spite of a six-year struggle with the crisis and in spite of the economic earthquake through which America has passed, the outlook for a better repartition of gold has not improved.

The accumulation of gold in France has been considerably reduced and this process will probably go further. Holland parted with a portion of her reserves, as also did Switzerland though on a smaller scale. On the other hand, the accumulation of gold in the United States is making further progress. The breathing space in this process which took place after the depreciation of the pound and the dollar was chiefly due to the conversion of foreign exchange into gold by central banks working under the gold exchange standard. However, with the stabilization of the dollar at its present level the inflow of gold has again commenced and is assuming dimensions which give rise to anxiety. During 1934 the United States increased their reserves by more than 850 million old dollars. This was a sum exceeding by about 30 % the total output of the world production of gold for the same year though the latter was a record figure.

It remains, therefore, to draw the ultimate conclusions, viz. : as long as the United States will refuse to accept new immigration, maintain a high tariff barrier and at the same time play the role of one of the most important creditors, the chances for a better repartition of gold will continue to be discouraging. Persisting in their protective policy and continuing to play their dominant part in the production of raw materials and foodstuffs and a considerable one in the production of industrial articles, the United States will not be able to part with their excessive reserves of gold even if they desired to part. Moreover, they will continue to play the role of a magnet attracting the lion's share of the annual production of new gold.

February 1936.

(Signed): Feliks MLYNARSKI.

**Memorandum
on the
cooperation of central banks**

by

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The future gold standard, when re-established after the present depression, will have to face similar difficulties as before the crisis in the first post-war decade. Such supposition concerns equally the probable shortage of gold and the prospects for its distribution between countries and continents.

Gold production during the period of 1913-1928 gave record results. In spite of that the gold cover of the total volume of deposits of all kinds in all central and non-central banks of the world fell from about 18 % to about 9 %. Modern accumulation of deposits representing economic progress has been more rapid than even the record influx of new gold. There are no reasons whatever to expect that this process will change. Under the present technique of production and the modern level of banking organisation the accumulation of deposits will continue to progress very rapidly, leaving the influx of new gold far behind.

The first years after the present crisis will show less difficulties, because the production and dishoarding of gold during the depression have mobilised exceptionally large stocks. Moreover, the devaluation of most currencies, perhaps even a general devaluation, will render the position of central banks easier, increasing the nominal reserves by conversion into lower parities. However, a few years will be enough to neutralise the above extraordinary means by an accelerated rhythm of economic progress. We shall be back at the point of issue. The problem of

gold adequacy will reappear on the agenda of international discussion and practice.

The same can be said about the defective distribution of gold. As long as America does not modify her commercial policy, she cannot be expected to cease to be an excessively strong magnet draining gold from the rest of the world. It can hardly be expected, however, that America will rapidly and easily change a policy deeply rooted in public opinion since generations. The change, if any, will come slowly and gradually. Whereas a return to free immigration is quite out of the question.

The picture, as presented above, clearly leads to the conclusion that the chances of a lasting and normal functioning of the future gold standard will depend in the first line on the success of future economy in the use of gold. The technical organisation of the future gold standard will have to reflect this principle of better and more consistent economy. It goes also without saying that for such a purpose a closer co-operation than heretofore between central banks will be needed, both in preparing new methods and, which is more important, in applying them in practice.

1. *The problem of legal reserves and the short-term capital movements*

The principle of greater elasticity in the use of the existing gold stock must form the basis of the new technical organisation, because retrogression of the supply of new gold will set in relatively soon, nor will distribution easily improve. Put in plain speech, this would mean that before all we should aim at a partial dishoarding of the gold lying in vault with central banks as their minimum reserves. To this end statutory requirements concerning the minimum reserves must be altered and the gold exchange standard so reformed as to render impossible hoarding of gold by banks of this type.

The minimum reserve requirements had been increased after the world war. In practice this step proved both unreal and harmful. The necessity of a change had already been suggested in the Report of the Gold Delegation, endorsed later by the Bank of International Settlements and the respective Committee at the London International Conference. In consequence both science and practice now equally agree that the legal reserve requirements

should be reduced to 20 %, maintaining the obligation of adding the total of sight liabilities to the outstanding notes. If the usual pre-war practice of not adding sight liabilities to the note circulation were adopted, the minimum reserve could be reduced to 30 % only. In both cases there would be a considerable economy in the use of gold, because about 2 1/2 milliard old dollars would be dishoarded from the minimum reserves and put into circulation, thus increasing the amount of gold in international circulation. Local cover would be reduced to the benefit of working reserves.

The above reform, suggested by the Gold Delegation, seemed at the time of drafting to answer fully the requirements of better economy in the use of gold. However, the crisis brought additional experience raising some doubt in this respect. In the atmosphere of lack of confidence the dangerous influence of short-term capital movements became more drastically evident. The gold standard of the XIX century was determined in its functioning by international movements of goods. The gold standard of the XX century, and more especially the post-war gold standard, is mainly influenced by capital movements. Transfers from market to market take place overnight and in very large sums. The question arise therefore, whether a reduction of statutory requirements concerning the minimum reserves will prove sufficient in the long run.

In countries where foreign deposits tend to accumulate and their movements result in sudden and abundant outflows of gold, central banks may consider it necessary to maintain a higher *de facto* reserve in spite of a reduced legal minimum, because every outflow of some importance will alarm public opinion. The reduction of the legal minimum to 20 % may then prove a fictitious measure. The danger is not imaginary. Would it, therefore, not be more practicable to discard the traditional system of percentage cover which attracts constant close observation by the market, and to adopt the Napoleonic system, i.e. to fix the limit of maximum note issue without a percentage cover? Under this system the management of a central bank might give gold away more freely, not being restricted by formal stipulations forcing the public opinion to follow closely any changes in the percentage reserve and, prematurely as a rule, alarming the market.

I do not propose to enter into further technical details.

There are many ways of fixing these details and those outlined above only serve to illustrate the theoretical problem. Still, one thing can be stated with absolute certainty already now : in view of the increasing importance of international movements of short-term capital, the traditional system of percentage cover, known as the minimum reserve requirements, grows more and more anachronistic.

There is, however, a question more important than the legal reserve problem. It is the question of reforming the gold exchange standard if we are to restore it after all the unfortunate experience of the last fifteen years. The gold exchange standard had its merits as well as its defects. It was convenient as a principle to hold foreign exchange in addition to gold in the reserve, because conversion of foreign exchange in gold could thus be delayed. This resulted undoubtedly in some economy in the demand of gold. However, this asset was more than counter-balanced by the defects of the gold exchange standard.

One of these drawbacks consisted in using the foreign exchange, included in the reserve, as short-term capital deposited with foreign commercial banks as interest-bearing investment. Changes in the interest rates caused these capitals, owned by foreign central banks, to wander from market to market. The discount policy of central banks of the countries on whose money markets foreign exchange of this kind accumulated was seriously impeded. Control over the money market had to face the influence of foreign central banks working under the gold exchange standard.

Another defect of the gold exchange standard consisted in the adverse influence exercised on the distribution of gold and on the gold market. Banks of this type purchased gold frequently in order to maintain their minimum reserve, whereas they sold it in exceptional cases only when their stock of foreign exchange was exhausted. We had there a special type of gold hoarding by banks working under the gold exchange standard. At the same time banks of this type enjoyed better chances on the gold market. Supporting the stability of their currency by illimited sales of foreign exchange at a relatively fixed price, central banks working under the gold exchange standard rendered private arbitrage to their disadvantage impossible, while on the other hand they could enjoy the inflow of gold in the way of such an arbitrage more freely and for a longer time. The arbitrage mechanism, one of

the fundamental measures for the functioning of the pre-war gold standard, broke down and ceased to liquidate excessive disequilibria in the distribution of gold between countries and continents. Moreover, banks working under the gold exchange standard could always purchase gold on the London market using their foreign exchange. The "unknown buyer" appeared on the London gold market, complicating the distribution of new gold supplied by the mines. Banks working under the pure gold standard, i.e. banks owning no foreign exchange and purchasing gold only on the spot against their own notes, found themselves seriously handicapped in this respect.

In the light of the above analysis it is easy to detect the direction of future reforms in the technical reorganisation of the gold exchange standard. As far as accumulation of foreign exchange is concerned, the Gold Delegation, following my criticism, recommended that the foreign exchange assets of central banks should be kept with other central banks, never with commercial banks. Exception could be made only for the Bank for International Settlements as an organisation of close co-operation. Thus, the danger of rendering more difficult the discount policy of central banks in countries on whose money markets foreign exchange tends to accumulate would be alleviated, if not removed.

The disturbing influence on the gold market and on the distribution of gold can also be removed. In order to attain this aim, banks working under the gold exchange standard should continue to purchase foreign exchange and include it in their reserves as therefore, but holding it with other central banks only, — whereas they should not be permitted to sell foreign exchange to the public in cover of claims resulting from imports or debt obligations. Instead of selling foreign exchange, they could sell for example cheques drawn on foreign central banks and payable in gold. Thus we would have a form of selling gold earmarked abroad and not from the bank's own vault. Such cheques or certificates should be drawn in grams of gold and remain valid for a certain fixed period, say a week in Europe and two weeks in relations with America. The new system would obviously require a division of gold reserves, increasing the portion earmarked abroad and reducing the portion held in vault.

After all, such a repartition of reserves would not be difficult nor absolutely necessary, because — granted a close co-operation between central banks — a bank drawing a gold certificate would

purchase its value at a foreign central bank and reduce accordingly its account with this bank. The other bank would in its turn sell this gold debiting the account of the first bank, but at the same time it would purchase back the same amount of gold from the customer presenting the certificate received from abroad. The purchase and sale of gold would thus constitute two synchronic transactions. Transports of gold would become unnecessary and international movements of metal would be effected by book entries.

The gold exchange standard would thus modify into a gold clearing standard, retaining the advantages of the pre-crisis system and losing its disadvantages.

Finally, there is one more question in connection with the reform of the gold exchange standard. It is the growing importance of international movements of short-term capital. The pre-crisis practice of the gold exchange standard tended to increase the disturbing influence of such capital. A reform of the pre-crisis practice will not in itself remove this danger. The accumulation of short-term private deposits in the leading markets determining the functioning of the gold standard has always widely exceeded the accumulation of foreign exchange belonging to central banks working under the gold exchange standard. A reform of this system will not in itself solve the problem. However, we already have Prof. Keynes' interesting suggestion in this respect. According to it, the future gold standard should adopt a wider margin than heretofore between gold-points in order to check the disturbing influence of capital movements on gold movements.

Should my system of a gold clearing standard be accepted, technical conditions would be created under which central banks would be able, by continual and close co-operation, to fix in an arbitrary way a wider margin between the purchasing and selling points of gold, because physical transports of gold would disappear altogether giving way practically to a monopoly of central banks. At the same time such co-operation would have chances of exercising control over forward transactions usually accompanying speculative movements of capital. Of course I mean control in the sense of a moral influence preventing the abuse of such transactions and in no way interfering with their natural function in connection with economic necessities.

2. *Mutual credits of Central Banks*

The technical reforms suggested in the preceding chapter are interesting from a theoretical point of view. In practice, however, they do not answer the most important question, viz: in what way assistance should be given to the debtor countries endeavouring to save the remainder of their gold and foreign exchange reserves by all kinds of trade restrictions and foreign exchange regulations? For there can be no doubt that a favourable start of debtor countries i.e. the possibility of carrying through a relaxation of foreign exchange and trade restrictions, will be of paramount importance to the general return to stabilization and to a normal functioning of the gold standard. It is a more important problem than the reform of the gold exchange standard and the lowering of minimum reserve requirements.

It would be an illusion to expect that a debtor country, drained of metallic reserves and fighting desperately against further outflow of foreign exchange, would be able without further special assistance from abroad to abandon the present anti-liberal commercial policy and embark upon a policy of free exchange of goods. To-day even creditor countries lack courage to take this step and persist in maintaining the system of quotas and compensations or, some of them, hesitate to stabilise at a new level. It would be still more misleading to expect the restoration of international credit and to induce creditors to add new loans to the old ones, which have not been paid off.

In the light of the above, the start of debtor countries with the assistance of new credits granted for this purpose by creditor countries is highly improbable. There remains only one issue; the creation of a new form of credit by the central banks of debtor countries by means of their closer co-operation. Should it be possible to create such a new form of credit, the central banks which would avail themselves of this kind of mutual credits would dispose of the new form of foreign exchange in addition to their present reserves. The pressure on the old reserves would be reduced in the same proportion. To this extent a gradual increase in the volume of international trade and repayment of old debts might be facilitated.

In the first phase of the new system of co-operation the paying capacity of debtor countries would improve without any

help from creditor countries. Should this first step prove successful, it would be easier for the latter countries to join this action at a later stage in order to lend support to the fortunate initiative of debtor countries.

I see the possibility of such an initiative in the field of commodity exchange between debtor countries.

International economic intercourse consists in a continuous exchange of goods and services on the basis of their value in gold. The differences in mutual liabilities are settled by means of gold which, from the international point of view, is not money but the most suitable instrument for covering deficits. Let us recall that a transaction which represents import to one country means export to another. The total volume of imports of all countries is equal to the total volume of exports if expressed in terms of gold. Suppose, moreover, that all countries enjoy a continuous equilibrium in commodity exchange, i.e. that the value of their imports is always equal to that of their exports. There is no excess of imports over exports and there is no necessity to use gold or foreign exchange for covering deficits. This would mean an ideal state of equilibrium in world economy.

Presupposing the hypothesis of such an ideal equilibrium, it would not be difficult to envisage that the total trade in goods would be carried on by means of exchange clearing between the respective central banks. The importer of country A would, for example, apply to his central bank and buy there a crossed cheque (serving exclusively for settling payments) which would be drawn by the central bank of country A on the central bank of country B, i.e. the exporter's country. For such crossed cheque the importer of country A would pay to his central bank in the domestic currency according to parity of exchange in relation to the currency in which this cheque has been drawn. The exporter of country B receiving such a cheque from the importer of country A presents it for payment at the central bank of country B. The crossed cheques should be drawn in one of the strong gold currencies.

The final payment would take place by means of simple clearing between the two central banks. Granted an ideal state of equilibrium, no larger and permanent differences in the volume of mutual obligations would accumulate, except temporary differences resulting from seasonal trade fluctuations. On an annual basis, commodity exchange would be carried on smoothly by

means of the clearing of crossed cheques and without using gold.

Unfortunately, actual international trade never reaches a state of ideal equilibrium. Although the value of yearly world imports is more or less equal to the value of total exports being two sides of one medal), — it is no more than a statistical fiction having but little in common with the real technique of payment. The situation is complicated by many factors. Besides seasonal fluctuations which are possible even under an ideal equilibrium, frequent changes in prices come into play, as well as sales on credit contributing to the postponement of payments and being responsible for the fact that the balance of payments never coincides in time with the balance of actual commodity exchange. Moreover, other factors also come into account, such as the total of so-called invisible assets or liabilities. Last but not least, international credit brings about movements of capital complicating still more the technique of international payments.

It is obvious without further examples that in time the balance of trade corresponds less and less to the balance of foreign payments. Instead of approaching the state of ideal equilibrium, world economy is retreating from it. Consequently, we persist in applying the old traditional methods of payment, much more ancient than central banking.

Instead of direct exchange clearing, which was and remains impossible as far as the total volume of international exchange of goods and services is concerned, every importer is looking for foreign exchange on the market, while every exporter offers the same for sale. The foreign exchange market on which the purchase and sale of bills plays a main part is an institution older than central banking. The supply and demand on this market regulates the exchanges and central banks play the part of last resort to which the market can appeal. Regardless, however, of the different methods of payment, international trade remains what it was, i.e. the exchange of goods and services using gold as an instrument for settling differences in obligations. And, though we have not been able so far to create a direct clearing of obligations resulting from commercial exchange, the latter, if taken from a broad perspective, is affected in its last stage as if the system of exchange clearing existed.

The process of payment extends over a longer period but, sooner or later, the ultimate result is the same: those payments balance. The difference in time between the balance of trade

and the balance of foreign payments (resulting from the former) displays rather a tendency to increase. In spite of this fact, however, in actual practice both accounts will balance each other sooner or later depending on the interference of services and credit in the total of international exchange.

The statement of the simple and undisputed fact that commercial exchange is in its ultimate stage an exchange of goods for goods renders more easy the reconsideration of the question whether it would be possible to organise this exchange by means of clearing, without employing the existing gold and foreign exchange reserves in central banks. Clearing of the total exchange of commodities, as we have seen above, would not be possible. Country A imports from country B more than it exports to the latter and on the other hand exports to country C more than it imports from the third country. Moreover, the exchange of commodities is linked with the exchange of services and of capital. In result the general balance of foreign payments overshadows the balance of trade which represents only a part of the mutual obligations. The question remains open, however whether it would not be possible to settle payments resulting from at least a part of the commodity exchange by means of a clearing of mutual obligations, without resorting to effective transfers of gold and foreign exchange.

Let us illustrate this question by an example.

Suppose that country A imports from country B goods to the amount of 100 million french francs. Simultaneously country B imports from country A goods to the value of 60 million francs. The clearing of the total is not possible, because country A imports for 40 millions more and will be indebted on account of this excess of imports. Moreover, the exchange of services and of capital also comes into play. Suppose, however, that the central banks of both countries make an agreement on the basis of which they grant each other a mutual revolving credit of 30 million francs. At the same time they arrange that, within the limits of this credit, they will sell to importers on presentation of invoices crossed cheques in francs drawn by one central bank on another. Then a permanent excess of liabilities of one of these banks towards the other will never occur. For, if such an excess appears, it will be liquidated within a short period, because the fixed amount of credit will constitute only a part of the value of the total imports. The bank which sells a greater sum in

crossed cheques, thus having larger temporary liabilities, will suspend their future issue, lest they should exceed the limit. At the same time the other bank continues to sell such cheques and within a short time the sum of mutual obligations will be balanced.

Knowing from experience that compensation, sooner or later, is bound to come, both banks will be able to avail themselves of this credit at leisure, thus contributing to the reduction of the pressure exerted on their previously accumulated reserves of gold and foreign exchange. In this way their transfer capacity will improve. It will be easier then to use a part of their gold reserves for increasing foreign trade or for the payment of debts. It is not an illusion because the mutual credit would be a revolving one. If the limit of 30 millions is attained before the end of the year, it may be subsequently liquidated in part by means of compensation and then utilised again. During the period of a year a larger part of imports than the equivalent of 30 millions might be compensated in this way. Without the inflow of new credits from creditor countries the transfer capacity would improve undoubtedly.

The advantages of the new system of co-operation are not obvious enough if we confine ourselves to the example of two banks only having concluded a credit convention. Suppose however, that the system of mutual revolving credits is extended not over two, but over, say, ten banks. Then the liquidation of temporary surpluses will be easier, because a bank which is indebted to one member of the system can at the same time be the creditor of another. The clearing of crossed cheques could thus be effected in triangular or polyangular combinations. An ideal solution of this problem would be to use the Bank for International Settlements as a common centre for all members of the system. Clearing could take place once a week or once a month depending on practical experience. Should one of the member banks register a surplus of liabilities, while the other bank would not give its comment to wait for compensation which, sooner or later, is bound to come, the B.I.S. could lend temporary assistance to the debtor bank by extending credit to it. Such a credit would be secured by crossed cheques purchased from the creditor bank, while gold earmarked at Basel or in the given central bank to the account of B.I.S. could form an additional guarantee. Relatively small sums would be involved,

say 5 % of the total gold holdings of the given central bank. It would be an arrangement similar to the gold clearing fund of the Federal Banks of the United States, where likewise 5 % of their gold reserve had to be placed at the disposal of the Secretary of Treasury in Washington in order to liquidate the surplus of liabilities between Federal banks. The difference would consist in that in America the gold clearing fund serves to liquidate the surplus of liabilities arising from the issue of notes, while under the system as suggested here the gold fund at Basel would serve to liquidate the surplus of liabilities arising from the issue of crossed cheques.

Approaching the end of my considerations, I wish to make one important reservation. In the plan just outlined, technical details constitute only an illustration of the essential idea and should not be considered indispensable for the realisation of the system. This concerns such details as the currency of cheques, the amount of mutual revolving credit, the relation between the amount of this credit and the value of mutual imports, the methods of liquidating the surplus of liabilities with the assistance of the B.I.S. and the form of the temporary credit granted by the B.I.S. to the banks joining the convention. It goes without saying that all these technical details require a closer study by competent experts. And even after such a study it can be said in advance that only practice and experience will show gradually how to develop and improve the new system.

I for my part will for the present emphasise only the fundamental idea that :

- in spite of the deplorable state of metal and foreign exchange reserves in debtor countries;
- in spite of the difficulties these countries encounter in securing new credits on the markets of creditor countries;
- in spite of existing trade restrictions and exchange regulations;
- some credit action aiming at facilitating and accelerating general stabilization is possible.

The secret of action of this kind lies in the credit co-operation of the central banks of debtor countries and in the strengthening of this co-operation by having crossed cheques cleared at B.I.S. There was and is no such co-operation. If a group of countries willing to start the above system could be found, others would follow the example. Such a supposition is no

academic hypothesis, because the system as outlined here gives the possibility for carrying on a large portion of annual imports with the help of the new form of credit and, which is no less important, without calling upon London, Paris, New York and creditor countries in general.

The experiment would be relatively easy, because it threatens on one with a complication of foreign payments, nor does it require any modification of the statutes or any violation of the traditional principles of central banking. This last consideration is of particularly great importance, because we know from experience that any alteration of the statutes or of the traditional methods of banking meet with great difficulties and it is advisable to avoid them, lest confidence in the domestic currency should be impaired.

Likewise, if no changes are introduced in the statutes it would be easier to abandon the whole experiment, should practice not justify our expectation. Thus, the experiment would present no risk and its liquidation would entail no loss.

Suppose, however, that actual practice will confirm the theoretical expectations, i.e. the proposed system will develop and embrace an increasingly large number of central banks. Let us finally imagine that all central banks of the world will be linked together into a system of such mutual credits and that they will organise through the intermediary of the Bank for International Settlements a general clearing of the respective cheques and create a common gold fund, serving to liquidate surplusus of liabilities. Should the total amount of mutual credits reach the sum of one-third of the total value of world imports, then not one-third, but about half of the total world trade could be carried on without resorting to actual transfers of gold or foreign exchange, as it would be based on credit clearing. The surplus above one-third would be due to the fact that the credit in question would be a revolving one, i.e. the maximum limit could be reached more than once during the period of a year.

The total volume of new interbank credits, equalling one-third of the total value of world imports, would amount to about 4 billion gold dollars of the old parity, if the figures of world trade for 1935 are taken as basis of calculation. The expansion of bank credits by such a large amount and the reduction in the same proportion of the pressure on the existing reserves of gold and foreign exchange of central banks ought to exert a depressing

influence on the purchasing power of gold. Is it not the major problem, since the crisis consists mainly in a prolonged process of appreciation of the value of gold? Will not the proposed system, helping to reserve this tendency, contribute to the economic recovery of the world?

February 1936.

(Signed): Feliks MLYNARSKI.

Memorandum
on
the frozen credit problem in Central Europe

by

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There is still outstanding a great mass of "frozen" or "unliquidated" indebtedness. How far is it possible to envisage a return to gold without a previous clearing up of these positions? How far is it necessary to envisage special machinery (index numbers, loans, international tribunals, etc.) to prevent a repetition of such difficulties in the future?

The problem of the external indebtedness of the Central European countries is one of the most important factors in the dislocation of trade and international credit. The general aspect of the German problem being, I suppose, a matter of common knowledge, I shall confine myself to Central and Eastern Europe and shall study the origin and actual situation of the problem as regards these territories. I shall begin by observing that Czechoslovakia is the only country to have pursued a policy differing from that of its neighbours and to have refused the offers of long- and short-term foreign capital with which this country was inundated. This is why, during the five depression years which followed, this problem did not assume the same importance as in the other debtor countries. Debt transfers were not suspended and are still proceeding, notwithstanding the aggravation of the situation due to Czechoslovakia's creditor position as regards countries which have suspended their transfers, and its debtor position as regards the countries of Western Europe, with which its debt transfers are still proceeding. The other countries of Central and Eastern Europe -- in particular, Hungary, Austria,

Yugoslavia, Rumania, Greece and Bulgaria — are typical examples of that group of States which, after the war and during the international boom period, received considerable capital from abroad, generally in the form of short-term loans.

At that moment, all these countries were faced with the necessity of reconstituting the capital lost during the war and the post-war inflation period, and many of them were in need of capital for purposes of economic recovery. In this connection, it should be pointed out that this part of Europe must be considered as an *immense reservoir of purchasing power*, which is also a source of profit for other European countries. To stimulate the economic development of these countries, it is necessary to provide them with long-term credits, as done by Great Britain before the war, in the case of overseas countries.

One of the essential causes of the above-mentioned difficulties is that a considerable amount of this capital was invested at short term and at a high rate of interest. The debtor countries (the South American countries were in a similar position) had regular recourse to further loans in order to pay off the principal and interest of their debts, thus meeting their obligations by means of an increase in the latter.

As soon as the situation changed, and the creditors, actuated by anti-economic motives, made efforts to recover the capital advanced, it was inevitable that considerable difficulties should arise in the debtor countries and even spread to their neighbours. Completely unaware of the real situation, the creditors had neglected to study transfer possibilities when granting the loans, and continued to ignore this question when contemplating the withdrawal of their capital.

This calling in and suspension of credits gave rise to successive transfer *moratoria* in Hungary, Austria, Yugoslavia, Greece, Bulgaria, and finally Rumania. An early result of this measure was to hold up the settlement of current commercial debts; this, in its turn, called forth reprisals on the part of States with frozen export liens on the former countries and, finally, resulted in the institution of clearing systems based on the rigorous control of foreign exchanges. At the present moment, there is unanimous agreement as to the mistake made by the creditor countries — and also by the debtor countries — and the serious consequences which it has entailed as regards European trade as a whole. These clearing agreements were dominated

by the anti-economic pre-occupation of equilibrating individual trade balances from country to country, the inevitable result being the throttling down of international trade. They spread like a rising flood from Eastern and Central Europe to the Western countries and constitute an insuperable obstacle to international trade.

The object of the foreign exchange control exercised in the majority of these countries was to prevent the export of capital and to maintain the currency at its normal parity. It was soon realized that the impossibility of meeting obligations towards foreign creditors, e.g. commercial commitments, proved no obstacles to the smuggling of goods and foreign exchanges, that even the most rigorous control could not hinder the formation of *unofficial* rates, concurrently with the official rates, and, similarly, that it was powerless to prevent *currency depreciation* in various form and in varying degrees. And we are now confronted with the phenomenon that neither transfer moratoria nor clearing agreements, nor foreign exchange control have sufficed to check the formation of different exchange rates, to dispel lack of confidence and to avoid currency depreciation in countries which have resorted to these measures. In the creditor countries, the transfer problem has been completely overlooked as has also that of European indebtedness to the United States. The principle that international debts can only be paid in *goods and services* — in the absence of adequate international credit — has not been observed, and this is one of the causes of the increasing aggravation of the situation in the debtor countries. The latter were unable to meet their obligations from the moment that the creditor countries persisted in their commercial and financial policy.

Thus, from the monetary point of view, the repercussions of this problem are evident in the form of the *ceasing of uncontrolled payments* from country to country and the *unofficial depreciation* of the currencies, the rate of which is subject to fluctuation, and is sometimes at a lower level than that at which it would be maintained if the transfers had continued and if the automatic functioning of the foreign exchange rates were assured; from the economic point of view, the said repercussions take the form of a dislocation of international trade which tends to obstruct the exchange of capital, to compress the volume of the balance of payments and, accordingly, to restrict the possibility of equilibrat-

ing the latter. If, at the onset of the depression, it had been possible to persuade the creditors, by arguments of an economic character, to convert the debts into long-term credits, in view of the falling off in the prices of the principal export commodities of the debtor countries and the necessity of lowering the rate of money, the situation in the latter countries, and with it the economic situation of the whole of Europe, would have developed on different lines.

But the economic evolution continued, and numerous problems, also connected with the debt question, righted themselves *automatically* in the countries under discussion; thus it is that the *actual debt total is probably considerably lower* than the figure laid before the Stresa Conference in September 1932. Up to a certain point, it is possible to quote, for purposes of comparison, the case of Germany, whose indebtedness at the present moment has certainly fallen to less than half the estimates of 1931-1932, so that, viewed from the angle of the balance of payments and in the event of a normal development of the economic situation, the debt problem is no longer, as formerly, a vital question for Germany. The manner in which the *debt burden* of the countries of Central and Eastern Europe has been *lightened* calls for some explanation. As regards sterling and dollar debts, an automatic decrease followed on the fall in these two currencies. Further alleviation was initiated by the creditors themselves in the form of a *reduction of interest* and the conversion of part of the debts into long-term credits at a lower rate of interest.

A large amount of foreign capital was invested in the mines and the industries of the debtor countries and remains in these countries in the form of long-term capital investments.

Finally, certain minor settlements, effected abroad, took the form of the winding up of the assets of the debtor countries in other States; and in certain countries (Austria, Yugoslavia, Hungary), it was possible gradually to write off the debts by using these funds for touristic purposes in the countries themselves or for the purchase of stock or real property.

Austria has gone farthest in this direction; at the present date, the transfers are no longer subject to hindrance and the *debt problem has virtually been solved*. Hungary's situation is still comparatively precarious. In Yugoslavia and in Rumania, important capital investments in the mining and national industries have resulted in an increase of the export trade, and, accord-

ingly, in the means available for international payments. It is unquestionable today that the capitals which, during the last five years, could not be transferred and thus remained in the debtor countries have *contributed to the economic revival of the latter*, even if marked in certain cases by over-hasty industrialization, a factor which may, in its turn, result in further obstacles to international trade.

It may be said, on the whole, that, in the countries under discussion, the problem of the frozen credits is far less acute than in 1931/1932. Whether it is possible for these countries to return to the gold standard depends on a whole series of international questions. Above all, it would be necessary to abandon the principle of fictitious monetary parities, in order to secure a certain adjustment which would in itself facilitate the solution of the problem. In this respect also, Austria might serve as an example. The currency rate constituted under these conditions would not be lower and would probably be higher than the unofficial rates at present existing in the various countries. At the same time, it would be necessary to abolish the clearing agreements and to re-instate liberty of trade, the automatic functioning of which might lead to the constitution of a trade balance and of a balance of payments necessary for meeting reciprocal commitments, subject, naturally, to the modification of the trade balance of the other countries. A further stage would consist in the *consolidation* of what remains of the international debts, by means of an agreement between debtors and creditors, less difficult now than four or five years ago. In view of the depletion of the metallic reserves of these countries, with the exception of Czechoslovakia and Austria, the principle established at Stresa is still valid, namely, that it would be necessary to procure for these countries a *Currency Stabilization Loan*, the principal effects of which would, in reality, be psychological and moral rather than material. Generally speaking, it would appear impossible to surmount the existing obstacles otherwise than by a return to liberty of trading and the parallel re-establishment of the automatic functioning of foreign exchange rates and prices.

All these measures of consolidation converge towards one and the same goal, the goal which we have unceasingly before our eyes, namely the political problem. The clearing of the political horizon would appear the sole factor likely to facilitate the monetary and commercial consolidation of the debtor countries — together with the co-operation of the creditor countries,

which may not weigh very heavily in the balance. But, in this case, it must not be forgotten that the economic structure of the countries under discussion has been transformed during the depression, that they constitute a relatively enormous reservoir of purchasing power and future initiative and that it would accordingly be logical, in view of the present economic situation in Europe, to invest foreign capital in these territories.

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As regards the question of a special organization to cope with such difficulties in the future, I doubt whether such machinery could function on an international basis, even if generally accepted. One of the fundamental causes of the present depression lies in the decline of the price of corn and other export products of the debtor countries; a general clause providing for debt reduction in proportion to price decline might, up to a certain point, correspond to such depreciation, but certainly not in the degree to which the debtor countries have suffered. The use of such a clause would moreover prove an obstacle to future loans, in so far as, by restricting risk of price decline, it would result in an increase of the interest rate of a sum representing the anti-risk insurance premium. In view of the fact, moreover, that this accumulation of credit was due almost exclusively to the existence of the gold exchange standard, the effects of which are still visible although the system itself has been more or less abandoned, the danger of such credit expansion would appear less menacing in the future.

The sole method — capable of ensuring theoretical equilibrium — might take the form of a general clause for insertion in long-term loan contracts, based on the principle of loyalty and providing, in the first place, for the eventual revision of interest rates as soon as the latter, owing to general economic causes, such as a falling off in prices or fluctuations in the price of gold, become too unfavourable for debtor or creditor. The Financial Committee of the League of Nations or any other international body might be instructed to examine whether or not the clause should be applied. This would depend upon preliminary agreement of the parties to accept the arbitrator's award. But even if this were the case, loans would still be attended by an element of uncertainty which might exercise an unfavourable influence on the rate of interest and the complacency of the lender.

May 1936.

(Signed): Antonin BASCH.

**Memorandum
on
International short term indebtedness**

by

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INTERNATIONAL SHORT-TERM INDEBTEDNESS

I. *Introductory*

Whatever may have been the deeper forces underlying the situation in 1931, the proximate cause of the calamitous international liquidity crisis of that year, which broke the gold standard system so patiently and painfully restored from 1925 onwards, was the pyramiding of foreign short-term liabilities over and above foreign trade and other normal short-term financing. This financial crisis of unprecedented severity revealed in a crude light the unsoundness of the structure which had been built up. The movements of capital, so vast in comparison with experience gained in the past and still so recent as to be vividly remembered (even without the ever-present reminder of the wreckage left behind), induce a natural hesitation to take steps to restore an international standard without some assurance that the errors of the past will not be repeated.

The specific question may thus be posed: To what extent may it be anticipated that short-term foreign financing and the movements of short-term funds will affect the adequate working of an international standard in the future?

Before attempting to answer this question it is useful to give a brief review of events and to examine the results of experience gained.

II. *Before 1931*

The events of 1931 focused the attention of the world on the dangers to a country inherent in the accumulation of excessive short-term foreign liabilities and it is in fact only after the collapse that statistics have generally been collected and compiled on this subject on most markets. Although the Macmillan Report on Finance and Industry in England gave for the first time certain data on the short-term foreign assets and liabilities of the London market covering the years 1927 to early 1931, it was not until 1932, after the gold standard had been suspended in England, that the Bank of England obtained regular monthly figures covering the short-term foreign position of the banking system. In most European countries where the withdrawal of foreign funds in 1931 resulted in the imposition of restrictions on the exchange markets a census of foreign liabilities was made and the extent of the position revealed for the first time. For the United States yearly figures, which are fairly comparable since about 1927, have been collected and published in connection with the admirable studies on the balance of payments of the U.S.A. made at the Department of Commerce; since 1927 also the figures of all member banks of the Federal Reserve System on the "call dates" (about once a quarter) contain indications of foreign short-term assets and liabilities, while the weekly figures of the "reporting" member banks as published since November 1935 show the total foreign deposits with these banks representing over 90 per cent of the quarterly figures of all member banks). The work of the League of Nations Secretariat on balances of payments has induced the appropriate authorities in a number of countries to collect and publish at least yearly figures on the movement of short term foreign assets and liabilities. Only in very rare cases are statistics available regarding the pre-war period — in particular, it may be mentioned that the Swedish private banks have published their foreign claims since 1861 and their foreign liabilities since 1877, while the private banks of Finland have published monthly figures of their foreign assets and liabilities monthly since 1886. These are, however, exceptions to the general rule; evidently it was thought either that the subject was of insufficient importance to warrant special attention or that no particular danger was to be anticipated from this direction.

But the problem is not a new one and a reference may be found in Bagehot's *Lombard Street*, to the position in London over sixty years ago, when the large payments from France to Germany made over London caused the accumulation of a German deposit amounting probably to £ 40 million and of which Bagehot said "— this foreign deposit is evidently of a delicate and peculiar nature. It depends on the good opinion of foreigners, and that opinion may diminish or may change into a bad one... In proportion as we augment the deposits of cash of foreigners in London, we augment both the chances and the disasters of a 'run' upon England. And if that run should happen the bullion to meet it must be taken from the Bank..." There is little doubt, however, that such special deposits in London were exceptional before the war. But the growth of international trade with London as the "clearing" centre led to the growth of London's short-term position on foreign account; Bagehot says: "A large deposit of foreign money in London is now (1873) necessary for the business of the world... for the deposit at a clearing-house necessary to settle the balance of commerce must tend to increase as that commerce itself increases." London was, before the war, probably the only market which had foreign short-term liabilities of any magnitude and these liabilities (and corresponding assets) arose naturally in connection with the trading activities of the country and London's central position as banker of the world¹. Shifts in the foreign position of the market, often arising from some disturbance thousands of miles away, were always a possible source of strain to London and this, combined with the slender gold reserves on which the structure was based, was a reason for the frequent changes of bank rate (in 1873, for example, the Bank of England changed its rate on an average once a fortnight). More than once the London market turned for help to Paris which, with strong gold reserves and a less sensitive foreign position, was able by granting credits to tide London over its difficulties (as, for instance, in 1837 and 1890).

After the war new complications arose. The financial strength of the United States and the growth of that country's foreign trade caused the emergence of another financing centre

¹ It should be recalled, however, that Germany before the war regularly borrowed the equivalent of some 3,000 to 4,000 million marks from the West (chiefly from London) at short-term (up to 3 months) and lent on longer term to the East (chiefly to Russia).

and "clearing-house" of considerable importance in New York. World trade had thus two great clearing centres between which large balances arose to be settled over the sterling-dollar exchange. From 1927 to 1929 the short-term liabilities of the United States on foreign account were around \$ 3,000 million and at the end of 1930 were within 10 per cent of this level. These liabilities arose not only on trade account but also for the following reasons :

- a) The United States was lending very heavily on long-term account and short-term balances naturally arose between the time of the flotation of an issue and the final utilisation of the proceeds;
- b) The growth of the system of central banks holding foreign exchange to supplement their gold reserves was considerable after the war and was based largely on dollars;
- c) The attraction exercised at certain times by the high rates for "call money" on the New York stock exchange.

And besides lending at long term a considerable volume of short-term foreign lending took place from New York. At the end of 1930 the United States short-term foreign banking assets attained \$ 1,800 million, of which about one-half was on account of acceptance credits granted.

After the stabilization of the franc, Paris also became an important financing centre by reason of the enormous banking reserves of gold and foreign currencies built up after 1926, largely as the result of the repatriation of funds exported by French nationals in the years 1923-1926 and representing the unrealised active current balance of payments of those years with a depreciating currency. At the end of 1928 the Bank of France held the equivalent of over F. fcs. 32,000 million in dollars and sterling at short term on the New York and London markets, while the other French banks probably held a further F. fcs. 5,000 million or more (which was partly re-lent to Germany). Other secondary centres such as Amsterdam and Zurich were also lending abroad much larger sums than usual at short term.

But a further complication in the post-war period was the heavy foreign borrowing at short term by Germany and central and south-eastern Europe generally. The short-term foreign liabilities of London and New York were denominated in the home currencies and arose either out of foreign trade financing or from deposits made by foreigners in these great banking

centres. To some extent these liabilities were incurred in the usual course of business and were comparable with pre-war experience, although surpassing the normal volume. The short-term debts of Central Europe were an entirely new and abnormal factor and were denominated preponderatingly in foreign currencies. The currency inflations following the war destroyed the working capital of these countries which were also called upon to transfer enormous sums on reparations and war debts accounts. In addition, capital was exported by nationals of these countries to escape the monetary disorders at home. From 1924, when the Reichsmark was stabilized and the Dawes plan came into operation, Germany borrowed heavily abroad and foreign funds were invested in the country. By the end of 1930 the gross foreign indebtedness of Germany (omitting German assets abroad) amounted to over RM. 30 milliard, as follows :

	RM milliard
Long-term (bond issues, etc.)	11
Foreign investments in Germany	6
Short-term	<u>14 1/2</u>
	31 1/2

From 1924 up to the middle of 1931 Germany borrowed abroad at long term nearly RM 10 milliard and paid about the same amount in reparations. It is probable that Germany borrowed as much as was possible on foreign markets at long term while the hunger for capital remaining in the country attracted foreign short-term banking funds, which were abnormally large owing to the active balances of payments of the creditor countries (themselves due partly to reparations and war debts receipts). Political uncertainty also contributed to the granting of credits nominally at short term (often for long-term purposes).

The developments in Austria and Hungary were somewhat similar, although on a smaller scale. Published data for the latter countries are not available until the end of 1931, when already a large portion of the short-term indebtedness of the three countries had been repaid.

Short-term foreign debts	End of 1931	
	National currency	Swiss francs
	(in millions)	
Germany	RM . 10,500	13,120
Austria	Sch. . 1,329	970
Hungary ¹	Pengö 1,838	1,660
Total		15,750

Meanwhile the position of England had changed and the foreign short-term liabilities of London no longer represented only trade financing and the other foreign deposits incidental to the functioning of a "clearing-house". The Macmillan Report draws attention to the fact that "London is now (1931) practising international deposit banking, as distinct from international acceptance business and the deposits associated with this, on a larger scale than before the war". A large part of the foreign deposits in London had no commercial counterpart and were of purely "financial" origin. The position had gradually changed since the war for a number of reasons. The pound was supported before 1925 by the influx of American and other money invested in London to benefit from the declared policy of bringing back sterling to the old par. After 1925 American money was largely replaced by French funds which in 1927-1928 became concentrated in the hands of the Bank of France and the French private banks. In the latter year French deposits in London amounted to some £ 200 million. Other central banks also held considerable amounts of sterling in their reserves. When the gold standard was suspended in 1931 the losses incurred caused the revelation that the following central banks held sterling in their reserves:

	£ millions
France ²	62
Belgium	12 1/2
Holland	11
Java	2 1/2
Italy	17
South Africa	9 1/2
	<hr/>
	114 1/2

¹ Including some middle-term.

² Much reduced from the 1928 figure.

Some banks, like the Swiss National Bank, sold out most of their sterling before 21st September. Others known to have held sterling to a large extent in their reserves have not published figures, particularly the central banks of those countries whose currencies depreciated with sterling, and which thus made no losses.

Having adopted the gold standard at a rate which perhaps slightly overvalued sterling against the dollar and which certainly overvalued the pound vis-à-vis the French franc after the latter had been stabilized, the large volume of foreign funds in London was retained by the attraction of a comparatively high bank rate. London was also probably overlending at long term during this period. From 1925 to 1931 the current balance of payments showed an active balance of £ 350 million while repayments on capital account were perhaps £ 200 million, giving £ 550 million surplus on these items. Total long-term foreign lending exceeded this figure by over £ 200 million at £ 780 million, of which £ 470 million for the Empire. The Empire was undoubtedly a great drain on London at this time, especially after 1928 when the agricultural depression set in. A graph published in the sixth Annual Report of the Bank for International Settlements shows that the central sterling resources of India, Egypt, Australia and South Africa declined from the end of 1925 to 1931 by £ 100 million. If the total banking funds of Australia be included as well as those of New Zealand and the Crown Colonies and allowance be made also for borrowing of sterling utilised directly to cover adverse balances of payments to other countries, this figure would be more than doubled. Sterling was thus in a vulnerable position in 1931 when the liquidity crisis broke out.

The main factors in the position prior to 1931 may now be summarised as follows (not in order of importance) :

(a) There were two "clearing" centres for world trade financing after the war, exercising varying attractions during the period;

(b) The repatriation of capital which had previously gone abroad for safety put large accumulations of liquid foreign funds in the hands of a few holders, particularly the Bank of France and the French private banks;

(c) Reparations payments and the scarcity of working capital in Germany and Central Europe generally caused these countries to borrow at short term what they could not get long.

And fears of political instability made lenders content to lend short for "safety";

(d) The system of central banks holding foreign exchange in their reserves received considerable extension after the war;

(e) In many cases the monetary reserves held were inadequate compared with the volume of current foreign liabilities;

(f) London was in a vulnerable position for special reasons.

Thus a number of peculiar circumstances combined to raise the unstable structure which was imperfectly revealed by inadequate statistics and the danger of which was not well appreciated.

III. 1931 and after

The collapse of the Austrian *Kredit-Anstalt* in May 1931 shook the ramshackle structure and brought it tumbling down. Withdrawals of foreign credits from Austria, Hungary and Germany assumed panic proportions and some flight of national capital also took place: the drain was first met from central and other banking reserves and, as these proved inadequate, from credits granted by the Bank for International Settlements and by central banks — and finally by standstill agreements, foreign exchange restrictions and moratoria. Fears for the soundness of the banking system in Central Europe which started the 'run' grew into fears for the stability of currencies. By July sterling and the Scandinavian currencies came under pressure which they resisted until September when the gold standard was suspended in England. In October 1931 and again in 1932, there was a record efflux of gold from the United States which was, however, successfully met from the substantial reserves of that country.

Estimates given in the Annual Reports of the Bank for International Settlements show that the short-term foreign liabilities outstanding in Europe and the U.S.A. were reduced from the equivalent of Sw. Fr. 70 milliard at the end of 1930 to Sw. Fr. 45 milliard at the end of 1931, and from 1933 to 1935 they have fluctuated around 30 milliard. It is impossible to give precise indications of the various methods by which 25 milliard of Swiss francs of short-term debts were liquidated during the year 1931, but they may be roughly estimated as follows:

	Million Sw. fcs.
From central bank reserves of gold and foreign exchange	6,500
Central bank and other relief credits granted	5,000
From depreciation of currencies . .	3,500
In other ways (from foreign exchange reserves of commercial banks, by sales of securities, shifts in trade financing, etc, and including losses)	10,000
	25,000

It is evident that the methods by which repayment may be made are limited and the liquidation over the past five years has in general taken one or other of the following forms :

- 1) Replacement (English short-term credits raised in dollars and French francs to repay short-term foreign liabilities in sterling);
- 2) Consolidation into long-term (*Kredit-Anstalt* debts);
- 3) From current balance of payments generally or by earmarking some particular item (additional exports, Germany and Hungary: tourist expenditure, registered marks for Germany);
- 4) From balance of payments capital account (proceeds of debts repaid, partly in anticipation, to England in the spring of 1932 assisted in repayment of the francs and dollar credits);
- 5) By utilisation of gold and foreign exchange reserves;
- 6) By the swing of foreign trade financing back towards the normal.

A few remarks may be added with regard to the last item. It has been the experience in every country whose currency has come under pressure that importers tend not only to refuse to utilise the normal period of credit but to cover their requirements for months in advance: they prefer to utilise the home currency while it retains its international value rather than run the risk of being forced to pay extra for the foreign currency necessary for their purchases. Exporters, on the other hand, tend to allow foreign currencies, the proceeds of exports already made, to lie abroad and to finance their current operations as far as possible by borrowing at home. Thus a double strain falls on the ex-

change market: the normal supply of foreign currencies from exports dries up while the demands from importers greatly increase. For a country with a large foreign trade the strain on the exchange market due to the effects of this change over in trade financing may be very considerable. The swing back towards normal comes when the expected depreciation of the home currency has taken place or when the danger is presumed to have passed — or sometimes earlier as traders are unable to maintain their positions any longer. The strength of sterling and the Swedish krona in the spring of 1932 was due in part to the fact that the normal demand for foreign exchange from importers was not present, having been met in advance in the previous autumn.

To compare the changes in structure of international short-term indebtedness from 1930 to 1934 the following rough calculations are made:

- a) Trade financing — it may be estimated that finished goods are imported on three months' credit while foods and raw materials are paid for on an average one month after shipment; world trade is 40 per cent in manufactured goods and 60 per cent food and raw materials and these percentages and credit terms are applied to the figures of world imports in the table below;
- b) Central bank holdings of foreign exchange are known approximately;
- c) Funds accumulated for foreign debt service may be estimated roughly at three months interest — for this item one-quarter of the receipts from interest and dividends each year has been taken from the special table in the League of Nations memoranda on balances of payments — with estimates made for missing data.

The results obtained are presented in the following table:

In milliards of Swiss francs	At end of year				
	1930	1931	1932	1933	1934
Trade financing	22	15	11	9½	9
Central banks holdings.	14	7	4	3½	3½
Foreign debt service .	4	3	2	1½	1½
Total	30	25	17	14½	14
All other	40	20	22	17½	15
B. I. S. estimate of total ¹	70	45	39	32	29

This table is intended to give merely an idea of the order of magnitude of the items and not, of course, a mathematically accurate picture. The rise of "all other" in 1932 may be due to the blocking of current trade debts on account of foreign exchange restrictions, beyond the "normal" volume shown under the first heading. Otherwise the decline of the items has proceeded from year to year.

The item "all other" includes such classes of funds as those of Australian and Irish banks in London, which to a certain extent supplement the sterling reserves of the Commonwealth Bank and the Irish Currency Commission, but it also comprises the abnormal short-term lending of the post-war period and other "bad money". This item, it is hoped, will continue to be reduced, while trade financing and foreign debt service should increase with the return of better times.

Rough comparison with 1913 may be made as follows :

¹ This estimate applies only to Europe and the U.S.A. and it must therefore represent something rather short of the world total. The B.I.S. estimates are made by adding together the data obtained and estimates made for the countries taken separately. The above table gives a new approach to the subject.

SHORT TERM INDEBTEDNESS

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In milliards of Swiss francs	1913
Trade financing	15
Central banks holdings	2 1/2
Foreign debt service	2 1/2
	Total 20
All other	?
	Total ?

The total of the first three items is one-half only of the 1930 figure, while "all other" must have been relatively very low.

A review of the present situation gives a completely different picture from that of 1930 before the breaking of the crisis. The total short-term indebtedness in gold values has been reduced to less than half, although this does not of course give a real measure of the reduction of the debt in national currencies and account must be taken of the depreciation of sterling and the dollar by some 40 per cent. The material upon which the estimate of the Bank for International Settlements is based is to a great extent confidential and the division of the total amongst the various countries has thus not been made public. But the three principal debtors at short-term are Germany, England and the United States and for these countries certain figures have been published from which the next table is compiled :

In milliards of Swiss francs	At end of years	
	1930	1934
Germany	20	8
U. S. A.	14	2
England ¹	10	6
	Total 44	16
Others	26	13
B. I. S. estimate of total	70	29

In broad lines the principal changes in the position are as follows :

a) The short-term indebtedness of Germany has been reduced by well over 50 per cent, in fact, the total short-term debt was

¹ Taking the Macmillan Report figure of £ 400 million at the end of 1930 which was perhaps rather too low. For 1933 the B.I.S. fourth Annual Report says : " Calculated in sterling total foreign short-term funds now appear to be in the neighbourhood of the 1930 level " — this figure is here carried forward to 1934 merely as an indication.

estimated to have attained over RM 16 milliard in the middle of 1930 and for January 1936 is given at RM 6 1/2 milliard; what remains is blocked by exchange restrictions, standstill agreements or on clearing accounts. The indebtedness of Hungary and other central and south-eastern European countries, although lower than in 1930, is still such that there is little chance of the free movement of capital being restored until measures for consolidation have been undertaken. The only exception is Austria where with energetic selfhelp and the aid of a relatively small foreign loan it has been possible to clear up the wreckage of 1931, to abolish most of the exchange restrictions and to allow standstill agreements to lapse.

b) The short-term assets of foreigners held in the United States have been reduced from nearly \$ 3 billion in 1928/1929 to around \$ 1/2 billion in 1933/1934 owing largely to the liquidation of central Banks' holdings of dollar reserves. In 1935 the flow of funds to New York has again raised the short-term liabilities of the United States to over \$ 1 billion, the highest level since the spring of 1932.

c) The short-term liabilities of London changed very considerably in composition — the short-term assets of the sterling area countries grew rapidly (particularly in 1933 and the first half of 1934) from the exceptionally low level of 1931; American funds in London grew, particularly in 1933, while sterling short-term assets of the gold bloc, and of the continent generally, were reduced to the bare minimum compatible with current business relations. During 1934 and 1935, American funds were largely withdrawn, their place being taken by an influx of capital from the gold bloc countries.

d) The short-term liabilities of the gold bloc countries, which were low in 1930, rose in the intervening years on account of the influx of foreign capital which has since been withdrawn. Capital funds, the property of nationals of the gold bloc countries held temporarily abroad in foreign currencies (mostly sterling and dollars), have grown considerably in the past two years and at present amount to a very substantial total.

IV. *The experience gained*

What are the various types of short-term foreign liabilities and what does experience teach of their behaviour in a time of crisis?

"Short-term" is usually taken to imply the employment of funds up to a maximum of twelve months, by central banks and other agencies which collect statistical information on this subject. The dividing line between short and long is however rather indefinite and the volume of short-term funds is constantly fluctuating as through the mechanism of the stock exchanges a long-term foreign liability of a market may be quickly mobilised and become short. It is therefore necessary to take into account the *intention* of the holder of the funds (e.g. British Government securities held by the National Bank of Egypt or the Sveriges Riksbank against the note circulation), and also the *potential* short-term (i.e. mobilisable longer liabilities).

It is also necessary to distinguish between a) short-term *credits* made on the basis of a definite written contract (bill, acceptance, etc.) which may again be divided into various classes — trade financing (bill, etc.), banking credits (in anticipation of long term issues, etc.) etc and b) *deposits* from foreigners (generally in the large money markets) of which the classes are — central bank and other banking reserves, trade financing (balances of international companies), arbitrage balances, "flight money", etc.

In spite of the difference in initiative involved in a credit (a) and deposit (b), the debts are generally denominated in the currencies of the (long-term) creditor countries.

Although technical and legal differences exist between credits granted by a foreign bank to a debtor country and a foreign deposit placed in a creditor market, experience has shown that those different types of short-term liabilities can in fact be equally dangerous. Thus the calling of credits mostly expressed in foreign currencies from Germany in 1931 was followed by the withdrawal of balances denominated in sterling from England, each with disastrous results.

In a crisis a particularly dangerous type of short-term liability is that against which there is no specific asset. Funds accumulated to meet debt service or some other maturing liability cannot easily be disposed of, but moneys deposited in a market merely to earn a higher interest rate or for "safety" may rapidly be withdrawn. Similarly, the foreign exchange necessary to repay a credit obtained to finance an export of merchandise is available automatically from the sale of the goods, while the employment of a foreign credit to finance some internal business

does not automatically provide a suitable asset to cover the liability if the credit is called.

Trade financing which normally turns over quietly without causing undue disturbance may, if a currency is suspect, be accelerated or delayed so that an unnatural strain is thrown on the exchange markets. The importance of pure speculation has been greatly exaggerated and in general speculation with borrowed money against a currency can only be successful in so far as it creates a psychological atmosphere favourable for other, more important, factors to come into play — and to be successful the situation must already be far gone.

Most dangerous of all, because no reserves may be adequate to cope with it, is a flight by nationals from their own currency.

V. *Some general considerations and prospects for the future*

The events of the past few years have tended somewhat to the eclipse of New York as a centre for the financing of world trade and commerce but there is little doubt that in the future the rival "clearing-house" to London will regain the lost ground and the disadvantages inherent in this decentralisation of functions will again arise. It seems inevitable that from time to time strains will occur on the dollar-sterling exchange which it will need the goodwill and co-operation of the authorities on both sides of the Atlantic to overcome, if serious difficulties are to be avoided.

In other ways, however, a number of important changes has occurred since 1930, which may be briefly summarised as follows:

a) The gold exchange standard in its post-war form is now completely liquidated, in particular no large country holds appreciable reserves in foreign currencies, and it appears unlikely that such enormous holdings as those of the Bank of France in 1928 will ever again be seen. On the other hand, there has been a growth of foreign exchange reserves held in "natural" centres, e.g. by the sterling area in London, and for these countries there is in general a safety-valve to let off the pressure of too great accumulations of sterling in the indebtedness at long term of the Empire countries to London.

The foreign exchange standard appears appropriate for smaller economies but even here certain guiding lines should be observed (concentration of funds through the central bank of the market concerned, etc.):

b) Devaluation and higher current production have almost doubled the gold stocks of the world measured in the devalued currencies. It follows that nearly twice as much national capital may be shifted with the same transport of gold.

This is of great interest in the case of London whose particular situation before 1931 has already been mentioned. The Macmillan Committee gave London's short-term foreign liabilities at their highest point of £ 500 million at the end of 1928 : at that time the Bank of England's gold reserve was £ 154 million. Even if London's foreign liabilities were now at the 1928 level the revaluation of the Bank of England's gold holding at present rates gives £ 350 million, in addition to the substantial reserves of the Exchange Equalisation Account and the foreign short-term assets of the market generally;

c) Reparations and other economically unnatural payments have ceased and it is unlikely that the pyramiding of short-term credits to Central Europe (or elsewhere), of which they were a fundamental cause, will ever be repeated;

d) Increased knowledge of the position — since 1931 nearly all central banks are, by law or persuasion, in the position to obtain information on the foreign short-term position of their market from the commercial banks and other institutions. In some cases, e.g. Switzerland, foreign lending must receive the consent of the central bank, and this attitude of the creditor countries is complemented by the position of reserve taken up by the borrowers; the President of the Austrian National Bank, for example, has declared that short-term foreign credits will not be accepted except for current trade financing.

But even taking into account the improved prospects which these new factors foreshadow, it must be emphasized that the technical safeguards which may be adopted by central banks can never be sufficient to fight successfully against an extensive efflux of national capital. The only safeguard against such calamities must be the absolute confidence of the public in the currency systems. This can only be achieved and maintained when general conditions are such as to deserve confidence. It is essential that parities with foreign currencies should be fixed at *fair* levels and that no country should attempt to obtain an unfair advantage of its neighbours. In addition, confidence will only be retained in the long run by a sound financial and economic policy which must be the foundation for a sound currency. In this connection

THE TECHNIQUE OF STABILIZATION

the effective collaboration of central banks is of the highest importance, but the financial and economic policy of governments is also fundamental.

It seems probable, in fact, that the world of the present day is more exposed to crises of the nature of 1929 and 1931 than was the case in earlier times, and more careful and informed management is thus called for. There has been an enormous growth of negotiable instruments, certificates, bonds and shares, etc., which are only liquid in so far as they may be sold or "shifted" to some other holder and do not have the self-liquidating qualities of the commercial bill. Estimates made for the United States¹ show that the ratio of "net liquid claims" to total national wealth rose from 15 per cent in 1890 to 25 per cent immediately after the war — and to 40 per cent in 1930. When a small proportion of these claims is presented they may be met but a widespread attempt to "cash in" strains the liquidity mechanism until it breaks. And this problem has also its international aspect. Nationally, banks and stock exchanges may be forced to close, while internationally currencies are wrenched from their moorings or maintained artificially only by rigid restrictions.

VI. *Conclusions and answer to original question*

It is essential for the working of an international standard to regain the freedom of capital movements where it has been suspended and to maintain it elsewhere. The free movement of capital is necessary for the normal levelling up of balances of payments and for the expansion of international business activity. It is, therefore, impossible to guarantee that in the future abnormal movements of capital will not again disturb the mechanism of the standard.

But before it is possible to restore the free movement of capital everywhere, the wreckage left behind from the liquidity crisis of 1931 must be cleaned up and in particular the situation in Germany and south-eastern Europe must be cleared of exchange restrictions and these countries must somehow acquire sufficient reserves.

But by and large it may be considered that for the future

¹ See *Liquid Claims and National Wealth*, by BERLE and PEDERSON, 1934.

there in a better chance of successfully overcoming the problems outlined in this note. Not only have central banks in general adequate statistics but these are better understood and, in the light of experience of the past, better judgment may be available for the future. In the period before 1931 repeated warnings were given by Dr. Schacht and others that the position was unsound but the significance of these pronouncements was not appreciated. Reparations have now disappeared and with them one of the fundamental causes of the growth of the unsound situation. A future international standard would start from a lower level of foreign indebtedness and there is little likelihood of earlier mistakes being repeated, at any rate on the same scale. In addition, the increased gold production and the higher reserves in those countries whose national currencies have depreciated give a more adequate basis for the foreign indebtedness which remains. The burden of external as well as internal indebtedness would be alleviated by a rise of world prices which, although slow in coming, appears inevitable in the long run.

But fundamentally the problem is one of confidence which each country must merit by its sane financial and economic policy and its ability to cope with new problems which present themselves and will not be solved along the patterns of the past.

May 20th 1936.

(Signed): F. G. CONOLLY.

Memorandum
on
the changes in economic structure and their repercussions
on the movements of capital and balances of payments

by

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Profound changes have been taking place in the technology of production, and in the relationship between the growth of population and the provision of overseas countries with capital facilities. It will be necessary to ask how far such changes are likely to modify the demand for capital in the future, and so alleviate pressure on the balances of payments of overseas countries.

The Joint Committee of the Carnegie Endowment and of the International Chamber of Commerce has done me the honour to ask my opinion on the problem enunciated above. I am replying, as briefly as possible, in the following memorandum.

Among the numerous factors influencing the future of the international capital market, improved production technique and variations in the rate of increase of populations can be isolated only by *abstraction*. But in a study in which it is desired to keep strictly to *facts*, it is impossible to ignore the influence of other factors which are today predominant. It is only by constantly bearing in mind the latter, that it is possible to determine, more or less, the action of the former.

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In view of the international political situation, it is necessary to bear in mind the following circumstances :

1. The gravity of the international political relations is such

as to warrant wide-spread belief in the possibility of serious conflicts in the future.

2. The events of 1935 and the first quarter of 1936 have proved the absolute inefficiency of the so-called League of Nations as an instrument of peace. They have shown, instead, that its interference may determine the outbreak of international conflicts of much greater gravity than those which it has attempted to eliminate.

3. No provisional settlement of existing controversies (Franco-German, Italo-Ethiopian, Sino-Japanese) seems likely to preclude the probability of greater and more violent international disturbances at a non-distant date.

4. Governments which foresee that they may be involved in future conflicts, are devoting their entire energy to placing their countries in best possible conditions of military defence and attack and of economic resistance.

Governments which hope to remain outside future conflicts are making serious efforts to create maxima conditions of economic independence as regards the potential belligerents, and to mitigate the effects of eventual conflicts on the life of their countries.

5. The struggle for international political independence — which tends to reserve to each State far-reaching autonomy in decisions of an international political importance — already active in various countries, has been justified and further stimulated by the application of "economic sanctions" to Italy, and the controversy on the Locarno Treaties.

6. Intensified re-armament has resulted in the absorption, by military supplies and works, of important capitals, part of which under different conditions, would have been available for international investments.

7. The development of the industries directly or indirectly concerned with war absorbs other important capitals part of which might, in other circumstances, have been available for international investments.

8. Increasing State intervention in economic life (production, exchanges, transportation, productive organizations, Unions etc.) and the increasing extension and costs of social legislation, phenomena due, in part, to the international political situation — also absorb considerable savings which might in part, under dif-

ferent conditions, have been available for international investment.

9. The above-mentioned circumstances combine to produce the following results :

- a) Shortage of savings for foreign investment;
- b) Entire preference for short term investments as regards the small amount of savings available for foreign investments;
- c) International investments for non-economic purposes, the lending policy of wealthier countries being directed towards the military and economic re-improvement of their allies and dependents.



Further study of the situation from the point of view of international economic life (if seems superfluous to recall the close interdependence of political and economic relations, but it is necessary to distinguish one from the other for the purpose of study), must be based on the following considerations :

1. International economic relations are profoundly perturbed, owing to obstacles to the international movement of goods, labour and capital; obstacles which are partly — but only partly — due, directly or indirectly, to the instability and gravity of political relations.

2. No provisional adjustment of monetary parity would eliminate the actual causes of the above disturbances; even if such an adjustment were effected (I do not believe that it is possible at the present moment), the majority of the political and economic factors which have, during the past years, led to the multiplication of the obstacles to economic international relations would still continue to exist.

3. The development of the autarkical movement, which now extends to the whole world, and which has been intensified in certain countries, has determined such far-reaching and deep-lying changes in the concerned national economies from the point of view of international trade, that the return to an international division of labour similar to that which existed before the War, appears purely and simply utopian; it would even seem impossible to return to the conditions of 1929 of anything approaching them. Autarkical tendencies show no sign of decreasing; on the contrary, they would appear to be spreading and increasing in intensity.

4. The tendency to create autonomous economic units, represented by great Powers (United States) or Empires (British, Soviet Russia, Japanese, French) constrain countries outside such groups, to pursue either alone or by forming small groups with others, territorially contiguous countries, a policy of economic independence, whereby they encounter far greater difficulties owing to the smallness of their territory and scarcity of natural resources. This situation contributes to the difficulties of the less-favoured countries in equilibrating their balance of International payments and makes them realize to the full the disadvantages of their territorial position and of the absence of poverty of their colonies. Thus political and economic conditions are created which discourage the investment of foreign capital in the countries in question.

5. The experience of the last 25 years shows that in many cases international investments have proved the most unfortunate of all speculations, leading to the partial or total loss of the savings thus employed. The guarantee of Governments, of important Credit Institutions, even the intermediary of the League of Nations and the Bank for International Settlements (which implied a moral guarantee, if not a legal one), proved unequal to ensure efficient protection of foreign investments.

6. In the economic situation of the different countries, the decrease of actual income (expressed in terms of goods and services), due to the international exchange crisis, has resulted in a decrease of the saving capacity of the people and, accordingly, in the possibility of foreign investments.

7. The increase in taxation affecting private incomes which could otherwise have been freely invested by their owner, contribute to similar results. This increase is due partly — but only partly — to State action, dictated by the need of devoting part of the national revenue to investments (generally in the country itself) which the State considers as having a character of public utility.

8. The autarkical tendency, encouraging increased quality and intensifying the production in certain branches of industry, calls for the investment in industries protected by the State of important capitals, part of which in other circumstances, would have been available for foreign investments.

9. The above circumstances contribute to the following results :

- a) Scarcity of capital available for investment on the part of private investors;
- b) Tendency on the part of Governments to encourage the investment of such capital within national or imperial territories (or else in limited zones of common international interest);
- c) Shortage of capital available for investment beyond the above limits.

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Independently from any circumstance of a demographic or technical nature, it would appear that international capital investments will in the near future (with the exception of inter-imperial investments) remain at a very low level. Exceptions may occur between countries united by particularly close economic and political ties (such as the United States and Canada, Italy and Albania, etc.).

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The above statement will enable me now to proceed with the analysis of the demographic and technical factors, and will dispense me from innumerable digressions and explanations otherwise unavoidable.

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Let us just examine the influence of the demographic factors :

In the course of the 19th century and the first years of the 20th century, important international movements of capital were in a large measure closely linked with international migratory movements. It is not always those countries which furnish the largest number of settlers which provide the largest amount of capital. On the contrary, countries which have furnished the greatest number of colonists have, in many cases, contributed but small amounts of capital (Italy, Austria-Hungary, Russia, Ireland, etc.) whereas others have contributed much capital and few colonists (France).

A collaboration which associated the natural resources of

new countries with the work of old countries with a large population, and the capital of the latter, would not appear to offer today the same prospects of success as formerly. Certain new, politically independent, countries, still possess enormous natural resources which, so far, have only been partially exploited. But international exchange restrictions, based on autarkical tendencies, have destroyed or reduced the advantages resulting from the development of such resources. New countries endeavour to develop their own industries so as to be as little dependent as possible on the importation of industrial products; old countries encourage their own production of foodstuffs and raw materials, in order to reduce as far as possible the importation of such commodities. It is evident that when two countries do all in their power to reduce the reciprocal exchange of goods, they find themselves in the worst possible conditions for encouraging that of capital labour. It should also be noted that the new countries have learnt by experience how very often economic dependence upon a creditor country gradually leads to a greater or lesser degree of political dependence, so much so that today the new countries are shy of foreign capital. They prefer to proceed slowly with the development of their own resources, and to use their own capital as much as possible. On the other hand, as I have already mentioned, there is but small enthusiasm for foreign investments. Under these circumstances, the migratory movement towards new countries has considerably diminished, either spontaneously, owing to a lack of economic inducement, or under compulsion owing to the immigration restrictions. The lack of markets for products of the soil and sub-soil, the shortage of capital, have thus contributed to a decrease of immigration. On the other hand, the hindrances to the migration of masses gifted with an intensive force of initiative and great working capacity, have also resulted in the slackening not only of the demographic development, but of the economic development of the new countries. Slower progress in the colonization of new zones has reduced the need of new installations and communications, and consequently, of further influx of capital. On the other hand, the decrease in the birth rate in the new countries enables the inhabitants to devote a larger amount of their income to investments (instead of bringing up a family).

What I have said above about new politically independent countries also applies in part to those colonies suitable for settle-

ment which, having acquired a greater degree of economic development and a personal political individuality, tend to emphasize their independence in relation to the mother-country. This applies in particular to the British Dominions. But the numerous links, both political and economic, which unite these colonies to the home country, within the bounds of their imperial interests, tend to maintain between them a fairly active exchange of labour and capital and it is probable that such conditions will persist even in the near future.

Local demographic conditions have a relatively secondary influence on the movement of capital towards colonies which are relatively unsuitable for colonization, such as those of tropical Africa, this movement being mainly regulated by the requirements of the home countries as regards raw materials.

As far as the older countries are concerned, it is necessary to draw a distinction between those with little available capital for foreign investments and those which possess greater available capital for this purpose.

Old countries with relatively restricted territories (with a high density of population, such as Italy, Japan, Germany) would not object to the emigration of part of their population. But experience has taught these countries that the advantages gained by emigration to foreign countries are counteracted by sometimes greater disadvantages and for these and other economic and political reasons, these countries endeavour to find outlets enabling them to create colonies for their surplus population under their own flag. Furthermore, emigration to foreign countries is impeded both by the economic difficulties existing in the various countries and by the severe immigration restrictions. Notwithstanding the fall in the birth rate (very marked in Germany, less so in Italy, and beginning in Japan) a high demographic pressure persists in these countries, which it is impossible to relieve, owing to the difficulty of finding outlets for the surplus population. It is well known that this is one of the causes of the present state of international economic relations, which gives rise to both anxiety and instability.

Old countries possessing large amounts of available capital (Great Britain, France, and to a lesser extent, Belgium, Holland, Switzerland) are all suffering from a serious, sudden crisis in their birth rate. The extent of the birth rate crisis which has occurred in these countries is such that it affects in a negative

way the accumulation of savings. The future requirements of a numerous family are one of the strongest incentives to thrift; were there are no children, or only a few, this incentive weakens. The desire for immediate wellbeing and enjoyment prevails over cautions provision for the future, and, owing to the lack of this stimulus, the production of wealth is slackened. At the present moment, those European countries which, in the last century and early days of this one, were the most important international investors have, owing to changed demographic conditions, been compelled to abandon this position in a considerable measure. I have already pointed out how, owing to international political and economic conditions, the current of their investments has, as it were, been canalized within the boundaries of their empire or dominions, if such exist.

The United States is in a special position. According to certain of its characteristics it might be classified amongst the new countries, according to others it is nearer to the old countries. It still disposes of immense natural resources, which are as yet practically untouched, and is relatively sparsely populated in the major part of its territory. But it also disposes of immense capitals; it can finance at any time any expansion of its productive capacity, should this be possible. The lower birth rate and the immigration restrictions have arrested somewhat drastically the marvellous economic development of the country. So long as these conditions persist, it is doubtful whether this development can be renewed on a wide and permanent basis. Potentially, the United States represents one of the largest capital exporting markets, owing to the present demographic conditions. In many districts the fall in the birth rate is not sufficiently marked to affect seriously either production or saving.



Let us now examine the influence of technical factors.

It must be remembered that a considerable portion of the international loans contracted during the last hundred years, has been used by new or industrially backward countries for purchasing from older or industrially more developed countries the necessary material for their own economic equipment. With the capital of old countries, new countries have built railroads, factories, and have purchased the material and the machines necess-

ary for the operation of the latter. This development was facilitated by the fact that the individuals and corporations investing capital in new countries were so attracted by the prospect of immediate profits on these investments as to lose sight of the possible and probable effects of the said development as regards their own trade. Thus British capital was responsible for the development of industrial spinning and weaving in India, which subsequently caused serious prejudice to the British textile export industry; American capital contributed to the development of the Canadian hydroelectric industry, which resulted in the decline of the American coal exports to Canada; German capital promoted the development of an Italian chemical industry, to the detriment of German chemical industries. It would be easy to multiply such examples. During the initial stage, it is certain that the encouragement by capital exporting countries of the industrial development of new countries considerably stimulated the industrial exports of the former and, at the same time, cleared their way to ampler, more accessible and cheaper supplies of raw material and foodstuffs. But, during a second period, the development of the productive capacity of new countries, due to financial assistance from older countries, led to the emancipation of the new countries which were thus transformed into competitors; this, in its turn, has, in certain cases, led to a complete change in the direction of commercial currents, as, for instance, in the commercial relations between Great Britain and the United States. But even if we except the latter, which has become the greatest industrial country of the world, we still find, at the present moment, many examples of new countries able to produce in their own territory, not only every species of consumers' goods, but also industrial equipment (machines, etc.). Technical progress enables new countries to produce goods received in the past from older countries or to replace them by other goods which they are in a position to produce. In many cases, a further influx of foreign capital would but hasten their evolution in the direction of economic independence and would further diminish the already reduced exporting possibilities of older countries as far as these markets are concerned.

If we now examine the problem from the point of view of these older countries, it is easy to see that, during the above-mentioned initial period, their investments in new countries were attended by immediate and most successful results, such as :

large returns, wide outlets for export industries, abundant and useful stocks of raw material and foodstuffs, a lowering of the cost of industrial production, even through the expansion of business and enterprises. But during the second period, investments themselves were often an unfavourable factor, in so far as they precluded or impeded the development of those commercial currents they had originally helped to create or promote. Meanwhile improved technique of production has enabled older countries to extend and intensify the utilization of their own national resources and accordingly to extract from their own soil, sub-soil or atmosphere, materials and foodstuffs which they had previously been accustomed to receive from new countries. (The emancipation of continental Europe from the necessity of importing wheat owing to new methods of intensified cultivation, the substitution of artificial nitrates for those imported from Chili; German or Italian aluminium for American or African copper, are typical examples of this evolution.) Owing to all these reasons, the capital of the older countries, which for a century or more, has been poured into new countries, is now invested in the home-country. Improved production technique offers daily opportunities for home investment, while Government policies of protection and other forms of assistance, guarantee the profitable character of investments which, under a regime of entirely free international competition, would fail to attract subscribers.

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I do not believe it is possible to state in a general way that improved technique of production works in such a manner as to increase the international exchange of goods and capital, neither can it be said that it works to the contrary. In the successive phases of the development of means and processes of production which we call "Technical progress", one or the other result may at times predominate. Simultaneous but different developments in production technique may, at the same time, produce opposite effects. At the moment of the invention of the steam-engine, the railway was very rightly considered, as being the last word in rapid road travel; large quantities of capital flowed towards the new countries to enable them to build their railways, to purchase their rolling stock, to increase and renew their fixtures and to pro-

vide them with the necessary liquidities for the operation of vast railway systems. When the motor vehicle showed definite signs of becoming a serious competitor for the railway, the foreign capital requirements of the latter were reduced or ceased altogether, in view of the comparatively modest capital necessitated for its development. When the progress of experimental seed-growing resulted in the creation of early maturing varieties, thus opening up vast zones for the culture of wheat in Canada, it at the same time stimulated the flow of new foreign capital towards that country. But when, about the same time, similar progress in this branch of applied science was made in Europe, resulting in the creation of varieties of grain with an output very much superior to that of those commonly cultivated, capital ceased to flow into the new countries, and national savings were invested at home.

It would be an easy task to fill whole pages with examples demonstrating the potential and actual conflicting results of such factors of technical progress on the international movement of capital. But this would go beyond the scope of the study, the purpose of which is rather to show how the present phase of technical progress, by multiplying possibilities of the substitution of certain goods for others on both sides and by increasing, both in quality and quantity, opportunities for the exploitation of the resources of the various countries, tends to create favourable conditions for larger capital investments at home, in preference to abroad, as imposed and promoted by the existing economic and political conditions.

In conclusion, it appears to me that a study of present economic conditions justifies the assumption that capital investments in foreign countries will remain at very low levels (Inter-Empire investments excepted). Unstable political conditions, troubled economic relations, a decreasing birth-rate, progress in production technique, all these factors appear to combine in encouraging investment of capital within national or imperial boundaries, and in discouraging foreign investments. Only by the re-establishment of a general state of real and effective political peace (which at present seems unlikely), would it appear possible to surmount and abolish certain important obstacles to international lending. But, as already shown, other serious obstacles would continue to exist.

ANNEX

In the preceding pages I have dealt more particularly with the question of international long-term investments, believing them to be of special interest to the Joint Committee in its inquiry.

As regards international short-term investment, I need not recall their important rôle, in the international credit system, in times of political and economic peace. I wish to state that I consider that during these past fifteen years the pernicious effects of such investments outweigh their advantages. During this period, floating capital travelled from country to country, in a state of perpetual unrest, fleeing from those in which private property and currency stability were or appeared menaced, or trying to evade taxation. Every international political or economic perturbation has caused sudden and extensive movements of capital from one market to another, and since, during the period in question, no country in the world offered shelter from the storm, capitals have continued to move on.

The international mass movements of gold caused by this instability, have in their turn caused new and serious disturbances in international economy. In some cases they have acted like the cargo of a ship caught in a storm, which, rolling from side to side in the hold, imperils the equilibrium of the ship and is the cause of its sinking. Today, the restrictions imposed by many countries on the international transfer of gold or other forms of payment, act as a brake upon these unbalanced movements of available capital used for international short-term investments. And I have the impression that a stronger braking action will be exercised in the near future.

I believe that further restrictions will occur in this form of international capital investment.

March 25th 1936.

(Signed): G. MORTARA.

**Memorandum
on the
Problem of parities**

by

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What are the most appropriate parities in view of : (a) the conditions implied by the technique of stabilization; (b) the conditions under which Central Banks have to work? What further conditions are necessary in order to make it likely that the world's transfer problem can be solved under conditions of fixed parities?

The Joint Committee has asked for my opinion on this problem.

My answer will be as brief as possible, because I believe that, in the present political and economic international conditions, any discussion on the subject would be premature. It does not seem to me possible to hope for the conclusion of vast international monetary agreements as long as grave political controversies divide different States and great wars appear to be in preparation. Nor does it seem possible to reckon with the lasting effects of such agreements before the majority of countries have succeeded in stabilizing their international payments balances by the necessary private and public economic adjustment.

Even if we grant — which I do not — the possibility of reaching international agreements on a large scale for the restoration of currency stability, I maintain that :

- a) It would still be advisable to adopt the Gold Standard as basis; not that this Standard is most perfect in theory, but that it is least imperfect in practice;
- b) It would be advisable to fix the new parities in such a way as to alter as little as possible existing conditions.

especially in the case of currencies which have already for some considerable time maintained a certain effective stability (on the other hand, I would not refuse to envisage the possibility of re-valuation in the case of currencies which have recently been the object of sudden and considerable devaluation; nor would I exclude the case of the de-valuation of currencies, nominally maintained at a given parity, whereas in reality their parity is lower);

- c) It would be advisable to fix the new parity in such a way as to simplify as far as possible the exchange-rates of various currencies (e.g. the rate of five dollars to the pound sterling, which would so simplify accounts as largely to compensate the disadvantages resulting for one or the other of the countries in question from the new rate taking the place of that of 4,86 or 5,20).

March 25th 1936.

(Signed): G. MORTARA.

Note
on a desintegrated, provisional monetary standard
as a basis of stabilization

by

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General considerations

For wellknown reasons, the maintaining of stable rates of exchange presupposes continuous changes in the purchasing power of money in each country, if one does not isolate the markets by means of exchanges control and restrictions of trade. When the exchange rates are maintained stable in spite of e.g. a loss of foreign markets, the strain on the balance of payments and on the internal market may be considerable. The difficulties will be great especially when the international situation changes quickly, the free movements of goods and capital are restricted and the elasticity of the internal income formation is limited by the organization of the market. If the strain becomes unbearable, the ultimate outcome of the conflict will in most cases be a revision of the exchange rates and in unfortunate cases, even a break-down of the international standard. The history of the modern gold standard gives ample evidence of this. It shows a series of crises, which — under the double pressure of increasingly inelastic income formation and restrictive trade policy — have tended to become aggravated.

The natural objection that when a stable relation between the value of money on different places can be achieved within a country it must be possible also internationally, overlooks the fundamental fact that difficulties of adjustment to new conditions in a market that is part of a country can be eased by free commodity movements and the free transfer of means of production — influx of capital as well as efflux of labour — and by relief

measures to which there are and can be no international counterparts.

In these circumstances, it is evidently futile to argue about stabilization as if the problem were either to choose a system with absolutely fixed rates of exchange or some system in which the rates of exchange may be altered; if this were the alternative there would be no doubt about the way to choose. The question to be answered is whether alterations in the rates of exchange are to remain a result of financial crises — the various reasons considered morally more or less objectionable — or are to be effected according to fixed rules and acknowledged as the perfectly natural results of changes in economic conditions that they are. A choice between these two alternatives can be made only on the basis of a discussion of the technical form of a compromise, satisfying the demands just mentioned, and of the risks incurred in such a solution of the problem.

Motives for making a stabilization only provisional

To clear the ground it seems necessary to start by considering the character of the forces that call for an adjustment of the international value of the currencies, well known though they are. It is possible to distinguish roughly five different types. In practice, of course, the distinctions are anything but clearcut.

- 1) Temporary disturbances of the type caused by the movements of vagabond capital;
- 2) Fluctuations in the balance of payments originating in the seasonal variations of trade, payments of interest, etc. and influenced by the methods of payment;
- 3) Changes caused by business fluctuations. These changes are also of a transitory kind but are distinguished from the temporary disturbances proper by being of a more regular type. In a country exporting raw materials for the production of capital goods — timber, metals, etc. — and where home production reflects the development of exports with a lag, it is to be expected that the exchange position will be strong during times of business revival, and later, as a business expansion develops, will be considerably weakened. In a country exporting consumption goods or where an expansion usually starts in the home industries, the reverse will be the case;
- 4) Disturbances due to economic and financial policy. It

is, for example, probable that a country with an expansionist financial policy or where incomes are increased by a considerable heightening of the wage level, in some cases would be forced to an adjustment of the rates of exchange. The same may be the case if trade policy takes a strongly autarchic turn or if a system of high protective duties is abolished;

5) Structural changes. Changes in the direction of demand for various goods in international trade occur continuously in consequence of changes in the consumption habits and industrial technique or in consequence of capital movements. Technical changes furnish the market with new goods substituting products formerly used in consumption and for productive purposes, or create a demand for new raw materials and new types of machinery. The capital movements put new importers in the place of the old ones, or — at a later stage — give new countries and their natural resources a prominent place on the market. Directly, too, the capital movement may call for adjustments putting a great strain on the capital exporting countries.

All these changes affect the trade balances and thus may make it difficult to maintain stable exchanges. The demands on the exchange system and its elasticity are, however, of varying severity.

(ad 1) Under no circumstances can the temporary disturbances be allowed to cause appreciable changes in the rates of exchange. They ought to be met by other means. If all temporary disturbances were to cause changes in the relative value of various currencies, the policy would end in chaos and the exchange market would be swayed by international speculation.

(ad 2) Seasonal fluctuations were easily controlled already under the gold standard. Nor have they caused considerable difficulties in the countries with free currencies. At any rate a satisfactory solution can be reached by temporary credits which, from the point of view of importers or exporters, to some extent would take the form of forward transactions.

(ad 3 and 4) It may often seem tempting to meet the difficulties caused by business fluctuations or resulting from political moves by manipulating the exchange values. The comparatively transitory and regular character of the first kind of changes and the fact that difficulties arising from the policy pursued are to a certain extent self-inflicted, call, however, for great prudence. In principle it seems advisable so to construct the exchange

system as to afford no possibility of yielding to the pressure but undoubtedly heavy restrictions on this point can hardly be enforced, unless the economic policy of various countries be harmonised and mutual assistance with short term credits be granted to a greater extent than at present.

(ad 5) The structural changes, on the other hand, are of a kind that warrants a high degree of elasticity in the exchange system enabling smooth adjustments of the rates of exchange. When structural changes call for a *fundamental* adjustment, the obligatory maintenance of the international value of the currency leads to a strain on the home market which finally may force the country to leave the narrow road of absolute exchange stability. The importance of international stability is evidently so great, that *less considerable* structural changes which it is possible to meet by internal adjustment ought to be met in this way.

This birds-eye view of the problem — in no way complete — shows that it is possible to limit narrowly the field within which full freedom to alter the rates of exchange ought to be maintained. This being the case, it seems natural to consider as a reasonable alternative to the gold standard in its old form or — if it is considered possible to go further — as a first step on the road towards a safer arrangement, a system of provisional stabilization, in which the rates of exchange are kept stable as long as the existing world market situation — in certain respects defined at the time of stabilization — remains the same.

The organisation of a provisional standard.

What would be the best technical and legal form to give to such a stabilization?

First of all, it must be admitted that a universal international agreement intended to regulate by a single formula the relation between all currencies would be of small value. An all-embracing agreement can obtain no more than a general declaration of principles which, in practice, probably would be regarded as engaging to nothing. Nor is it probable that a satisfactory result could be gained by special agreement; the general rules governing the exchange policy can be supplemented but scarcely fixed by such agreements. In these circumstances the natural solution seems to lie in a regulation of the value of the currency in the monetary legislation of each country as was the case under the

international gold standard. In the future as in the past, laws regulating monetary conditions would thus stipulate rates to be applied when buying or selling gold or other currencies; to leave the authorities a margin for free adjustment either the buying or — preferably — the selling rate could be left undetermined. But the laws would also have to fix the time and manner of changing the rate stabilised.

As rules fixed by monetary legislation will of necessity be too vague to give sufficient guarantees from an international point of view and will moreover leave a rather wide margin of freedom for political speculation, they ought to be supplemented by international agreements and contain a reference to them.

Between countries with the same kind of dependence on the world market the need of mutual exchange adjustments is probably much less pronounced than between such a group of countries and the rest of the world. Within certain limits countries within a group of this kind ought to have a mutual interest in pursuing a uniform policy on the exchange market. It seems natural to build on the stable element that these groups represent. A step in the right direction would therefore be taken if countries with large common interest on the exchange market could be induced to enter into mutual undertakings not to use the legal possibility of altering the exchange relations without the consent of — or at least not without consulting — the other countries *within the same group*. This undertaking might be laid down in a special agreement but it would probably strengthen the system if it could be incorporated in tariff agreements or in agreements relating to mutual credit assistance.

Agreements with the aim referred to are possible also between countries with a large measure of mutual interdependence, for example with a highly developed bilateral trade. In this case it is evidently only the mutual interest and not — as in the first case — the comparatively rare need of mutual adjustments, that calls for a stabilization of the exchange rates; under these circumstances the grouping must of course be of a less definite character than when the countries linked together hold an identical position on the world market. A good example is afforded by the relationship between Great Britain and some of the Dominions or the Scandinavian countries. In this case agreements very often link together small countries or groups of small countries and a big market. If so, it seems natural that the

legal regulation of the rates of exchange in the smaller countries should be formulated in terms of the currency of the great country with which there exists a mutual agreement restricting the freedom of the exchange value. In most of the Dominions the currency should be based on sterling, in the Latin countries on the French Franc, etc.

The possibilities of rebuilding an international monetary system along these lines are evidently limited. The methods discussed can scarcely be applied to the relation between the world currencies. There are many reasons for this. It seems very difficult to find an adequate form for the conditions limiting the obligation to keep stable rates of exchange; too many forces are focussed on the development of the world currencies. And there is no mutual interest strong enough to give the agreements the compelling force that would make the conditions to more than a dead letter; nor is there any efficient way of controlling how the rules are followed. Finally, values on a sliding scale would probably be required to give the processes of adjustment the necessary smoothness; it may prove advisable to proceed by a method of trial and error that can be dispensed with when readjusting the international value of small currencies.

This being the case it seems probable that, under a provisional standard, the world currencies would have to be left free from legal regulations; of course this would not mean that the relative value were to be uncontrolled or would show continuous changes.

A price formation of gold controlled not by legal rules in any single country but by the joint action of the big central banks seems to be most in conformity with this freedom of the world currencies. Another arrangement would mean that on one point the possibility of free adjustment was limited by the strange conditions governing the price formation of gold. This objection is, however, not of deciding importance. Undoubtedly valuable results could be achieved even if one of the world currencies were linked to gold. Under a system of the kind discussed here the natural rôle of gold would be that of a good-for-all exchange reserve, by the aid of which international payments could always be made at the market price of gold in the currency stipulated in the contract. In these circumstances, gold would not lose its value in international trade in spite of the universal discarding of gold as a standard of value.

Theoretical considerations thus lead to the conclusion that the natural exchange system under a provisional standard would be one in which the smaller countries fixed the value of their currencies in relation to one or more other currencies and laid down the conditions for maintaining this value autonomously by legislation and by international agreements linking together countries with mutual interests to form blocks centered round world currencies which would remain free in relation to one another and to gold.

Evidently this system — which may appear as a product of abstract speculation — is much nearer to present day conditions than the gold standard, in so far as it is only a rationalized variety of the irregular system established in the years after the crisis of 1931. At any rate the discussion shows that in the market situation of to-day — troubled though it looks — there are to be found the elements of a rational exchange system in some respect surpassing the gold standard. In these circumstances there seems to be no reason to yearn back for the golden past unless it can be shown that practical difficulties make an attempt to reach stabilization by the way proposed too hazardous.

Difficulties inherent in a system of provisional stabilization

A first difficulty lies in the formation of currency blocks. Although a grouping more suitable for furthering exchange stability than the present one may and will probably be established, it is scarcely to be expected that we can ever arrive at a grouping that is optimal from an economic point of view. The political forces counteracting the economic factors are too strong. Geographical conditions, too, make it difficult to come to a fully satisfactory solution. However, the method of stabilising discussed in this note does in no way depend upon the establishment of a complete and economically adequate series of groups. It is a question of degree only; undoubtedly a strong formation of groups would be advantageous as a basis for continued stability within a system with a provisional standard, and in the same way a more natural grouping would mean a guarantee against unnecessary adjustments, but after all good results may be reached even if the grouping within the system is dominated by political considerations and established regardless of economic conditions. It is quite possible that in many cases political groupings will

show an internal strength that would not characterize groupings of an economically more rational kind.

The problem how to group various countries offers special difficulties in the case where a small country is dependent in the same degree upon the two large countries with mutually free currencies. Canada offers a typical example with its position between U.S.A. and Great Britain, and so do the Nordic countries with their dependence upon the British and German markets. A country in this position and which is of sufficient economic strength will probably find it advisable to remain free so far as is compatible with internal legislation. In other cases a way out of the difficulties will be found in the provisional character of the stabilization. If a small currency is linked to one of two equally important great currencies a considerable change in the relative value of these currencies must constitute a sufficient motive for a revision of the international value of the currency in the dependent country.

When studied from the view-points outlined above, the present groupings on the exchange market seem too casual and too little justified to be considered as definite. The present grouping is characterized by a certain internal inelasticity and probably the groups are too few. This being the case, a rationalization of the present grouping would probably be combined with the breaking up of existing constellations. The legal obligations forming the basis of the new system would scarcely be so far reaching as the present *de facto* stabilization suggests. Even in the future, however, the degree of stability achieved would probably go further than follows directly from international agreements and internal legislation.

Guesses as to the ultimate outcome of an attempt to realize the system outlined in this note are, however, of small interest. The future will disclose the solution. The suggestions made here are intended to serve merely as a background to a discussion of the possibility of the present system's working in a rationalized form.

Probably the world currencies retaining their freedom of movement in their relation to one another is considered the most objectionable aspect. This freedom means that instead of one international monetary standard — a gold standard or perhaps a sterling standard — there will be a number of equally important standards, as a sterling standard, a dollar standard, a franc

standard, a mark standard, and a yen standard. Does not this mean that the present unrest on the exchange market will be prolonged for an indefinite time? And is there not a risk that the uncertainty surrounding exchange conditions will make it impossible to reduce the present trade restrictions?

To judge from the experience gained after the crisis of 1931, however, one is entitled to a certain feeling of optimism. The central banks have proved their ability to manage a free currency and they have not yielded to the temptation to let the rates of exchange slip in an arbitrary way. On the contrary the central banks in most countries have led the development with a firm hand. The development shows that in some respects complete freedom is more binding than agreements.

A prolongation of the restrictive trade policy now prevailing would scarcely be warranted if the present discrepancies on the exchange market were discarded. After the exchange adjustments, which, owing to the abnormally large international discrepancies in cost of production levels are necessary prerequisites also for the restoration of a gold standard, the stabilization of the small currencies by internal legislation and international agreements and the control of the movements of the world currencies exercised by the great central banks will reduce the risk for devaluation for dumping purposes and other disturbances of the same kind. It is worth noting that the United States and certain other countries have lately found it possible to move in the direction of free trade. As a matter of fact, the possibility of an adjustment of the exchanges to new structural conditions ought to weaken the motives for introducing new tariffs or import monopolies in order to reconcile the exchange development with the national demand for steady employment.

Difficulties will, however, arise in the future also in consequence of the reaction of the public to changes in the rates of exchange. As long as there remains any uncertainty as to the future relative value of the world currencies, these currencies may remain objects of speculation. The uncertainty will also have an influence on the capital movements as the choice of objects for international investment will be limited by the risk of losses caused by the exchange development. Finally, exporters and importers in various countries will perhaps find it necessary to avoid exchange risks by various forward transactions all of which will mean an increase in the costs of international trade.

The development of exchange speculation in past years is not necessarily characteristic of a system with partly free exchanges. In some measure speculation has depended on the political development or been explained by the abnormal discrepancies between some important currencies. A typical example of the influence of these factors offers the heavy speculation against the surviving gold currencies. To some extent this is explained by the fact that international investors have not become accustomed to a free exchange and overrate the probability of fluctuations. The possibility of an effective regulation of the internal and external value of free exchanges has been proved only within the past few years.

In these circumstances it seems probable that the influence of speculation will be considerably lessened, when it is realized that the great central banks have both the intention and the power to control the development of the exchange rates, and when, further, the discrepancies between world currencies will have disappeared and newly developed tensions are to be met by successive adjustments of the rates of exchange, too insignificant and slow to furnish a good basis for speculation. That speculation will disappear is, of course, very improbable considering the importance of the movements of vagabond capital already under the gold standard. Speculation against weak currencies will therefore certainly be a feature characteristic of the system. Such speculation, however, would be unavoidable even under a re-established gold standard, as the risk of new devaluations will remain only too obvious.

The pressure of capital movements created by the maintenance of free exchange will probably be reduced as the public grows accustomed to the fact that the exchanges show a high degree of stability even though retaining their freedom; exchange rates kept stable for some time tend to be regarded as definite even in the absence of legal commitments. It seems possible that the development will be furthered by changes in the form in which credits are granted; when possible a creditor will probably minimize his risks by requiring repayment in his own currency or in a currency belonging to the same group as his own. It seems probable that the capital movements in general will tend to follow the least line of resistance to exchange risk and that capital movements between countries with mutually free currencies will to a large extent remain a prerogative of central banks,

being forced to keep a reserve also in free currencies or gold and being the institutions best qualified to appreciate the risks incurred. Such a development has its obvious drawbacks. However, the difficulties must not be exaggerated. The fact that the exchanges are known to be partially free will undoubtedly limit the freedom of capital movements, but, after all, international investors must be very sensitive to the risks even under a system of unconditional stabilization. The situation may in fact be considered more favourable when the risks are known, calculable and subject to certain regulations than when there is only an abstract knowledge of the dangers, as was the case under the post-war gold standard. It is an advantage of a system in which legal regulation governs the freedom of movement that international investors can base their credit conditions directly on rules in force controlling the exchange rates.

The adaptation along these lines of the forms in which foreign credits are granted has already begun. This explains in part how it has been possible to rebuild a system of international credits in a situation in which most currencies remain free in principle and there is no legal regulation of the conditions for a change in the rates of exchange.

There remains to say a few words about the costs contracted by importers and exporters in consequence of the transactions intended to minimize the exchange risks. Developments in recent years afford some hints as to how to look at the matter. It seems that the tendency to avoid exchange risks by various kinds of forward transactions is not so strong now as it was only a couple of years ago. Behind this change lies probably a revival of confidence based on the experience of the comparative stability of the present system and also a partial adaptation of contracts to the new conditions — exports and imports, when possible, being contracted in currencies showing only rare or small mutual variations. When such a change has been possible in a situation like the present one it seems probable that the difficulties discussed here can be discarded under a system of provisional stabilization and free exchanges to the same extent as under a gold currency system. This presupposes, however, that the present tendency towards an adjustment of the contracts will prevail — which may, but need not, mean that the direction of foreign trade will be modified in the same way. The adjustment of contracts will lead to a certain one-sidedness in the direction

of short term credits. In this way and through the corresponding change in the direction of long term capital movements, existing groupings will be strengthened and the mutual interest in the maintenance of exchange stability increased. In a way, then, the system discussed here will probably prove self-consolidating.

It has already been pointed out that a favourable development on the exchange market cannot be realized if the collaboration of the central banks remains as half-hearted as it is now in spite of all the praiseworthy efforts that are being made. This is true not only under a system of free currencies but also if a definite and universal stabilization on the basis of gold were to be attempted. In this note in which we discuss only the difficulties inherent in a system of provisional stabilization there is thus no need to investigate the possibility of better central bank co-operation. A few supplementary remarks may, however, be justified. It seems very important to agree that speculative short term capital movements and difficulties arising from business fluctuations shall be met by mutual credits. It will probably prove necessary for the central banks to help exporters and importers by selling and buying currencies on short term. In this way the exchange reserves of the central banks may be bound to an extent necessitating a collaboration also on the forward market. Of course operations on the forward market will be of far greater importance in countries with free world currencies than in countries with exchange rates provisionally stabilized on the basis of a world currency.

Conclusion

To sum up, it seems justifiable to say that none of the difficulties immanent in a system based on provisional stabilization along the lines discussed in this note are so serious as to make a solution of the stabilization problem in the way outlined too dangerous to be given a trial or attempted as a first step on the road to a more definite arrangement. As, further, the solution presented here has the obvious advantage of lying in the direction indicated by the development during the past few years the best policy would probably be to attempt a re-establishment of a satisfactory exchange system by inducing various countries to revise their monetary legislation in conformity with a system of provisional stabilization as well as to include exchange clauses in

being forced to keep a reserve also in free currencies or gold and being the institutions best qualified to appreciate the risks incurred. Such a development has its obvious drawbacks. However, the difficulties must not be exaggerated. The fact that the exchanges are known to be partially free will undoubtedly limit the freedom of capital movements, but, after all, international investors must be very sensitive to the risks even under a system of unconditional stabilization. The situation may in fact be considered more favourable when the risks are known, calculable and subject to certain regulations than when there is only an abstract knowledge of the dangers, as was the case under the post-war gold standard. It is an advantage of a system in which legal regulation governs the freedom of movement that international investors can base their credit conditions directly on rules in force controlling the exchange rates.

The adaptation along these lines of the forms in which foreign credits are granted has already begun. This explains in part how it has been possible to rebuild a system of international credits in a situation in which most currencies remain free in principle and there is no legal regulation of the conditions for a change in the rates of exchange.

There remains to say a few words about the costs contracted by importers and exporters in consequence of the transactions intended to minimize the exchange risks. Developments in recent years afford some hints as to how to look at the matter. It seems that the tendency to avoid exchange risks by various kinds of forward transactions is not so strong now as it was only a couple of years ago. Behind this change lies probably a revival of confidence based on the experience of the comparative stability of the present system and also a partial adaptation of contracts to the new conditions — exports and imports, when possible, being contracted in currencies showing only rare or small mutual variations. When such a change has been possible in a situation like the present one it seems probable that the difficulties discussed here can be discarded under a system of provisional stabilization and free exchanges to the same extent as under a gold currency system. This presupposes, however, that the present tendency towards an adjustment of the contracts will prevail — which may, but need not, mean that the direction of foreign trade will be modified in the same way. The adjustment of contracts will lead to a certain one-sidedness in the direction

of short term credits. In this way and through the corresponding change in the direction of long term capital movements, existing groupings will be strengthened and the mutual interest in the maintenance of exchange stability increased. In a way, then, the system discussed here will probably prove self-consolidating.

It has already been pointed out that a favourable development on the exchange market cannot be realized if the collaboration of the central banks remains as half-hearted as it is now in spite of all the praiseworthy efforts that are being made. This is true not only under a system of free currencies but also if a definite and universal stabilization on the basis of gold were to be attempted. In this note in which we discuss only the difficulties inherent in a system of provisional stabilization there is thus no need to investigate the possibility of better central bank co-operation. A few supplementary remarks may, however, be justified. It seems very important to agree that speculative short term capital movements and difficulties arising from business fluctuations shall be met by mutual credits. It will probably prove necessary for the central banks to help exporters and importers by selling and buying currencies on short term. In this way the exchange reserves of the central banks may be bound to an extent necessitating a collaboration also on the forward market. Of course operations on the forward market will be of far greater importance in countries with free world currencies than in countries with exchange rates provisionally stabilized on the basis of a world currency.

Conclusion

To sum up, it seems justifiable to say that none of the difficulties immanent in a system based on provisional stabilization along the lines discussed in this note are so serious as to make a solution of the stabilization problem in the way outlined too dangerous to be given a trial or attempted as a first step on the road to a more definite arrangement. As, further, the solution presented here has the obvious advantage of lying in the direction indicated by the development during the past few years the best policy would probably be to attempt a re-establishment of a satisfactory exchange system by inducing various countries to revise their monetary legislation in conformity with a system of provisional stabilization as well as to include exchange clauses in

their trade and credit agreements so that guarantees be created against arbitrary changes in the rates of exchange and a rational grouping be furthered.

A stabilization along these lines, starting from the smallest units and developed successively, seems preferable to a ready-made universal system, to which the countries are forced to adhere whether it is organic or not. If the stabilization is allowed to develop out of special regulations and special agreements as the time becomes ripe for a more definite move in one country or another, it follows that a long time will have to elapse before a general regulation, comparable with that realized under the post-war gold standard, becomes established. Even if a stabilization along the lines discussed here were to stop half-way towards a rational organization, this is better than attempting the impossible and afterwards having to retreat. In the long run it seems highly improbable that one could achieve a higher degree of international exchange stability by attempting a general stabilization than by proceeding by a slower and less formal method which would aim at a regulation of the rates of exchange compatible with a reasonable degree of internal stability.

February 1936.

(Signed): Dag HAMMARSKJÖLD.

Practical Conclusions

**Report of the Committee of Experts
submitted June 26, 1936
to the two Presidents of the Joint Committee**

Dr. Nicholas MURRAY BUTLER,
President of the Carnegie Endowment for International Peace
and

Dr. F. H. FENTENER VAN VLISSINGEN,
President of the International Chamber of Commerce

LETTER OF TRANSMISSION

We have the honour to submit the text of a report prepared by us as members of the Committee appointed by you to investigate the outstanding international problems of the time in the sphere of commercial and monetary policy. We are in full agreement upon the proposals contained in the report, though we are not to be considered as individually responsible for every detail of the wording.

*(Signed): T.E. GREGORY, Chairman of the Expert Committee;
Charles RIST, Bertil OHLIN, Andreas FREDÖHL, Eugen BOEHLER,
members of the Expert Committee.*

INTRODUCTION

Welcome signs of economic recovery following upon an unprecedented trade depression are manifest at the moment. But the recovery which is witnessed is only partial and, limited as it is to certain countries, it calls for a programme of co-ordinated action if its benefits are to be extended to all activities and are to assure thereby lasting peace and prosperity to mankind. The crisis from which we are gradually emerging has left in its train acute political unrest, many social problems of great magnitude and a dislocation of trading relations throughout the world which has meant poverty and suffering to millions of human beings. A solution must be found to these problems. A reconstruction of international economic relations is urgently required. The first

step must be a recognition of the fact that the present situation is abnormal, both as regards the causes which have produced it, and as to the consequences which it itself has produced.

Already on one occasion after the war — in the years 1924 to 1928 — an attempt has been made to reconstruct the world economically and financially. Currencies were stabilized, import and export prohibitions were abolished, and even tariffs were reduced. The result was rapid progress in production and in world trade, improvement of the standard of living and a general return to prosperity. Within a few years, however, success changed to failure. A depression came, perhaps more profound than ever before experienced in times of peace. Disappointed by this failure, there are those who seem inclined to draw the conclusion that any attempt to solve the world problems of to-day on international lines is out of the question. They therefore fall back on purely national remedies. In the monetary sphere they distrust general stabilization for the simple reason that the international gold standard, after its re-establishment, broke down in 1931. It is, however, not always sufficiently remembered to what extent post-war economy and finance were characterized by a number of artificial and precarious elements. It is this fact which, on the one hand, explains the severity of the crisis through which we have passed, and, on the other hand, holds out the hope that if these particular causes are eliminated, as they have largely been, recovery would be achieved on more secure foundation.

Firstly, the war left in its wake a tremendous superstructure of liabilities. Domestic debts had increased, and in the foreign field there were the political debts to which the economic structure had not become adapted, and which consequently proved a great strain on the balances of payments of various countries.

For a certain time, these various obstacles were submerged by a flood of international lending, but this development entailed new difficulties of its own. Long term loans were floated to a degree which, seen in retrospect, must be regarded as excessive; when the supply of long term capital declined, resort was had to short term lending and it was the instability of the latter which was responsible for one of the most characteristic aspects of the depression — the strain on the banking system and the balances of payments of many countries. Here, however, we are able to record substantial progress. Short term indebtedness in gold has been reduced by more than one-half and the volume of long term

debts has also become smaller. Reparations were effectively settled in Lausanne in 1932 and the war debt question is admittedly to be re-considered. The external liabilities of the war and post-war period thus no longer represent the same serious handicap to the attainment of equilibrium.

Secondly, this superstructure of indebtedness was built up on the basis of a price-level which, in terms of gold, was about 50 % higher than the level of prices in 1914. It had been hoped for a time that such an increased price-level would be maintained notwithstanding a decline in the current gold production, as measures might be taken to economize gold and, generally, to use it more effectively as a basis for credit. But these hopes proved illusory. There came a violent fall in prices, upsetting all economic calculations. The consequence was, however, that prices in terms of gold were suddenly reduced to below the pre-war level and, at the same time, gold production increased to record figures. A new situation has arisen and new forces are now at work. The world should be able to expect a definite rise in prices in the near future. Such an upward trend of prices, it should be noted, should greatly facilitate an adaptation of cost levels in different countries and a general reduction in trade barriers. In the past, it has been in periods of rising prices that trade barriers have been most easily lowered.

Thirdly, as a result of the destruction of capital during the war, rates of interest remained on very high levels in the post-war period. While countries in Eastern Europe were able before the war to borrow at rates of 4 and 4 1/2 %, and other countries even more cheaply, the bulk of the post-war lending to the countries on the Continent of Europe was at the rate of 6,7 or 8 %. Borrowing at such rates may have been necessary when it was a question of suddenly supplying impoverished countries with funds; but in the long run, large international capital movements on such a basis were bound to have unsettling effects. An adjustment to lower rates, both for international and domestic loans, was necessary, but such adjustment proved extremely difficult, given the large volume of Government and other indebtedness which had to be converted. In this respect, again, marked progress has been made in recent years in a large number of countries. It is illuminating that those countries which were able substantially to reduce the general level of interest rates were the first to enjoy a considerable recovery.

The depression through which we have been passing has thus been not only an ordinary downward trend of the business cycle, but it has also been aggravated by a number of factors arising out of the liquidation of the war. As has been indicated above, these special aggravations are no longer of the same weight as they were only a few years ago, and in several instances a true redress has been achieved. It cannot be too strongly stressed that this improvement in the technical position provides a hopeful basis for further efforts to bring the world back to general prosperity. There are of course many difficulties still to overcome. Adaptation must be made to structural changes, but such adaptation should be easier in a period of gradually rising prices, to which we may look forward, than it was in the period of declining prices after the war. There are further consequences of the depression itself which still have largely to be remedied.

Once the depression had begun, a twofold sequence of changes became apparent. Increasing economic distress accentuated political unrest; political unrest in its turn aggravated the lack of confidence which the depression itself generated. Indifferent to the general world situation, each nation attempted to solve its own local unemployment problem by measures which only too often increased the pressure on other areas. Instead of creating conditions facilitating a general increase in output and employment, many nations simply attempted to reduce the import of foreign goods. The inevitable effects was a disastrous decline in the volume of international trade and a breakdown of the normal machinery by which that trade was sustained.

Any programme of reform must take account, both of the facts of the present and of the necessities of the future.

Leaving on one side vague general ideals and theories, in order to devote itself entirely to what is at present feasible, the Expert Committee appointed by the Joint Committee of the Carnegie Endowment and the International Chamber of Commerce has endeavoured, on the basis of numerous reports by experts, to devise measures which can immediately be put into practice and which seem calculated to further appreciable progress in international economic relations.

Before going into the details of these recommendations, the Committee desires to emphasize what it considers as an extremely important point: it is useless for countries to conclude conventions for the concerted reduction of trade barriers so long as they

are not actuated by a sincere desire for co-operation and mutual understanding. A lasting solution of the existing difficulties will be impossible so long as the nations refuse to recognize and apply the fundamental economic principle according to which goods and services must be accepted in payment for international obligations, whatever their nature.

Subject to these preliminary remarks of a general character, what is necessary in the international economic field is a concerted attempt to diminish the existing obstacles to the reconstruction of international economic relations, whether these obstacles arise in the monetary sphere or in the realm of commercial policy.

The technical situation is decidedly more hopeful, but the general situation is still fraught with great anxieties. It is a commonplace — but a commonplace of the greatest importance — that the furthering of general economic prosperity presupposes at least a certain minimum of understanding between nations.

The spirit and the ideas by which the nations are actuated remain indeed of greater significance than the perfection of purely technical devices. If it should happen that the pessimists prove right and another great war breaks out, obviously we should experience all over again the upheaval of currencies and prices which characterized the period 1914 to 1918 and of which we still feel the after-effects.

But even though war be averted, the fear of war is in itself a powerful factor hindering economic improvement. It produces a tendency to autarchy and increase in armaments, mutual distrust leading to a stoppage of new international financing and a withdrawal of old credits — all developments which tend to make the world poorer than it need be. To the extent that re-employment depends on an extraordinary large volume of armaments expenditure, it obviously rests on a more precarious basis than if work were provided by the ordinary recurrent demand of the general public.

The conclusion is inevitable that world peace and a return to prosperity through the revival of world trade are one and indivisible.

PRACTICAL CONCLUSIONS

I. COMMERCIAL POLICY

In the later sections of this report, it will be pointed out that a pre-condition of a lasting currency stabilization is a more orderly arrangement of international commercial policies. At this place, it is necessary to urge the converse of that proposition, i.e. that a more liberal commercial policy will only be feasible given a certain minimum stability in foreign exchange rates, as well as a general increase in production and employment, which greatly depend on a sound domestic monetary policy.

A. TARIFF LEVELS.

The general tariff level, which had already mounted appreciably during the post-war years, has risen considerably in most countries since the depression. To-day, more than ever, a substantial reduction of tariffs is an urgent necessity.

Tariff demobilization, indispensable though it may be, can only be effected by a series of successive stages. In this respect, and as regards the various proposals submitted, it is necessary to discriminate between those which, in present circumstances, stand no chance of being put into practice and those which, on the contrary, could be carried out and bear fruit in a not too distant future.

1. *What it is not possible to achieve at present*

(a) A general tariff truce.

Under existing circumstances, a general tariff truce seems impossible. Those States which would be willing to adhere are probably restricted in number and their willingness to consider a truce would rapidly diminish if outside States were simultaneously to increase their tariff rates.

(b) An all-round and simultaneous reduction of tariff rates.

An all-round and simultaneous reduction of tariff rates, by multilateral agreement, appears equally impossible for the moment. In the first place, specific duties occupy a very important place in modern tariff technique. It appears to be very difficult

to find a formula by which specific duties levied on a very large number of articles can be reduced so as to arrive at an equal all-round percentage reduction. Further, the actual levels of the tariffs levied by different countries differ very markedly. Difficulties would at once arise as to the "fairness" of the percentage reduction proposed. In all probability, nothing of any substantial consequence would result.

2. *What can immediately be done to pave the way for wider tariff demobilization*

(a) Although the experience of the past few years seems to point to the impossibility of a multilateral policy of tariff reduction in the near future, something could be achieved by States which propose to negotiate new tariff agreements with each other, by abandoning the practice of raising their tariff rates preparatory to bargaining. Since such mutual raising of tariffs leaves the bargaining position of the contracting parties unaltered, it is clearly useless and its net effect is simply to strengthen protectionist sentiment.

(b) Instead of endeavouring to achieve uniform reduction by an all-round and simultaneous lowering of tariff rates according to a given percentage, it would be preferable that States should undertake, by multilateral agreement, to fix maximum rates which should only be exceeded in individual cases specified in advance. It is not within the sphere of an international body of experts to suggest to individual Governments what the appropriate maximum level of their tariffs should be. The first step in the direction of reform must consist in furnishing to the inhabitants of different countries a clearer guide than is at present available to them of the burdens which they are actually carrying through the tariffs at present levied on goods passing the various frontiers. The members of the Expert Committee are aware of the technical difficulties which have from time to time been raised when a suggestion for the creation of a comparative index of tariffs has been brought forward. Nevertheless, while they agree that final scientific accuracy cannot be achieved in the present state of economic knowledge, they are of opinion that an international index would possess such real significance in estimating the comparative burden imposed by the duties actually levied, that they strongly recommend the creation of an international centre whose

sole duty would be to construct such an index and to publish periodical surveys.

(c) The replacement of specific duties by *ad valorem* duties has frequently been recommended as being of a nature to facilitate tariff demobilization. The technical advantages of specific duties have led to a very considerable increase in their use. They are certain in their incidence, and they have the administrative advantage that the consumer is very often unaware of the heaviness of the burden which is imposed on him. But at the same time these so-called advantages do not outweigh the serious circumstance that specific duties, simply because the burden of their incidence is unsuspected, do in fact encourage an increasing measure of protection. It has therefore been suggested, in certain quarters, that the first step in the direction of a more sensible tariff policy should be the replacement of specific duties by *ad valorem* duties. In so far as this can be done, it is certainly desirable. But it cannot be denied that, under present conditions, such a policy would not only encounter serious difficulties, but would be attended with certain dangers. The world has arrived at the end of a period of falling prices. During that period, the burden of specific duties, levied on quantity and not on value, increased in proportion to the fall in the prices of the dutiable commodities. To replace specific duties by equivalent *ad valorem* duties at the present moment would be tantamount to renouncing the future benefits of a progressive alleviation of the incidence of the existing specific duties from the moment that prices show a tendency to rise.

The members of the Expert Committee are of opinion that the administrative advantages of specific duties are so great that it is impossible to expect any general transition from a specific to an *ad valorem* system, whether in the near future or ultimately. Nevertheless, they cannot refrain from pointing out that ignorance of the true burden imposed on the consumer when specific duties are used is frequently responsible for the levying of a grossly extortionate rate of duty, especially where manufactured articles are concerned.

B. IMPORT QUOTAS.

Import quotas, like the Exchange Regimes considered in Chapter E, have a most restrictive influence on international

trade. For the administrative authorities, they have the advantage that they fix either in quantity or in value the amount of permissible imports over a given period, but, from the point of view of the general interest, they present the serious disadvantage of opposing, more strongly than tariff rates, any automatic adjustment of international trade to changes in the economic structure of the different countries. Moreover, even if not in all cases formally inconsistent with the M.F.N.C., they result in practice in a serious diminution in the value of that clause. Under the quota system, an expansion of demand and an alteration of circumstances which would really make it desirable to increase the quantity of goods moving do not result, as would be the case under a freer tariff regime, in increasing the quantity of goods moving.

Further, experience has shown that quotas lead to a false sense of security. As the quantity of imports, by value or quantity, has been fixed, there is a tendency for aggravated domestic competition to arise, owing to a tendency on the part of national producers, encouraged by the more or less complete suppression of foreign competition, to develop industries, hitherto considered as too costly to be profitable. The degree of protection therefore offered to each single producer is less than appears at first sight.

Moreover, experience seems to show that quotas are just as liable to be used as instruments of international bargaining as tariff rates and, once incorporated in a tariff treaty, lose that flexibility which originally appeared to be one of their principal advantages. Theoretically, it would be possible to vary quotas upwards or downwards as circumstances demand. In fact, however, particular quotas are used as bargaining instruments to obtain concessions for industries not directly concerned with the articles covered by the quota. The quota, therefore, has become a powerful instrument restricting international trade without in practice possessing the potentialities of flexibility which are present in the case of ordinary tariff rates.

States should therefore agree :

1. To abolish quotas whenever possible, or to envisage such a measure at a not too distant date.

- (a) States could subscribe to a multilateral agreement on the necessity of abolishing the quota system as soon as currency stabilization has paved the way for a definite recovery of world trade.

It is not suggested that particular States should necessarily tie themselves by any specific declaration of purpose to definite quantities. What is required is a statement of intention in this field, when will weight heavily with world public opinion and business circles.

(b) The ideal to be aimed at is that of a substitution of regimes — a replacement of the quota system by protective duties at the lowest possible level. It might be possible to envisage a period of transition during which the existing quotas would be replaced by "tariff" quotas, pending the definite replacement of the system by ordinary tariff rates. These "tariff" quotas would consist in the quantitative limitation of goods imported at privileged rates, not, as in the case of ordinary quotas, of the quantitative limitation of imports. Imports in excess of the quota would no longer be refused admission, but would merely be subject to higher duty. Such a system would pave the way for a return to ordinary tariffs, without giving rise to a criticism often formulated in respect of another system, consisting of the immediate replacement of quotas by high tariff rates, i.e. that the high initial rate of such tariffs — even if liable to subsequent reduction — would result in an appreciable increase in the cost of living.

(c) Finally, it is necessary to recognize that, in the present state of world opinion, it would probably be easier to remove industrial quotas than quotas upon agricultural products. Self-sufficiency in agricultural commodities is an ideal which is of more than economic significance. Moreover, the demand for agricultural products is much more inelastic than the demand for industrial products. It is therefore not easy to envisage a time in the near future when the complete abolition of agricultural quotas would be possible by international agreement. But it is suggested that serious efforts should be made to remove all industrial quotas within... (say 24 months), by the issue of a multilateral declaration to that effect.

2. To improve the general working of the import quota system when it is impossible to envisage its immediate suppression.

The following suggestions were made by the Council of the International Chamber of Commerce at its meeting in November 1934. The Expert Committee appointed by the Joint Committee Carnegie/I.C.C. approves of these recommendations, which were along the following lines :

(a) If States do not bind themselves to increase the quantities covered by existing quota arrangements, they should at least undertake, by multilateral agreement, not to cut down the existing quantities.

(b) Notwithstanding formal agreements, efforts should be made to increase the volume of goods moving under the quota regime by a gradual increase of the minimum quantity or minimum value permissible under present quota arrangements.

(c) States should agree not to levy customs duty, licence or other dues on imports already restricted under the quota system, except in the case of an increase in the quota preparatory to a return to an ordinary tariff system. (See I. (b) above.)

(d) Finally, when applying the quota system, each State might usefully take the following general principles into account :

1. Quotas should, as far as possible, be fixed for a definite period, for example, for one year at least. Changes which may become necessary during the course of the year, for seasonal or other similar reasons, should be established in advance and not left to the last moment. The possibility of negotiating regular treaties, covering specific periods to govern the application of the quotas during these periods, would seem to merit consideration.

2. Each country should be entitled to take full advantage of the total amount of the quotas allowed, without any other administrative limitation whatsoever. In particular, where a licence of importation under a quota system is not utilized by the holder of the licence, it should be transferable by the competent authorities to another importer. Under the system as at present applied, when there are excess shipments in one period, the excess is generally deducted from the quotas for the following period. The principle should work both ways : any part of a quota not used during a given period should be carried over the next, with due regard to the diminution of consumption in the importing country.

3. Importers should receive increased guarantees of the fair and proper application of the quotas, as well as guarantees of prompt action in the matter of issuing licences without additional charges.

4. In fixing the quotas to be assigned to the various exporting countries, importing countries should bear in mind the actual origin of the goods and not merely the exporting territory,

roundabout methods being frequently used in order to escape the consequences of an equitable distribution of quotas.

The application by States of the above principles would at least have the effect of reducing the inconvenience of the system for those directly concerned. But neither these principles nor the preceding recommendations can render acceptable a system which is at the best an emergency regime, fated to disappear as soon as circumstances permit.

C. COMMERCIAL AGREEMENTS.

It has been suggested, in connection with quotas, that States can and should subscribe to multilateral agreements — subject to parallel measures of currency stabilization — emphasizing the impropriety of the quota system *per se*, and envisaging the gradual suppression of quotas, at least as far as industrial products are concerned. The desirability of the multilateral form of agreement seems evident in this case. Even bilateral agreements can contribute significantly to this end if a sufficient number of countries conclude them. Bilateral treaties, further, would, in the present circumstances, seem likely to contribute effectively to tariff reduction. The following methods are recommended :

1. *The conclusion of bilateral treaties* consciously used as an instrument for the reduction of tariff rates.

2. *The conscious utilization of the M.F.N.C. as an instrument in the reduction of tariff rates.* In the past, the M.F.N.C. has had two main forms, the "conditional" and the "unconditional". It is not suggested that the world should revert to a more general use of the conditional form of the M.F.N.C. On the contrary, American experience seems to show that there are great advantages in the use, which was common in Europe before the war, and which still persists, of the unconditional form.

In some cases, it might also be possible to envisage exceptions to the grant of M.F.N. treatment in the case of countries which, even after the restoration of more orderly currency conditions, continue to practise discriminatory quota or foreign exchange regulation.

D. REGIONAL OR OTHER MULTILATERAL PACTS.

The increase in the number of separate territorial units in Europe, as the consequence of the post-war situation, makes it

urgent that in certain European areas, e.g. the Baltic or Central Europe, there should be an extension of the "neighbourhood" relations of particular States in regard to the conclusion of special regional pacts. It is suggested that it is undesirable that countries not geographically interested in the conclusion of regional pacts should claim any reduction arrived at under such agreements, merely because they have contracted M.F.N. treaties with the various parties to such pacts.

Furthermore, another possible modification of the most-favoured nation clause should be favourably considered, according to which the clause should not prevent the establishment of multilateral agreements, aiming at tariff reduction, to be applied only between the contracting States. The condition for accepting such agreements should be that they are "open" i.e. can be joined by any other State extending to the contracting parties equally favourable treatment.

E. EXCHANGE AND CLEARING REGIMES.

Before entering into the question of exchange and clearing regimes, it is necessary to insist upon the fact that these emergency regimes are as much a matter of currency policy and currency difficulties as they are of international trade difficulties. In this respect, the currency problem and the exchange problem are integrally related, and it is impossible to find a definite solution of the one without solving the other.

Subject to this preliminary observation, there can be no question that exchange and clearing regimes are inimical to the extension of international trade, not merely because of their direct effect, but also because of their indirect effect in preventing "three-cornered" trade. They thus dislocate the essential machinery of inter-State economic relations and gradually bring about the ruin of international trade.

Unfortunately, existing complications make it impossible to expect the immediate abolition of such regimes and a frontal attack on these various measures would be attended by serious dangers, not only for the countries practising such measures, but also for international economic relations as a whole. In this field as in others, it is wiser to proceed by successive stages and only to contemplate for the moment preparatory measures calculated to facilitate the abolition of exchange and clearing regimes.

The prior conditions for the gradual abolition of exchange and clearing regimes seem to be the following :

1. The adjustment of rates of exchange to local economic and financial conditions. Rates of exchange should be such as to permit of the adequate transfer of interest and sinking fund payments, of the adjustment of balance of payments, and of the continued competition of local industries in export markets.

2. In so far as exchange restrictions are the result of an impossible debt situation, it appears that the most urgent need is the conversion of short-term debts into long-term debts, by means of freely negotiated treaties between debtors and creditors and of a reasonable adjustment of debt charges. Fortunately, the very low level to which interest rates have fallen in the leading money markets of the world, and the possibilities of improvement inherent in any recovery of world production, make the consolidation of debts and reduction of interest rates seem no longer utopian.

3. In any settlement of these questions, the necessity of increasing current production and the volume of international trade must take first place. If exchange regimes are entirely swept away, there is the danger that foreign creditors will at once try to remove their capital from an area which they hold in disfavour. It may be necessary therefore to proceed by stages and to aim at the freeing of commercial transactions in the first instance. Capital transactions might still remain subject to control, either by legal enactments or by "standstill" agreements, arrived at voluntarily for fixed periods between debtors and creditors, so as to prevent the exchanges being swamped by the immediate pressure resulting from the attempt to liquidate financial transactions. In other words, it may be necessary to discriminate between commercial and non-commercial transactions.

4. Debt consolidation should, in certain countries, be combined with a resumption of international lending. Certain areas have, in the past, borrowed on a large scale for equipment and reconstruction purposes. Allowance must be made for the usual short-term commercial loans associated with the current movement of international trade. Moreover, in certain cases, it may be necessary to borrow abroad, neither for the purpose of fi-

nancing short-term import movements nor for the purpose of the long-term provision of capital equipment, but for the purpose of reconstructing currency reserves. While, in certain cases — in particular since the war — some of these loans have been excessive and unwarranted, it must be admitted that in many other cases they have been helpful and, in general, that international credits have played a considerable part for a century in the economic development of all countries. Therefore, the resumption of international lending should be encouraged as soon as the solvency of the borrowing countries is such as to afford lending countries the desirable guarantees. It is necessary to emphasize the fact that it would be difficult to envisage a revival of exports in certain debtor countries, such as would enable them to arrive at a settlement of their foreign debts, unless their economic development were aided by new capital. It is not suggested that pressure should be put on the great capital markets for the purpose of making them regard such international loans with greater favour. What it is necessary to achieve is something much simpler: the revival of international lending by means of a decided relaxation of Government restrictions in the financially strong markets, and the removal of obstacles in the shape of such exaggerated tariffs and other import restrictions that debtor nations are prevented from paying their debts in goods and services. At the same time, it is necessary to fix import duties in the borrowing countries at a figure which will make it really possible for the capital sums borrowed to be effectively transferred from the lending country to the borrowing country.

II. MONETARY POLICY

A. PRE-CONDITIONS OF A SETTLEMENT.

There is a general agreement that international trade cannot flourish in an atmosphere of unsettlement as regards rates of exchange. A similar conclusion may also be drawn from the preceding chapters, namely, that it is impossible to expect a substantial reduction of trade barriers, in particular, the abolition of quotas, exchange and clearing regimes, so long as exchange rates are highly unstable. The general ideal to be looked forward to must therefore be the stabilization of the external values of

currencies, either by linking progressively the various currencies to one or two leading monetary systems, such as the pound or the dollar, or, ultimately, by a general restoration of the gold standard in some form. It must not be overlooked, however, that domestic monetary policy also exercises a large influence on international economic relations. A monetary policy which, by bringing about a lower level of interest rates, would favour a sound increase of production and employment in financially strong countries, directly increases their purchasing capacity. This leads to: *a*) an alleviation of the financial difficulties of weaker countries; *b*) an enlargement of the total volume of international commerce; and *c*) conditions favourable for other measures of international economic reconstruction, and therefore increases the chances of maintaining external stability.

In recent years, the technical possibilities of the gold standard have been reconsidered by financial experts and economists. There is some difference of opinion to-day on fundamental technical questions, such as :

1. The artificial widening of the gold-points with a view to avoiding too frequent movements of specie and strengthening the independence of local money and capital markets.

2. Whether, and to what extent, to restore a gold exchange standard, on lines somewhat different from the system formerly in use which, in many respects, proved highly defective.

3. The expediency of the exclusive monetary use of gold for international settlement, of reducing the minimum cover of Central Banks, of developing clearing operations between banks of issue on the basis of increased activity on the part of the Bank for International Settlements, etc. and other reforms of a similar character designed to encourage autonomy in the use of gold and to permit of the more effective use of existing gold reserves.

4. The character of the co-operation between Central Banks, through the agency of the Bank for International Settlements, as regards both credit and currency.

These questions, which are merely quoted here as examples, are of the greatest technical significance, but are of lesser importance when it is a question of determining first principles. The question of the restoration of the gold standard cannot be decided upon in the light of these minor and technical considerations.

These questions were discussed at length in the individual reports of the experts, which furnish the basis of the present document. There are still marked differences of opinion among economic authorities, and detailed consideration of the various suggestions put forward has been purposely omitted from the present report, in order to approach the monetary problem from its essential and more general angle.

It would be useless to demand currency stability in any form without first paying regard to the conditions which would make it possible.

Among these pre-conditions are :

1. *The adjustment of the exchanges of each country to a rate which would represent a fair parity in relation to other countries, taking into account the position of the balance of payments, relative costs and prices, and the domestic debt structure.*

It must of course be recognised that the significance of these various circumstances differs from country to country. The extent to which devaluation must be practised is a matter upon which general conclusions are impossible, since the currency position of each country and the flexibility of its cost level is peculiar to itself. All that can be said is that, without an adequate adjustment of exchange rates, the demand for permanent stabilization is purely academic.

2. *The settlement of outstanding debt problems.*

In this respect, the situation is probably more encouraging today than it has been during the last four or five years, owing to the gradual decline of the amounts involved by the debts themselves and to the gradual improvement in the possibility of converting long term debts on to a lower interest basis of investors in foreign loans. As an example, we may cite the case of Australia, where the burden of the external debt has, in recent years, been greatly diminished in consequence of the conversion of maturing long-term debts on to a lower interest basis.

3. *Easing of the clearing and exchange positions.* (See Part I, Trade and Tariff Policy, Chapter I.) It is difficult to envisage an easing of the exchange and clearing positions without an adjustment of exchange rates and without a certain measure

of monetary stability. In practice, these various operations should take place more or less simultaneously and should pave the way for a final settlement of the monetary problem.

B. POSSIBILITY OF A JOINT DECLARATION ON MONETARY POLICY.

Attempts to arrive at a settlement of the exchange problem have hitherto broken down owing to the unwillingness of any single State to commit itself unless others were prepared to commit themselves also. This resulted in the impossibility of fixing upon the permanent rate at which to stabilize, so long as the currency situation in certain areas was still obscure.

These major considerations of policy are likely to persist for some time to come. It appears therefore that, in view of the unwillingness of statesmen to commit themselves as to permanent rates, the preliminary step towards greater stability must consist in a declaration of ultimate objectives, leaving the implementation of the policy to the future.

A Joint Declaration on Monetary Policy by the leading world powers would not commit any one of them to irrevocable decisions on specific rates of exchanges, but it would greatly assist the process of education and the revival of confidence, provided agreement were achieved upon the major objects.

Such a Declaration should cover the following points :

- (a) *The avoidance of currency depreciation as an instrument of international trade competition;*
- (b) *The preservation and extension of the existing stability of rates except as necessitated by adjustment to fair parities;*
- (c) *The elimination of seasonal variations in the value of currencies;*
- (d) *Recognition of the desirability for a transition to a more permanent regime without undue delay.*

The practical problem is: under what conditions can the transition spoken of be realized? To this question, a twofold answer must be given :

1. It is clear that no final decisions in this sphere on monetary policy are possible before the future level of certain vitally important currencies (sterling, dollar, franc, mark, yen)

has been decided upon. It is not the function of an international body to dictate to any individual country what the future level of its rate of exchange should be. It is equally clear that it is purely utopian to expect a definite settlement of the international currency problem until the outlook as regards the currencies mentioned above is clearer.

2. On the other hand a much greater degree of adjustment has, in general, taken place than is universally recognized. Existing exchange rates show a high degree of stability; interest rates have been largely adjusted to a new level; the prices of staple commodities themselves show signs of rising rather than falling; the fall in interest rates is beginning to stimulate long term investment; the volume of indebtedness incurred in the past is being liquidated on an imposing scale; the terror of an imminent shortage of gold has been dissipated as a consequence of a revaluation of gold stocks and the increase of gold output.

Imp. G. Thone, Liège (Belgique)

JOINT COMMITTEE
Carnegie Endowment International Chamber of Commerce

International Economic Reconstruction

An Economists' and Businessmen's
Survey
of the Main Problems of Today



Headquarters of the Joint Committee
INTERNATIONAL CHAMBER OF COMMERCE
38, Cours Albert-I^{er}
PARIS VIII^e

ERRATA

Page 160, line 23, *please read* the individuals and corporations investing capitals *instead of* the states investing capital.

Page 185, note, *please read as follows* : This estimate applies only to Europe and the U.S.A., and it must therefore represent something rather short of the world total. The B.I.S. estimates are made by adding together the data obtained and estimates made for the countries taken separately. The above table gives a new approach to the subject.

**International Economic
Reconstruction**

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FOREWORD

By two resolutions, the first of which was adopted at the International Conference held at Chatham House, March 5th 1935, under the auspices of the Carnegie Endowment for International Peace, and the second at the eighth Congress of the International Chamber of Commerce, held in Paris from June 24th to 29th, 1935, it was decided by these two organizations to collaborate in an exhaustive survey and study of the principal aspects of international economic relations. Following this decision, a Joint Committee Carnegie Endowment-International Chamber of Commerce, was appointed by these two bodies. At a first meeting held on October 8th, 1935, the Joint Committee agreed to call upon a Committee of Experts to prepare the technical basis on which they would ultimately found their own opinions and recommendations. It was further agreed, at a second meeting held on November 16th 1935, to limit the Joint Committee's present investigations to the two main problems of the *removal of trade barriers* and *monetary stabilization*, whereupon the following statement was adopted, as constituting a summary of the guiding principles to be followed by the Committee in its work :

CURRENT PROBLEMS OF ECONOMIC RELATIONS BETWEEN NATIONS

The International Chamber of Commerce which was called into existence by the businessmen of the world for the promotion of international economic intercourse, and the Carnegie Endowment created for the purpose of assisting efforts towards the maintenance of peace, believe that economic dislocation leads to world impoverishment and this in its turn is a fruitful source of conflict between nations. They therefore think that there is no more urgent task than an examination of the conditions which would

most immediately contribute both to economic improvement and to a more harmonious state of international political relations. It appears to both these bodies that the following problems should in the first place be subject to expert investigation.

The improvement of commercial relations between nations and particularly the conditions under which it may reasonably be expected that existing barriers of trade can be lowered including a study of the technique by which this end can be most effectively reached.

The improvement of monetary relations between nations and more particularly the conditions under which a satisfactory currency stability can be attained internationally.

These problems of course do not exhaust the field of investigation of the economic relations between nations which influence both prosperity and peace. There are, for instance, the questions of internal planning, in its relation to international intercourse; the question of raw materials in all its complex implications; the whole problem of population and immigration, and so on. But the International Chamber of Commerce and the Carnegie Endowment are of the opinion that the two problems specially set out above should be attacked in the first place. Any solution found for these problems would not only greatly help towards political pacification and economic recovery, but would make a solution of the other problems ipso facto the easier.

As soon as these general decisions had been taken, the Committee set to work. In order to inform itself more thoroughly in regard to the problems which it had been called upon to study, it sought the assistance of a certain number of economists of various nationalities, especially qualified to deal with international economic questions, and requested them to reply to a list of definite questions addressed to them in accordance with the general program established by the Committee of Experts. The eleven economists thus consulted responded to this invitation. The number of specialists in economic questions collaborating with the Joint Committee, including the six members of the Committee of Experts, was therefore seventeen. Thanks to a close collaboration between the experts and the members of the Joint Committee, the work made rapid headway. The Committee of Experts met for the first time on March 25th, 1936 to examine the memoranda submitted by the experts, a great number of

which it had already received, and to discuss the elements of draft practical conclusions for submission to the members of the Joint Committee. On June 25th, 1936, the Committee of Experts held a final meeting in order to complete the text of its practical conclusions, which subsequently, on August 4th, 1936, served as a basis for the drafting of the practical recommendations of the Joint Committee itself.

This important study having been terminated, the Joint Committee decided to publish the results as soon as possible, considering that it was its urgent duty, in view of the contemporary character of the problems dealt with and the gravity of the international situation, to make the documentation thus collected immediately available to all interested in economic questions, to important business leaders, in short, to all who were in a position to exercise a favourable influence on public policy.

Readers should bear in mind that the documents published are the work of *experts*. The conclusions by which they are followed have also been drawn up by experts. As for the recommendations strictly speaking, they only engage the personal responsibility of the members of the Joint Committee. They represent the results of the task assigned to the Committee by the Carnegie Endowment and the International Chamber of Commerce and are at present under consideration by both these organizations as a basis of future action and work.

August 4th, 1936.

October 20th, 1936.

Immediately after the decision to publish these studies and the practical recommendations drawn up in August by the Joint Committee and in which emphasis was placed upon the critical state of international relations and the need for prompt action "by the leading nations to substitute friendship for fear and to stabilize the politics of the world", France, Great Britain, the United States of America, and other principal nations acted in September.

This action seems to be conceived, and, we hope, will be continued, in happy consonance with the needs and facts and tendencies exposed in the attached studies. While the rapid sequence of events renders it superfluous to pursue the study and publication of the detailed recommendations we had at one time thought necessary, we are encouraged to believe that further dispassionate study of the situation as it develops will increasingly enlighten business men and help the Governments of the world to devise the appropriate measures for the restoration of world trade and the attainment of a durable peace.

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owment
;
SINGEN,
Chamber

Dr. Nicholas Murray BUTLER, President of the Carnegie Endowment for International Peace ;

Dr. F. H. FENTENER VAN VLISSINGEN, President of the International Chamber of Commerce.

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- M. Alfred FALTER (Poland), Member of the Council and Executive Committee of the International Chamber of Commerce ; President of the Central Union of Polish Industries ; General Manager of the « Robur » coal-mines ;
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- M. A. E. JANSSEN (Belgium), Former Minister of Finance ; Professor of Economics, University of Louvain ;
- M. Ernest MERCIER (France), Managing Director of the Union des Syndicats de l'Electricité ;
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- Mr. Hisanori MUNAKATA (Japan), Superintendent of the London Agency of the Bank of Japan ; Member of the Board of Directors, Bank for International Settlements ;
- On. Gr. Uff. Avv. GINO OLIVETTI (Italy), Member of the Council of the International Chamber of Commerce ; President of the Associazione Italiana Fascista di Industriali Cotonnieri ;
- Mr. Björn PRYTZ (Sweden), Member of the Council of the International Chamber of Commerce ; Managing Director of the Aktiebolaget Svenska Kullagerfabriken.

Alternate : M. K. G. LUNDAVIK, Former Minister of Commerce ; General Manager of the Sveriges Industriförbund ;

LORD RIVERDALE, K.B.E. (Great Britain), Vice-President of the International Chamber of Commerce ; Chairman and Managing Director of Arthur Balfour & Co. Ltd., Capital Steel Works, Sheffield ;

Dr. James T. SHOTWELL (U.S.A.), Trustee of the Carnegie Endow-

- ment ; Director of the Division of Political Economy and History of the Carnegie Endowment ;
- Mr. Harper SIBLEY (U.S.A.), President of the Washington Chamber of Commerce ;
- Dr. Hans SULZER (Switzerland), Member of the Council and Executive Committee of the International Chamber of Commerce, President of the Swiss National Committee of the I.C.C., President of the Swiss Union of Commerce and Industry, President of the Sulzer Brothers Ltd., Winthertour.
- Alternate* : Dr. E. WETTER, Member of the Council of the I.C.C. ;
- Dr. Ernst TRENDELENBURG (Germany), Staatssekretär i. e. R. ; Vice-President of the Economic Chamber of the Reich ; President of the Reichsgruppe Industry ;
- Mr. Eliot WADSWORTH (U.S.A.), Vice-President of the International Chamber of Commerce ; President of the Boston Chamber of Commerce ; former Assistant Secretary to the Treasury ;
- Mr. Thomas J. WATSON (U.S.A.), Member of the Council and Executive Committee of the International Chamber of Commerce ; President of the American National Committee of the I.C.C. ; Trustee of the Carnegie Endowment ; President of the International Business Machines Corporation ;
- The Associate Director of the European Centre of the Carnegie Endowment for International Peace : Mr. Malcolm W. DAVIS ;
- The Secretary General of the International Chamber of Commerce : Mr. Pierre VASSEUR.

THE COMMITTEE OF EXPERTS IS COMPOSED AS FOLLOWS :

- Professor T. E. GREGORY (Great Britain), Chairman ; Professor of Economics, University of London ;
- Professor Dr. E. BOEHLER (Switzerland), Professor of Economics, Technische Hochschule, Zurich ;
- Professor Bertil G. OULIN (Sweden), Professor of Economics, College of Commerce, Stockholm ;
- Dr. Leo PASVOLSKY (U.S.A.), Member Research Staff of the Institute of Economics, Brookings Institution, Washington, D.C.¹ ;

¹ Dr. Pasvolsky served on the Committee during the early stages of its work. He resigned on taking up an official Government appointment.

- Professor Dr. Andreas PREDÖHL (Germany), Professor of Economics, Institut für Weltwirtschaft, Kiel ;
- Professor Charles RIST (France), Former Professor of Economics, University of Paris ; Honorary Deputy-Governor of the Bank of France.

The following economists were also consulted by the Joint Committee :

- Dr. Antonin BASCH (Czechoslovakia), General Director of the Manufactures Réunies de Produits Chimiques et Métallurgiques, Prague ;
- M. Dag HAMMARSKJÖLD (Sweden), Member of the Finansdepartementet ;
- Dr. Hubert Douglas HENDERSON (Great Britain), Joint Secretary Economic Advisory Committee since 1930 ;
- Mr. Per JACOBSSON (Sweden), Economic Advisor to the Bank for International Settlements ;
- Dr. Ludwig VON MISES (Austria), Professor of Economics at the University of Vienna ;
- Dr. Feliks MLYNARSKI (Poland), Honorary Deputy-Governor of the Bank of Poland, Professor of Banking at the Academy of Commerce in Warsaw ;
- Professor Giorgio MORTARA (Italy), Professor of Economics at the Università Commerciale Luigi Bocconi, Milano, General Manager of the *Rivista di Politica Economica*, Rome ;
- Professor Lionel ROBBINS (Great Britain), Professor of Economics, University of London ;
- Mr. A. A. VAN SANDICK (Netherlands), Secretary general of the Rotterdamsche Bankvereeniging ;
- Professor Jacob VINER (U.S.A.), Professor of Economics, University of Chicago.

Secretary of the Joint Committee and of the Committee of Experts:
Mr. G. COURTOIS DE VIÇOSE.

INTRODUCTION

The program of work elaborated by the Committee of Experts, which provided for the preparation of memoranda by various specialists in economic questions, included a study of the following problems :

Improvement of Commercial Relations between Nations

PART. 1. — *The technological long-term factors in the reduction of the volume of overseas trade* : Professor Eugen BOEHLER (Zurich).

PART. 2. — *The fundamental reasons for increased protectionism*: Professor Lionel ROBBINS (London).

PART. 3. — *The technique of protectionism* : Dr. Leo PASVOLSKY (Washington) and Professor Jacob VINER (Chicago).

PART. 4. — *The road to recovery* : Dr. PASVOLSKY, Professor Andreas PREDÖHL (Kiel) and Professor Charles RIST (Paris).

Monetary Stabilization

PART 1. — *The Significance of Stabilization*

1. The relationship between currency instability and tariff (and allied) changes : Prof. PREDÖHL.
2. New technical arguments for postponing stabilization : memoranda by Prof. T. E. GREGORY, Dr. H. D. HENDERSON (London) and Prof. Ludwig von MISES (Vienna).
3. Exchange stabilization and the problem of internal planning : memoranda by Prof. BOEHLER and Prof. von MISES.

4. The position of individual countries or groups of countries : Dr. PASVOLSKY on the United States ; Dr. Antonin BASCH (Prague) on Czechoslovakia ; Prof. GREGORY on the sterling area ; Prof. RIST on the gold bloc ; Prof. FREDÖHL on the countries practising exchange control.
5. The possibilities of the sterling area : Prof. GREGORY.
6. The technique of the forward exchange market and the elimination of uncertainty : Mr. A. A. VAN SANDICK (Rotterdam).

PART. 2. — The Technique and Nature of Re-stabilization

1. The existing price problem : Prof. GREGORY.
2. The gold problem Prof. Feliks MLYNARSKI (Poland).
3. The cooperation of Central Banks : Prof. Feliks MLYNARSKI.
4. The frozen credit problem in Central Europe : Dr. Antonin BASCH.
5. International short-term indebtedness : Mr. G. CONOLLY (Assistant to Mr. Per JACOBSSON, Bank for International Settlements).
6. The changes in economic structure and their repercussions on the movements of capital and balances of payments : Prof. Giorgio MORTARA (Milan).
7. The problem of parities : Prof. Giorgio MORTARA.
8. Note on « A desintegrated, provisional monetary standard as a basis of stabilization » : Mr. Dag HAMMARSKJÖLD (Finansdepartementet, Stockholm).

This series of memoranda, which is published in English only, forms a volume distinct from the present one, and can be obtained at the seat of the Carnegie Endowment and at the International Chamber of Commerce.

On the basis of these documents, a general report has been prepared by Professor Gregory, setting forth the essential ideas and suggestions submitted by the various authors of the memoranda. This is the document which we are publishing in the following pages together with an introductory report by Professor Ohlin on the Problem of International Economic Reconstruction, the conclusions submitted by the experts and the practical recommendations of the Joint Committee.

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International Economic Reconstruction

by

Professor Bertil G. OHLIN,
Professor of Economics, College of Commerce, Stockholm

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Introduction

Few people will deny that stable world prosperity is dependent on the maintenance of close international economic relations. It would not, however, be justified to assume that these relations must be of the same character and have the same relative importance as in pre-war times. The Great War and, still more perhaps, its after-effects, have disturbed and changed the character of world economy. After the world depression of the last six years, no competent authority would expect a return of pre-war conditions in the economic sphere. On the other hand, it is impossible that the present disorganized state of international commerce and monetary conditions should have come to stay. If the world is to recover and to regain the necessary prosperity for the solution of pressing social and political problems, for which purpose a temporary boom of an inflationary character is quite insufficient, its international economic structure must be re-edified on a sound basis. Thus there exists at the present moment a reconstruction problem, or rather a series of reconstruction problems, which call for solution, and which it is the object of the present report to set forth and define. No attempt will be made to present ready-made solutions. But since the first condition of solution is recognition of the character of a problem, it is by no means impossible that the mere statement of the problems in their true light may be helpful. In some cases, the general direction in which their solution can be sought will be indicated.

The Goal of Economic Activity

It goes without saying that the organization of the international economic relations must depend upon the goal set by the various countries to their economic activity. If they are interested less in a high standard of living than in economic self-suffi-

reduced the risks of war. Thus some modification of an otherwise rational organization may be called for. As a matter of fact, however, viewed from a broader angle, there is very little contradiction between the consequences of the two aims : preservation of peace and growth of national income. Experience shows that war means the destruction of much capital and the disorganization of the public finances. In these and in many other ways, it leads to an enormous reduction of national income. What is certain is that, in the long run, there can be no greater danger to rapid economic progress than war. Thus a policy calculated to reduce risks of war may also be regarded as rational, from the point of view of economic development. Moreover, it is a fact to be illustrated below that certain economic methods which tend to reduce the efficiency of production and trade are precisely those which are most likely to give rise to international conflicts.

The standards which we have adopted for the following analysis of the suitability of various types of international economic relations are their influence on economic progress and the possibility of avoiding conflicts which may endanger peace. For the reasons just set forth, not much attention needs be given to possible discrepancies between these two standards. In other words, the main problem is the following : How can the existing state of world economic affairs be modified so as to create more favourable conditions for economic progress and the maintenance of peace ?

The National and Social, not the Individualist or Socialist Point of View

The significance of economic progress is considered from the standpoint of the collectivity and not from that of the individual. An economic event may be a source of profit to certain individuals and increase their income, but this individual increase is outweighed by the reduction caused by the same event in the income of others ; hence a reduction of national income. In the following analysis, such events are regarded as undesirable. The criterion used is the effect upon the national income. It follows that there is no predilection for certain forms of private capitalism, such as freedom to create international monopolies of a kind

ciency in case of war, then the reorganization of world economy will have to proceed on lines rather different from those adopted, if the principal aim is to raise the social and economic standard of the people. It follows that rational international organization in the economic sphere is impossible in so far as the goals pursued by the different nations are divergent or contradictory. Fortunately, differences of aim in economic policy are, as far as most countries are concerned, not very considerable. Almost all states strive for an increase in the real income and in the standard of living of their citizens. It is obvious that not only real national income per head but also distribution of income and security and stability of employment are taken into consideration. Taken in this sense, a desire to raise the standard of living is the principal factor by which the economic policy in almost all countries is determined. In the international sphere, an organization providing a higher standard would in every case be preferred to a system resulting in a lower one, unless there are special reasons of a non-economic character which speak in favour of the latter.

Defence and Economic policy

Of these peculiar circumstances, two merit special consideration in view of the wide influence which they exercise in the world of today, and which is likely to continue for some time to come. In all nations there is a deep longing for *peace* and at the same time a wish to be *prepared to defend* the country in the case of attack. Important economic sacrifices are accepted if it is believed that they contribute to peace and security. This entails two kinds of consequences as regards international economic relations. First, preference of an organization which involves less risk of international conflicts likely to lead to war. Secondly, the acceptance of a lower standard of living than would otherwise be possible, if this is absolutely necessary in the interest of the preservation in time of peace of certain lines of domestic production which are regarded as being of outstanding importance in the case of war. This last circumstance, and possibly the first one also, obviously entails an economic policy which deviates from what would be rational if the aim pursued were the highest possible national income or standard of life. The character of these deviations is relatively clear, despite the fact that there are alternative methods, such as the maintenance of large stocks of

the necessary war materials, instead of the fostering of anti-economic domestic production. For international economic organization, the repercussions of such considerations may be regarded as modifications of the organization which would otherwise be rational.

Even if there are nations which regard military power and other non-economic goals as more important for their economic policy than a high social standard, it is necessary for them to investigate what kind of economic relations between themselves and the rest of the world would produce the largest national income. For a high income and standard of life in peace time is important from the point of view of the effective conduct of war. These factors exercise an influence e.g. upon the level of education and, thus, the efficiency of the soldiers, and also upon the possibility of financing important armaments. (Thus a high level of national income enables a nation to gain certain advantages from a military point of view, which are out of reach if its economic policy is dictated by narrow military conceptions ignoring the influence of the standard of living) E.g. far-reaching autarchy may result in a reduction of military power, in so far as it lowers the economic standard. It therefore becomes obvious that even for countries which do not regard a high standard of living as the principal aim to be pursued (it is necessary to analyse the conditions under which the maximum national income can be obtained)

Peace and International Economic Organization

Besides the desire to have a strong defence and power of resistance, the other non-economic consideration touched upon above, is the wish for peace. There is a close inter-relation between these two considerations. As a matter of fact, the desire to possess a certain measure of military defence is in many cases merely the outflow of this love of peace. But the wish to preserve peace entails for economic organization certain consequences which have nothing to do with military matters. Certain types of international relations are apt to cause friction and misunderstanding and must therefore be regarded as a danger for peace. There may be other types productive of a somewhat lower real income in times of peace, but this disadvantage would, in the opinion of many, be more than outweighed if it substantially

which may threaten the growth or real income in the same way as extreme tariff protection. The argument below is based on social considerations. Neither is it dependent on any individualist, private-capitalistic or socialist philosophy, nor is it coloured by an international as opposed to a national outlook. On the contrary, it is assumed that each nation aims at a high standard for its own citizens.

Impossibility of «Back to 1914»

Another reservation might be added to prevent misunderstanding. The eventual lines of development, analyzed below, do not deviate radically from post-war economic development since it would be of little practical interest to speculate as to the efficacy of different international systems based, for instance, on an economic structure of a wholly communistic character or of a completely liberal sort in all countries. It is the problem of reconstruction as it appears in the world today which is the object of analysis. Hence there is no trace of the idea — so common among many people whose first contact with economic problems dated from the end of the 19th century — that the solution of all the present difficulties lies in a return to pre-war conditions. Even though it is true that the course of events in recent years has in many ways been deplorable, yet it must be recognized that this development has not been arbitrary and due only to the foolishness of political and economic leaders but that it is to a large extent the result of an inherent necessity and that — in any case — its effects cannot be undone. A considerable part of the present internal organization in the various countries must be taken as a given datum. It would serve no useful purpose to assume that internal economic policy can rapidly return to pre-war conditions and international economic relations be based thereon. But even though it is the actual economic and political situation which forms the basis of this analysis, there can of course be no assumption that this organization of society should remain unchanged. The argument is so general that most of it should be valid even if in coming years the general character of the national economic structures were to move somewhat in a socialist direction or a little back to more liberal forms. There is, of course, a close relationship between the character of the

international economic institutions, which are the subject of discussion in this report, and the national institutions. But as long as there are no radical changes in the latter, little adaptation of the former would be required in most cases.

Possibility of Rapid Progress

Some people seem to take the pessimistic view that the era of world economy in a pre-war sense has gone for ever and that international economic relations will play only a minor rôle in the future. It will be seen from the following analysis that this pessimism is scarcely justified. There are ample reasons for assuming — given certain political conditions — that a reconstruction and a revision of the world economic structure is possible. It may also be emphasized, at this point, that, in the event of suitable adjustment to new conditions, it would not be unreasonable to hope for the continuance of the rapid economic progress of pre-war times. The last half-century before the war, the standard of living in many industrialised countries was at least doubled and, in spite of the setback during the war, a similar improvement set in during the twenties. There is no reason why this economic expansion should not continue during the next decade or two. The recovery in many countries shows that the world economic depression which held up this development and led to incomplete utilization of productive resources and to an inefficient economic policy can be regarded as a temporary phenomenon. Nevertheless, (In view of the considerable economic losses of the last years and the widespread misery, it seems justified to say that one of the most important economic tasks of the world of today is to combat and mitigate depressions.) This also applies to international reconstruction. If serious economic crises can be prevented, it will obviously be much easier to avoid the development of anti-economic practices and policies in the international field.

In some competent circles, and certainly among the general public, the depression of the last years has caused exaggerated pessimism in regard to possibilities of future progress. This pessimism overlooks certain salient facts. Independently of political beliefs, everyone has to admit that, except during depressions, productive resources are utilized so intensively — available

labour power to more than 90 % — that an increased output of only a slight percentage would, under given technical conditions, result from more complete utilization. It is an illusion, only too widespread, that if the productive capacity were fully used the output could be doubled or trebled. The truth is that the great poverty and the unsatisfactory consumption level in the world both before and after the war is chiefly due to the fact that the ability to produce is and would be too low even if 100 percent of the available labour power were employed. The only remedy is an increased efficiency of production. Thus, (besides mitigating depressions, the most important thing is to create conditions favourable for a continued increase in the efficiency of production) There seems to be no reason to expect that technical development should cease and that under reasonable political conditions a further doubling of the standard of living in the course of the next fifty years should prove impossible, given a suitable adjustment of the economic structure. In an investigation of international economic relations, i.e. of the necessary international adjustments, the desirability (both of relative stability and of continued growth in efficiency) two things which are of course closely inter-related, have to be considered. The international organization should be so stable and elastic that risks of financial and economic breakdowns, calculated to intensify depressions, would be minimized. On the other hand, it should not prevent an active, domestic policy for the stimulation of economic production. A rational international system in a world without business cycles might become irrational in the actual world, if it precluded domestic policies to smooth out the business cycle. Such a system could not be durable. The desire for state intervention to help recovery during depressions would give rise to measures which would soon destroy the international system. The existence of business cycles makes it desirable that the international organization, far from preventing an active domestic policy, should tend to coordinate anti-depression measures and efforts to control booms in the different countries. What is urgent today is to discover what kind of adjustment of international economic relations to new political, technical and psychological conditions is at the same time desirable — judged by accepted standards — and practicable.

CHAPTER I

Economic Progress before the War

A. INTERNATIONAL TRADE, CAPITAL MOVEMENTS AND MIGRATION

The last 100 years before the world war saw immense economic and social progress. As far as is known, never before in the history of mankind had the standard of living risen so rapidly. This is all the more remarkable as the world population also increased with unusual rapidity, in Europe alone from 187 millions in 1800 to 480 millions in 1930. The explanation of this unprecedented development lies chiefly in the following two circumstances. This period was the era of industrialization during which an entirely new technique came into use. New sources of power and new machinery resulted in the manifold increase of the efficiency of labour. Secondly, it was at this time that the development took place which makes it possible to speak of a *world economy*. Improved methods of communication opened up contacts between Europe and the distant regions overseas. European labour and capital began to flow in large streams over to sparsely populated districts with large natural resources. It consequently became possible to obtain a growing quantity of food and raw materials at relatively low cost and to pay for them by the exportation of manufactured goods. If the volume of world trade in 1880 is put at 100, the index for 1850 was only 27 and that of 1913 no less than 270. Thus in little over 60 years international trade had grown to 10 times its former volume. This international division of labour and specialization meant an enormous increase in the efficiency of production and helped to raise the standard of living of the masses. It also created high earnings for manufacturers and land owners and, thereby, led to a large accumulation of capital without which it would not

have been possible to build houses and factories and to provide transport facilities for the rapidly growing population.

Migration as a Condition of Economic Growth

It is obvious that one of the conditions of the utilization of the natural resources in the new countries was a corresponding increase in their originally scanty population. The great European migration made this possible in the course of a few decades. If we take the whole century up to 1924, the number of immigrants to the United States reached 33 millions, while the corresponding figure for the Argentine was 5 1/2, for Canada 4 1/2 and for Brazil somewhat less than 4 million people. In 1930 the number of persons of European stock in the overseas countries reached 160 millions.

The most important emigration country was the United Kingdom, which supplied no fewer than 17 million emigrants from 1846 to 1924. During the same period, 9 1/2 millions came from Italy, 5 from Austria-Hungary, 4 1/2 from Germany, and 4.3 millions from Spain. It is obvious both that the rapid increase in the output of primary goods in the new countries would have been impossible without this inflow of labour and that its employment in Europe would only have been possible at a much lower standard of living than that which the European nations actually achieved. Especially in the case of Great Britain, it is difficult to see how the growing number of citizens could have been fed without access to the food supplies from overseas countries. Failing emigration possibilities, many of these people would never have been born at all.

The Export of Capital

The distribution of European capital was a parallel movement, which played a similar rôle for the economic expansion in the new countries and for the European supplies of food and raw materials. Great Britain was the greatest exporter not only of men but also of capital. In 1913 its foreign investments reached the enormous amount of 4,000 million pounds sterling. This was more than all other foreign investments taken together. It has been computed that France had invested about £ 1,800,000,000,

and Germany from £ 1,000,000,000 to £ 1,250,000,000 in other countries. The foreign investments of other nations were smaller, although considerable in the case of Belgium, Switzerland and Holland, if the size of these countries is taken into account. The Belgian figure exceeded £ 100,000,000 while that of Switzerland approached £ 180,000,000 ; the Dutch investments are supposed to have been still larger.

Great Britain invested nearly half of its exported capital in the British Empire, 20 per cent. in the United States, and nearly 20 per cent in Central and South America. Less than 5 per cent was invested in Europe, chiefly in Russia, Spain and Turkey. France, on the other hand, preferred to lend to Europe, while investing large sums in Egypt and in the French Africa colonies. Germany invested heavily in Europe, but spread its capital fairly evenly over many parts of the world.

The Changing Character of Trade

(This movement of labour and capital led to the rapid growth of industry in the new countries and thus was the indirect cause of international trade on a large and rising scale.) Thus, the transfer of productive factors was the indirect cause of the growing transfer of goods. On the other hand, the migration and capital movement finally began to increase the industrial activity overseas to such an extent that it made part of the earlier international trade superfluous. Not all the productive resources were needed in the new countries for the output of primary commodities. Industry therefore turned more and more to the manufacture for domestic consumption of textiles and other commodities which could be relatively easily produced even in countries without long experience in the new machine technique. Hence it was only in the beginning of the new era that the world economic structure was built on the basis of a number of countries producing — not only exporting — chiefly primary goods and buying the larger part of the manufactured goods from the old countries. A gradual change took place. The proportion of manufactured articles from Europe consumed in the overseas countries declined in comparison with those produced at home. The imports began to consist more and more in machinery and other industrial equipment and in highly specialized articles.

This development is well illustrated by the following figures (WAGEMANN: *Struktur und Rhythmus der Weltwirtschaft*) for exports from Germany, Great Britain and the United States, although other causes may also have influenced these figures in the direction shown in the table below.

	1800.	1900	1913
Capital goods	26 %	39 %	46 %
Consumption goods	74 %	61 %	54 %

(But although the character of international trade was changing the foundation of world economy was still, more than ever, international specialization and division of labour. The advantages of this organization are obvious. First of all, it entailed the adjustment of industry to the natural aptitudes of the different regions both as regards natural resources and the bent and talent of the population. It also implied the adjustment of production to differences in the supply of capital. Secondly, the gain from specialization on a limited number of tasks was considerable. Technical development made the economics on large scale production more and more important ; and large scale production was only possible if the goods could be widely spread over great markets.)

Trade and productive factor movements as substitutes

The importance of this adjustment of production to the varying conditions in different countries is perhaps most evident, when we realize that trade indirectly places foreign productive resources at the disposal of nations importing commodities from abroad. On the whole, each country specializes in the production and exportation of commodities which contain relatively large quantities of productive factors which are abundant and cheap in that country. On the other hand, imports consist chiefly of goods, the production of which requires relatively large quantities of productive factors which do not exist at all or only in minor quantities in the importing country. Thus, the export of goods is really indirectly an export of abundant industrial agents, while the importation of goods means an indirect supply of those productive factors of which the supply is scanty or entirely lacking. The movements of commodities serve to some extent as a substi-

tute for the transfer of primary productive factors, natural resources remaining fixed, while labour and capital move only with a certain difficulty. It can also be said that factor and commodity movements supplement one another. Obviously, the combined effect of the considerable labour and capital movement which actually took place and the enormous international trade which grew up was a world economic organization which implied a much more effective use of the resources of mankind, a much more rapid progress and a much higher standard of living than would otherwise have been possible.

It is undeniable that the rapid economic growth in the pre-war period was largely due to this relatively free intercourse between nations as regards commodities, men and capital. To quote the memorandum prepared by Mr. Henderson: «It was this, together with a rapid growth of the productive power of industry that made possible the remarkable improvement in the standard of life which took place in the Western world in the latter part of the 19th century. Indeed the development of the division of labour between the old world and the new based on real and urgent, mutual needs, was perhaps the central feature of the world economic life in the 100 years that preceded the Great War.»

B. THE FUNCTIONING OF THE PRE-WAR GOLD STANDARD

Why did the Gold Standard function well?

It is often asserted that the existence of a stable international monetary system was a necessary condition of this internationalization of economic life. There is much truth in this statement. It seems clear that the fairly universal acceptance of the gold standard in the 'seventies and its smooth functioning in the following decades, i.e. the external currency stability, was a factor which potently helped to develop international economic relations. On the other hand, it is universally agreed that the gold standard did not work in a satisfactory manner after the war. Hence it may be worth while — as a background for the following discussion of international monetary reconstruction — to discuss these two questions: (1) Why did the gold standard function well in the 40 years preceding the war? (2) Which rôle

did it play in international economic relations and the development of world trade ?

The two decisive criteria of the effectiveness of an international monetary system are, its ability to guarantee 1) external stability, i.e. stable foreign exchange rates, and 2) a relatively constant purchasing power of money and thereby stable economic conditions in general. The excellent record of the pre-war gold standard in the first respect was due principally to the coincidence of a number of favourable circumstances, the most important of which will be touched upon below.

Short-term Credit Transactions

No international currency system can function without a certain quantity of short-term capital movements which exercise an equalizing influence on the balance of payments. During peaceful conditions short-term credit transactions usually fulfil this function. On the other hand, in times of war and political unrest, the liquid funds are apt to flow from one country to another to find shelter in quiet places. This results in pressure on the balance of payments of the financially weak countries. During a pre-war period of relatively peaceful sentiments and no important and lasting wars, floating balances of this latter disturbing sort practically did not exist. Short-term credit transactions helped to maintain equilibrium in the balance of payments without any considerable changes in the foreign exchange rates of the leading currencies being necessary.

Credit Policy and the Adjustment of Trade Balances

While such transactions helped to bridge over temporary difficulties, the more durable pressure on the balance of payments called for more fundamental adjustments. Above all, this meant that in certain countries the balance of trade had to be shifted from an import surplus to an export surplus or at least in an upward direction, while in other countries the reserve had to take place. Such adjustments of the trade balances were mainly caused by the special sort of credit policy on the part of central banks imposed by the pre-war gold standard. Countries where the balance of trade and services had shifted in a negative direc-

tion, exported gold, and as a consequence of the decrease of the gold reserve — or future possibilities of gold export — the central bank restricted credit. Even without action on the part of the central bank, gold export — or a failure of normal gold influx — caused a certain stringency on the money market. This brought about a direct reduction of imports and a pressure on the internal price level which indirectly tended to increase exports and reduce imports. This foreign trade adjustment was made all the easier as the countries receiving gold reduced discount rates and pursued an expansive credit policy, thereby stimulating importation directly and indirectly. This relatively standardized policy of the central banks was the principal guarantee of the maintenance of stable foreign exchange rates in a world where, in spite of relative tranquillity, international economic relations were subject to many important alterations.

Of course, the adjustment of the trade balance was relatively easy in view of the absence in most countries of severe trade restrictions. Quantitative restrictions were rare and tariff levels in most countries moderate. Another important factor was the flexibility of cost of production levels. If a country had to increase its international competitive power, and therefore restricted credit, it was feasible to reduce costs through wage and price reductions. Trade unions were not strong and cartel prices played an insignificant rôle. As a matter of fact, only small reductions of wages were required.

The Rôle of London

It would, however, be going too far to say that the gold standard functioned automatically, even if this expression is to be taken as including the standardized behaviour of central banks. As a matter of fact, the international monetary system was, to a large extent, managed from London, which could exercise a considerable influence on monetary developments in the whole world owing to its position as a leading financial centre. Short-term credit transactions were mostly handled via London, and from Great Britain came the most important foreign capital investments on long-term. In many cases, these long-term capital movements seem even to have exercised a balancing function, largely perhaps owing to the fact that they flew in channels corresponding to economic needs and were not caused

or disturbed by political factors. The fact that Great Britain was at the same time the financial centre, a great exporter of capital and, as a free trade country, a highly important market for commodities, helped to make the international adjustments relatively smooth.

Foreign Exchange Stability, Capital Movements and Trade

Stability in the foreign exchange rates was an important condition of the international investment on a large scale. And, as already explained, this export of capital from the Western countries was an essential feature in the process of expansion in the New World, which brought the old countries with their rapidly growing population, an increasing supply of cheap food-stuffs and raw materials. Had the foreign exchange rates been subject to large fluctuations, it is improbable that the international capital movements would have acquired anything like the magnitude they actually did. World economic progress would have been slower.

It goes without saying that the assured stability of the foreign exchange rates also directly contributed to the development of international trade. One of the important risks involved in the trade of earlier days was now reduced to almost negligible proportions. The stimulus thereby obtained for foreign trade should, however, not be exaggerated. During the period 1850-1870, when the international gold standard did not exist, the volume of foreign trade grew at about the same rate as in the beginning of the 20th century and quicker than during the period of falling prices from the middle of the 'seventies to the middle of the 'nineties. Besides, trade between European gold and silver standard countries, like China and India, increased rapidly despite considerable changes in the gold quotations of the silver currencies.

Liberty of Action in Domestic Economic Policy

Apart from its influence on foreign investments and trade, the existence of a stable gold standard affected economic development in so far as it restricted the liberty of Governments as regards their economic policy. This, perhaps, had temporary disadvantages. But at least during the period of rising prices

from the middle of the 'nineties to the outbreak of the war — a period with brief and not very serious depressions — the need for Government intervention was relatively small. That the international currency system set narrow limits for monetary manipulations was an advantage at a time when there would have been little excuse for such manipulations. A comparison between the development in Europe and South America, where some unfortunate monetary experiments were made, supports this view. Of course, credit restrictions for the maintenance of exchange stability sometimes, and in certain countries, led to a depressed state in industry, which could otherwise have been avoided. But this sacrifice was undoubtedly worth while in view of the advantages reaped by every country from being party to the international gold standard. Especially during the period of rising prices, the sacrifice was small, and adjustment of the internal cost level to foreign conditions was easy. Nothing more was needed than to refrain from raising the wage level, which was rising in other countries. This meant a relative reduction in costs which was often quite sufficient to reestablish balance.

Failure to Keep the Wholesale Price Level Stable

When we turn to the other aspect of the monetary system — ✓
the stability of the internal purchasing power of money — we realize at once that there were, in the account of the pre-war gold standard, heavy debit items which should not be forgotten. From the 'seventies to the middle of the 'nineties, wholesale prices fell rapidly. The Sauerbeck index declined from 111 in 1873 to 61 in 1896. Even if this sensitive index somewhat exaggerates the fall, there can be no doubt that such deflation intensified the agricultural crisis in many countries. Thus it cannot be said that the gold standard functioned so well in respect of internal purchasing power as in respect of external stability of the exchange rates. It is true that the gradual rise in the price level during two decades immediately preceding the war probably stimulated economic progress. But this rise — much needed after the long deflation — was certainly due neither to any quality inherent in the gold standard nor to any considered policy on the part of central banks. The decisive factor was that, by a mere chance, gold production, owing to the discovery of new gold fields, happened to assume large dimensions.

CHAPTER II

Breakdown of the International Economic System in 1930-1933

A. THE INSTABILITY OF THE ECONOMIC SITUATION IN THE YEARS BEFORE THE DEPRESSION

The Restoration of International Commerce in the 1920-ies

The war destroyed a large number of international economic relations and changed many others. In the years around 1920 international trade and capital movements were subject to an enormous number of restrictions and Government interventions. Surprisingly quickly, however, a relatively free international intercourse was restored. Already in 1925, commercial policy had been «normalized» to such an extent that relatively few quantitative restrictions remained. The monetary and financial systems of old and new countries were reorganised, in many cases with the active aid of the League of Nations, which played a prominent rôle in the admirable work of international economic reconstruction in the 1920-ies. The index of world production of primary commodities in 1925 had risen to 17 per cent above the 1913 figures. This should be compared with an increase in world population by 6 per cent and in the volume of world trade by 7 per cent. The following four years saw an extraordinary rapid improvement in technique and management both in agricultural and manufacturing industries. Transport facilities were much improved through the growing use of motorcars and electricity. As a number of currencies had been stabilized and the commercial policy, although far from stable, did not change very much, international trade expanded even more than production. For foodstuffs the increase in output was small, but the production of raw materials advanced by almost 5 per cent per annum and the activity in manufacturing industries seems to have risen even a little more. During the whole

period 1925-1929, the increase in the production of primary goods was 11 per cent but world trade showed the impressive rise of 19 per cent. This trade revival was stimulated by a large increase in international lending.

The Causes of Instability

To a superficial observer, it may have looked as if the world was well on its way out of the economic difficulties caused by the war and would soon achieve much greater prosperity than ever before. As a matter of fact, however, as later events have proved, the situation was less satisfactory than it seemed. For various reasons the organization was unstable and had little power to resist the pressure, which was to come from a business cycle recession. It may be useful to touch upon some of these causes of instability.

A rising standard of living and the coming on the market of new *durable* articles for consumption, like motor cars, household equipment, etc. had changed the character of demand in a less stable direction, as has been pointed out by Mr. Loveday. Before the war, consumers' demands had been subject to relatively small variations. Now, however, it proved easy enough for many families to put off purchases of such durable consumption goods for some years during a period of depression.

A second factor of instability was that tendencies towards a growing surplus capacity in the production of certain foodstuffs and raw materials had developed owing to the increased cultivation in many countries during the war, the reappearance of Russia as an exporter, new technical methods, and many other circumstances. It seems certain that, even if no depression of a business cycle character had arisen, conditions of production and demand would have resulted in a fall in the prices of some important primary goods and in a crisis in world agriculture. It was possible for even a relatively small pressure owing to a general decline in business to start this deflation of primary goods' prices, especially as the difficulties were increased by the existence of large and growing inventories. When prices start falling, business men are anxious to reduce stocks and therefore, the greater the stocks, the speedier the falling off in demand for goods from producers. The holding of stocks by certain loose monopolistic organizations made the position even more delicate. (See Ch. VI.)

Price Relations and Indebtedness

3 (Another cause of instability was the unbalanced price system.) In some industries and in certain countries costs had become too high in relation to prices and the financial position of a number of firms was very weak. This was the case, for instance, of industries which had lost a large part of their former export market. Besides, many firms in Germany and other countries on the European continent had borrowed large sums of money at interest rates almost twice as high as before the war. There was also a growing tendency of capitalists to build up bank deposits and to purchase bonds instead of shares. The ensuing enormous indebtedness weakened the financial structure. In many countries, farmers were also heavily indebted.

It is more doubtful whether the obstacles to international migration raised after the war were a serious handicap during the period under discussion although their effects in the long run are considerable. (See Ch. VII.) Greater freedom of migration would probably not have done much to mitigate the depression.

✓ The Changing Character of International Indebtedness

In the international sphere, both manufacturing and agricultural nations had adapted themselves to a continuous flow of capital on a large scale. The former had built up a capacity for producing large quantities of manufactured goods, which the latter could only buy so long as foreign capital continued to flow in. Now, in the post-war years, capital movements, even long-term, were less steady than before the war. For instance, American capitalists had not acquired the traditions and experience which the British financial houses had gained by the lessons of several decades. Sudden changes from large scale lending to refusals to lend abroad at all were not improbable. This might easily have serious consequences as the American tariff policy made virtually impossible a rapid increase of European sales, as required by the debt situation. Instead, it was probable that sales to the debtor nations would fall, and thus, that the United States also would suffer from sudden changes in capital movements.

What made the position particularly vulnerable was the fact that many countries had borrowed extensively on short-term, as their credit standing was not good enough to warrant long-term loans. Furthermore many capitalists, like the French in 1924-1926, only wanted to invest abroad on short-term. A large amount of wandering capital was moving from one country to another in accordance with changes in economic conditions and confidence. Thus the risks of a sudden pressure of credit movements on the balances of payments were very much greater than ever before the war. The reserves of gold and foreign exchanges held by central banks were entirely inadequate to cope with these difficulties. An abnormal quantity of gold was concentrated in Washington, whereas many central banks had very small reserves. This « maldistribution » of gold, was, however, rather a sign of the unhealthy state of the balances of payments due to commercial policy and capital movements and the obligation to pay reparations, than an independent cause of further disturbances.

A special reason for capital movements from Europe to the United States and for some other difficulties was the fact — pointed out by Professor Riefler — that the United States in the 1920-ies had to adapt themselves to an interest level fully one per cent *lower* than before the War, whereas Great Britain had to adjust its economic system to a rise in the rate of interest by one half. This gave capital values in the U. S. A. a rising trend and helped to create a boom, whereas the low capital values in Great Britain made people feel poor and pessimistic (Cf. the present feeling of prosperity in Great Britain in spite of a much larger unemployment than in 1929).

It should also be added that London had lost its place as the leading financial centre, and that New York and Paris were trying to establish themselves in a rival position. Satisfactory methods of cooperation between these centres had not yet been developed. It is also worth stressing that those very countries, which were likely to be affected by political crises, and by a world economic depression, had incurred the largest debt burden, a great part of it on short-term basis. Germany, for instance, had, according to German estimates borrowed 16,000 million marks on short-term — foreign estimates are 20-30 per cent lower — when the financial crisis broke out. The short-term foreign assets were only a fraction of this amount. The obligation to pay large

reparations accordingly resulted in an increase of instability, although it was only one of many important factors (see section B below) and not — as it is often asserted — the factor chiefly responsible for the intensification of the crisis. The German foreign borrowing in 1924-1929, which had been allowed to mount in a very risky manner and which much exceeded the amount paid in reparations — for this reason the reparations did not cause any transfer difficulties before the crisis — had been used partly to refill exempted stocks and for the rationalisation of industry, but not particularly for the strengthening of the export industry. Much of the foreign capital which had flown into Germany and other debtor States seems to have been invested in an unsound way. (The obligation to pay reparations and the high interest and amortization payments on the private and public foreign loans were rigid, whereas the currents of capital in and out of the debtor countries were most uncertain and irregular) a fact which caused great difficulties when the depression had broken out. This also applies to the case of some producers of primary goods, like the British Dominions and several South American states. As was to be expected, the prices of their export goods fell heavily when the depression set in. This occurred at the very moment of the virtual cessation of international lending, — first on long-term and then on short-term — owing to the depression and reduced confidence. It is no wonder that it proved impossible for these countries to maintain the stability of the foreign exchange rates required by the gold standard.

B. THE INTERNATIONAL RELATIONS DURING THE DEPRESSION

In view of these characteristics of the situation around 1928-1929 it is no wonder that the business cycle depression developed — to analyse its cause in the U.S.A. or elsewhere, falls outside the scope of this report — into a major crisis of extraordinary severity. To what extent a different economic policy would have resulted in a less disastrous course of events, will not be discussed here. The sole purpose of the following observations is to present a picture of certain salient features of the actual occurrences, particularly in the international sphere.

Difficulties of Countries Producing Primary Commodities

The main characteristic of the crisis, at any rate during the first two years, appears to have been that an industrial depression set in almost simultaneously with an agricultural crisis, due to quite different causes, at a time when the power of resistance and the stability of the economic situation were, for reasons already touched upon, reduced and much smaller than before the war. The industrial depression and the agricultural crisis exercised an aggravating influence upon one another. This resulted in a fall in the prices of not only raw materials but also of vegetable foodstuffs. As a result of this fall in the value of primary commodities, the purchasing power of certain groups of population was seriously reduced. The effect of this dislocation of the price system was enhanced, by the fact that it at the same time dislocated the ordinary international economic relations. Countries whose exports consist mainly of vegetable foodstuffs and industrial raw materials saw the value of their exports rapidly falling to 50 % or less of what they had been accustomed to. At the same time, their balances of payments were adversely affected by the restriction and diversion of international capital movements. For a time, debtor countries were able to postpone the difficult process of adjustment to reduced long-term borrowing by resorting to short-term balances and new short-term credits, and thus succeeded in maintaining the balances of payments in equilibrium. After a time, however, long-term lending practically ceased and it became more and more difficult to obtain short-term foreign credits. Debtor countries were forced to restrict credit heavily, thereby reducing imports and diminishing the volume of home investments. Stocks of staple goods were thrown on the market and the downward price trend increased. This naturally had an adverse effect on the general position of these countries.

Growth of International Short-term Indebtedness

The borrowing industrial countries, in particular Germany, whose economic position was at first fairly well maintained, could not fail to be affected by this change in the currents of international capital. German obligations in the form of interest

and amortization payments on foreign loans had risen to something like 2 milliards of marks a year and the Young plan called for the payment of a similar amount as reparations. For these and other reasons closely associated with domestic and foreign political developments, it became increasingly difficult during the latter half of 1930 to obtain long-term loans, and Germany, like other debtor nations, was forced to go in for short-term borrowing, which was however to a large extent offset — as far as the balance of payment goes — by a flight of capital.

International short-term indebtedness thus assumed vast proportions in the early part of 1931 — something like 10,000 million dollars. Even before the crisis it had been increasing heavily and had reached a far higher level than before the war, partly owing to the extension of the gold exchange standard ; in countries with a monetary system on this basis the central bank was bound to redeem its notes with money orders on the gold-standard countries and therefore had to keep large balances there. It goes without saying that the immense number of short-term engagements was a primary cause of the instability of the world's financial system that led to a complete financial crisis in 1931.

Increasing Obstacles to Foreign Trade

Long before this, however, countries in a more favourable industrial position had begun to feel the adverse reactions brought about by the worsening of the situation in agricultural and debtor countries. The latter's import restrictions increased the difficulties with which the former's export industries were faced, and resulted in unemployment. Export difficulties were further enhanced by the protectionist tariff policy that was gaining ground everywhere. A factor of some importance in this respect is that the increased duties on agricultural produce in industrial countries aggravated the situation on the world market for these commodities, thereby reducing the agricultural countries' capacity to buy manufactured goods. The difficulties with which manufacturing industries had to cope in their turn caused losses and diminished savings, thus still further detracting from both capacity and willingness to lend out capital abroad.

Causes and Consequences of the Fall in Prices

During a depression of this nature the profit prospects naturally diminished rapidly everywhere, and there was no longer any attraction to invest fresh capital in production. Despite a downward tendency of the interest level, real investments fell off with ever-increasing rapidity. This reduction in the demand for real capital could not fail to accelerate and increase the tendency to a general lowering of wholesale prices, which in turn still further aggravated the economic situation. That the fall in prices had such disastrous consequences was mainly due, of course, to the fact that for obvious reasons, the level of costs, wages, interest charges and other contractual obligations, decreased to only a very slight extent. This gave rise to losses which led to restricted production and unemployment, and consequently to a falling off of demand and a fresh fall in prices. This price decline, together with the immense burden of indebtedness led, in many cases, to forced liquidation.

Thus it may be asserted that the severe fall in prices, which quite outweighs the price movement during periods of depression in pre-war days, was a primary cause of the severity of the prevailing depression. This method of expression is, however, not particularly happy, seeing that the fall in prices was itself a consequence of the course of development that has been briefly outlined above. The circumstances mentioned and the psychological effects of the depression and of the political unrest prevailing in the world combined to reduce the demand for capital for investment purposes. Furthermore, unemployment and falling incomes caused a reduction in the demand for consumption.

Thus it is that these circumstances led to the disastrous fall in prices. The political conditions in Europe, India and the Far East, and the protectionist policy, which enhanced the feeling of insecurity and the lack of confidence in the world, were very important factors in this development. These together with the change in the international movements of capital, for which they were partly responsible, were a primary cause of the intensification of the fall in prices, which industrial depression and surplus production of agricultural goods would almost certainly have brought about even without their aid. On the other hand, by aggravating the economic situation and by weakening the credit

of individuals, private enterprises and States, the fall in prices has itself largely contributed towards the prevalent pessimism and the development of a « crisis mentality ». The lack of confidence is thus not only a cause but also an effect of the fall in prices.

The International Liquidity Panic

The course followed by the depression during 1931 led to a severe financial crisis along two different, though cognate, lines. The first of these, which may be called the international liquidity panic, has already been partially discussed. Its ultimate cause was the inability — touched upon above — of certain *debtor countries* to keep their balances of payment in equilibrium and at the same time to meet their foreign engagements with the rapid decline of the value of their exports and the impossibility to take up new foreign loans. The extent to which it would have been necessary to adjust their trade balances is illustrated by the fact that prior to the crisis the annual influx of capital amounted to about \$ 2,000 mill. There was little possibility, during a period of precipitate decline of prices of primary products and increasing foreign trade restrictions, of bringing about so rapid a change in the trade balance as to offset the stemming of this flow of capital. So long as previously accumulated balances and fresh short-term credits were available, a minor adjustment could have saved the situation. But when, as in the beginning of 1931, such credits were no longer to be had, and even those previously granted were cancelled, the position of practically all debtor countries became untenable. In order that they might not be compelled to abandon the gold parity of respective currencies, most of these countries introduced exchange regulations, which made it practically impossible to export capital. This resulted in the freezing of the foreign short-term credits.

This had been going on for some time when some doubt even arose as to the liquidity of a number of *creditor countries*, whose position had been weakened through the freezing of the liquid balances on the Continent ; there was a regular run on their money markets, and Great Britain, followed by half a dozen other countries, was forced to abandon the gold standard. Gradually, the gold parity was also suspended by other countries which had succeeded, by exchange regulations, in nominally maintaining

the value of their currencies. During 1931 and 1932 about half the globe adopted a depreciated paper currency.

This international liquidity crisis was primarily due to the vast volume of short-term indebtedness and to the difficult position in which Germany had come through the obligation to pay reparations and through excessive borrowings in 1925-1929. With the general waning of confidence, the creditors demanded immediate repayment. The loss of confidence was in turn largely due to the weakening of the balance of payment in many countries resulting from the above-mentioned changes in trade and capital movements. It is vain to speculate as to the extent to which it would have been possible to avoid this difficult situation, had creditor countries been more willing, in proportion as they were disinclined to grant loans, to accept foreign goods, and thus to enable the debtor countries to create a large export surplus. The former, as a matter of fact, took exactly the reverse course and endeavoured by means of high tariffs and import restrictions to prevent their own trade balances from moving in a negative direction. Under such circumstances it became impossible for other countries adequately to adjust their trade balances ; their position was maintained for a time by means of short-term credits, but became untenable when even these credits begun to be withdrawn. (There can be no doubt that this unwillingness of creditor countries to pursue a commercial policy which was consistent with their refusal to continue the foreign lending, was one of the chief factors in the financial breakdown)

An inevitable consequence of the unwillingness of most creditor countries to lend capital and to import goods was that they attracted large quantities of gold from the rest of the world. This « maldistribution » of the world's gold supplies was, however, as already observed, a consequence, rather than a cause, of the conditions governing international payments and the trend of prices dealt with above. The influx of gold into the U.S.A. and France did not lead to an expansion of credit and to a rise in prices in those countries, which would have resulted in an increase of their import surplus and, directly, and, still more, indirectly, in a strengthening of the position of other countries, owing to the checking of the fall in prices.

The Internal Liquidity Crisis

The second course along which the liquidity crisis developed was an internal one and due to weaknesses inherent in the banking system, particularly in Central Europe and the U.S.A. It is not necessary to discuss here the nature of these weaknesses. It was by reason of them that many banks were incapable of withstanding the pressure that the fall in prices and the decline of output exerted on their resources by ruining a great many firms to whom they had granted credit. The withdrawal of deposits on a large scale was successfully prevented by State intervention. Owing, however, to the non-liquid position of borrowing enterprises, a large proportion of the bank credits became frozen. This then was a national equivalent to the international freezing of credit mentioned above.

The tendency of the saving public to keep their money in bank accounts, and the efforts of the banks, dictated by the fear of a «run», to keep their funds as liquid as possible, led to the tightness of the money markets that characterized the situation from the late summer of 1931. The result was that in several countries businessmen found it practically impossible to obtain fresh loans. Investments were thus reduced to a minimum, not merely because the demand for credit is influenced by the business world's pessimistic views of the future, but also because lenders were afraid to bind their capital even on terms that under less abnormal conditions would have been considered absolutely safe. The result was that prices continued to fall heavily in countries that maintained their currencies on a par with gold.

In countries which, like Great Britain and many others, depreciated their currency, the fall in wholesale prices ceased. But, as prices rose very little if at all, their export prices in terms of gold were much reduced. This increased the pressure on the price level in the gold par countries. As the industry of the latter could not reduce its costs in proportion to the depreciation of the foreign currencies, it claimed and received increased protection through higher import duties, quantitative regulations, quotas and — in some countries — through a restrictive application of foreign exchange regulations. For agricultural exporting countries in particular, the quota restrictions proved very cumbersome. Export values declined and in several cases their curren-

cies were further depreciated, which again increased the downward trend of prices in other countries, etc. One consequence was that the prices of foodstuffs on the world markets fell to a small fraction of their pre-depression level, while maintained at a relatively high level — two or three times the world market prices — in most countries, owing to the import restrictions. These high prices and the fall in the purchasing power in the cities limited consumption and led to the dumping of surplus quantities on the free markets, where prices declined still further. The result was a new wave of import restrictions.

The Vicious Circle of Deflation, Depreciation, and Trade Restrictions

This vicious circle of deflation, depreciation, trade restrictions, further depreciation, further deflation and trade restrictions continued with brief spells of relative standstill up to the beginning of 1935. Since that time the changes in commercial and financial relations have been less important. This is probably mainly due to the fact that business conditions in a number of countries have improved¹. Although it is true that restrictive commercial policy is due to a number of factors, there can be no doubt — as seen from the foregoing account — that its chief cause in recent years has been simply the depression, i.e. the unemployment, losses and monetary dislocation attendant upon the latter.

Causes and Effects of the New Commercial Policy

In a situation where a large number of workers were out of employment it proved impossible for politicians to refuse to apply import restrictions in order to substitute home production for certain goods formerly imported from abroad. As a matter of fact psychological reasons, which have been interestingly described in Professor Robbin's memorandum, were not the only ones compelling political assemblies to take this course. It cannot be disputed that if one country alone were able to apply such measures *during severe depressions* without calling forth reprisals in the form of additional import restrictions elsewhere, they might very well result in increased employment in the former.

¹ As to the causes of this improvement, see the discussion of policy in the sterling block below.

National income would be increased, as it is usually more productive to employ labour in relatively inefficient enterprises than to leave it unemployed. Obviously therefore, politicians, if they had been entitled to believe that the restrictive commercial policy of their own country would not call forth retaliation on the part of other nations, would have acted quite logically and reasonably in making an ever increasing use of such restrictions, as the depression grew more intense. Unfortunately, as practically all nations pursued the same policy, the combined effects of all restrictions could not fail to be an enormous reduction in world trade and serious disturbances for export industries everywhere.

The immediate influence of this policy on the volume of the output in manufacturing industries is uncertain. It is conceivable that the considerable new investments in home market industries, stimulated by protection and import restrictions, have exceeded in volume prospective investments in export industries which, in view of their unprofitable character under these conditions, have never materialized. Hence, restrictions may have resulted in an increase of the total volume of investments, for instance during 1933 and 1934. Against this must be set the directly depressing effects of the increased dislocation, internal and international, which was caused by the restriction policy. It is therefore impossible to say with certainty whether the total volume of output in 1935 would have exceeded the actual figure, if fewer trade restrictions had been applied. On the other hand, it cannot be doubted that they constitute a serious obstacle to the reorganization and adjustment, which are necessary conditions of stable recovery. But it is only fair to stress that in deciding on this new commercial policy, politicians acted under the pressure of circumstances. In many cases they took a short view, because it was psychologically and politically impossible to take a long one. In countries which had maintained the old gold parity, severe import restrictions were the only alternative to depreciation, except in the few which would have been in a position to part with a considerable fraction of their gold reserve. Thus the question of the influence of trade restrictions on world economic developments cannot be separated from the following problem : what would have happened if a number of countries had depreciated their currencies instead of maintaining them at the old parity ?

Among the other factors, which have loomed behind commercial policy during the depression, (it is necessary to mention the increased number of internal state interventions and the nationalist evolution of the recent years.) Here again, however, there is a close connection with the intensification of the crisis which, to many, made it seem more excusable than before to act as if the welfare of one's own nation was the only thing that mattered. It was inevitable that the use of restrictive measures in many cases have led to reprisals, followed in their turn by further measures against the countries taking such reprisals. Quantitative restrictions like quotas are apt to become discriminatory and, therefore, to breed discontent and resentment. Such proceedings have proved singularly effective in creating misunderstandings, sometimes even arousing hatred between nations. There can be no doubt, therefore, that they have increased the risks of serious political international conflicts which might conceivably lead to war. — Naturally, the wish to be prepared for war also played a certain rôle in the institution of protection for the home production of certain commodities.

The Different Development of the Gold and Sterling Blocks

One of the most striking aspects of the development in recent years is that, despite these unfavourable international economic relations which inevitably exercised a depressing influence on *all* sections of world business, the actual movement of production and trade within the various countries has differed to a remarkable extent. After the considerable disturbances caused by the depreciation of the pound sterling and certain other currencies in the autumn of 1931, a certain measure of recovery took place in these countries, whereas the depression increased in countries maintaining their currencies at a gold parity. This is only what one would expect as the immediate effect of the depreciation. But, in the first half of 1932, when expectations of a considerable increase in wholesale prices were not realized in what is now usually called the «sterling block», and a policy of wage cuts and reduction in state expenditure continued, the depression gathered force all over the world. Then, in the third quarter of the same year an almost wide recovery set in. After a three years depression, it was natural to assume that this revival would

develop into a lasting one, if no special circumstances intervened to prevent it. As a matter of fact, however, this general revival lasted less than a year or until the spring of 1933, when the deflation of prices began again in the gold block — under the influence of the dollar depreciation — and production and employment declined anew. This had unfortunate and important repercussions on international economic relations. It is therefore necessary to query here why the process of deflation gained new force and thus led to a prolongation of the depression in a large part of the world.

This development stand in a most glaring contrast to the considerable recovery which at the same time took place in the countries with depreciated currencies where retail prices remained relatively stable despite a certain rise in wholesale prices. The result was that, in the spring of 1936, the output of manufacturing industries in the gold parity countries was only 70-80 per cent of the 1928 level, whereas in the sterling block the corresponding figure lay 10-30 per cent higher than in that year. One thing stands out clearly. This different development was not to any considerable extent due to an expansion of export industries in the sterling block caused by the depreciation. As a matter of fact, the gold value of exports in these countries, calculated as a percentage of the pre-depression figure, was not essentially higher than in the gold parity countries, although the *quantum* of exports was maintained a little better. It is natural therefore to draw the conclusion that the different general development has been mainly due to a difference in the *internal* economic policies of the sterling and gold blocks, a difference which may or may not have been an indirect consequence of the currency situation. The policy of deflation was energetically pursued by the gold block, while it naturally ceased altogether during 1932 in the sterling block. Herein must be sought the principal cause of the different trend of industry and trade. Such a statement would, however, be misleading if it were not added that the necessity of pursuing a deflationary policy, in order to maintain gold parity, arose chiefly from the continued depreciation of the paper currencies in the course of 1933, especially after the American dollar had gone off gold. Of course, there remained for the gold block countries the alternative, chosen by Germany, of maintaining only a nominal parity, and of stopping the policy of deflation in order to embark upon a policy of increased demand

and rising prices and costs. In reality this would have implied the giving up of the gold standard, as is shown by the existence of the special types of depreciated marks. Be this as it may, a comparison between the development in Germany and in the gold block countries supports the conclusion reached from a comparison between the latter and the sterling block : In Germany, in spite of a decrease in foreign trade at least as large as in France and in other gold parity countries, the domestic policy of expansion led to an increase in the output of manufacturing industries up to a figure which in 1936 is about as high as that reached before the depression. Thus there can be no doubt that the intensification of the crisis in the gold block since 1933 was due to the deflationary policy which these countries found it necessary to pursue in order to maintain the gold standard.

The Different Policies of the Gold and Sterling Blocks

Let us analyse briefly the main difference between the policies in those countries and in the sterling block. (In the latter the depreciation was followed by a declaration that prices would not be allowed to drop, but that, on the contrary, the goal was to bring about a certain rise of the price level.) This did much to dispel the fears of the business world that the general fall in prices might continue. The first condition of profitable production and thus of revival was fulfilled. The natural forces making for recovery after a long depression were released. Exhausted stocks were refilled, worn out machinery replaced, etc. (In the gold block, on the other hand, every businessman had to reckon with the fact that a downward adjustment of costs and prices was inevitable.) Hence, he naturally preferred to postpone his purchases as long as possible. Demand and production declined.

Secondly, in the sterling block, wages of public officials and in private industry were not further reduced after 1932. In some countries the slowly rising cost of living and other circumstances even led to small wage increases. In the gold block, on the other hand, wages were greatly reduced both for public servants and for workers in private industries. This definitely contributed to the downward trend of the whole price system. While it was a necessary, although insufficient, adjustment of the costs in the gold block to cost conditions in countries with depreciated

currencies, it nevertheless could not fail to intensify the crisis in the former for the time being.

3 Thirdly, in the sterling block, the majority of countries pursued an "easy money" policy, partly by the means of open market operation. The capital market became very liquid and interest rates dropped to 3 per cent and lower. This had a stimulating effect on the building industry which in several countries rose to new record levels and thus helped to provide much new employment. In the gold block it was of course impossible to pursue a monetary policy which would have tended to raise prices instead of depressing them. (Besides, the scare of devaluation and a following inflation of prices made capitalists in these countries most unwilling to hold government bonds.) Their prices consequently decreased to low levels. In other words the effective rate of interest rose to high levels. In France it varied around 5-6 per cent during 1935-1936.

The Financial Policy in Gold and Sterling Countries

4 A fourth aspect to consider is public finance. Some of the countries of the sterling group balanced their budget in 1932 on the termination of their deflation policy. In other sterling countries public expenditure was increased and financed by loans in order to stimulate recovery in this way. After the expansion of the past few years with the increase in income and the decrease in expenditure on unemployment, these countries have also been in a position to balance their budgets. Turn now to the gold block countries. The chief aim of their economic policy was to balance the budget. For this purpose, all kinds of government expenditure were seriously reduced. But the falling volume of employment and incomes led to a corresponding reduction in public revenue and the deficit remained. This experience seems to show that it is practically impossible to balance a budget in countries with European economic and financial structure, as long as a process of deflation is going on beyond a certain point. It is indeed paradoxical that in 1936 there should still be heavy budget deficits in many of those countries in which budget balance is the essential aim of economic policy, while the budget has almost balanced itself in countries where public borrowing to cover a voluntary deficit during the depression was used as a

means to stimulate a recovery which has since taken place. It is evidently necessary when discussing budget deficits under periods of depression to distinguish between two sorts of deficit. It makes a decided difference for the course of business whether the budget deficit arises in the deflationary country *in spite of a reduction* in state disbursements or whether it is a *consequence of an increase* of state public works and other expenditure. In the latter case, the deficit is a means to expansion of total demand, in the former it is a result of contraction in demand. A second observation is also indicated. Obviously the connection between unbalanced budgets and price inflation is not as simple as often maintained in the 1920-ies (Cf. the Brussels Resolutions) when it was said that failure to equilibrate the budget meant inflation. Prices have risen in Great Britain and certain other countries where the budget has been balanced while they have fallen in countries showing a heavy budget deficit.

Foreign Trade

The last aspect of the comparison between gold and sterling countries concerns their foreign trade. It has already been observed that the export industries in the sterling block had not been able to maintain their export values in terms of gold on a higher relative level than countries belonging to the gold block. In terms of the depreciated currencies, however, export values have naturally risen considerably in the former group of countries, by 50 per cent and more. This has helped to bring about an internal revival, as the incomes of people working in the export industries have, in terms of the domestic currency, risen in the same proportion as export values. Naturally this rise in incomes has led to larger purchases at home and, thus, has helped to stimulate a recovery in home market industries. The increase in the output of the latter is also partly due to the protection obtained by means of currency depreciation. Meanwhile, the home market industries in the gold parity countries received similar protection through tariff increases, quota policies and, in some cases, exchange regulation, and yet their output has not increased. Evidently, (something more than protection against foreign competition is necessary in order to bring about an increase of production.) There must be some domestic factors

encouraging an increase in demand from which the home market industries can profit. Here again the comparison between the expansion in Germany and the depression in other gold parity countries is most illuminating. Obviously, it is not the import restrictions in themselves which have resulted in increased output. It should also be observed that import restrictions and internal regulations often go hand in hand. While such a policy may have been necessary in countries maintaining the gold parity, there can be little doubt that it has introduced an element of insecurity into business and in that way, in some countries at least, has acted as an obstacle to recovery.

It follows from the above account of the international economic evolution of the past few years that the breakdown of international economic relations cannot be said to be due to any one specific cause. It would not even be true to say that it was caused by the depression, although we should be more justified in singling out the depression in this connection than any other factor. International disturbances have in their turn intensified the depression. The causal relation is not a one-sided one. It is more correct to say that the breakdown of international economic relations was one of the aspects of the development which took place when a severe depression struck a world economic system with only little power of resistance.

The Main Lessons of the Course of Events since 1930

The practical conclusion as regards future policy seems to be that every effort should be made both to increase power of resistance and to prevent or mitigate depressions. The second aspect is worthy of emphasis. It is difficult to see how monetary, trade and financial conditions could have remained stable during a lasting, severe depression, even if the special weaknesses and causes of instability which had come into existence before the crisis had not been present. Consequently, it would be a serious mistake to attempt the building up of a stable and rigid system of international economic relations without in any way considering the risks of so binding national Governments in their domestic policy as to make energetic anti-depression measures difficult or impossible. The aim should be to create international institutions and conditions that will help to coordinate the various

national efforts to combat depressions. This means, among other things, that the international system should be elastic rather than rigid.

Revival before Readjustment

A second set of conclusions to be drawn from the events of the last five years is that the structural maladjustments which combined with a regular business cycle recession to produce a crisis of exceptional severity, have not disappeared. In certain lines of agriculture and in some other industries, excessive capacity of production continues to exist. E.g. the unemployment existing in almost all branches of economic activity has until recently prevented the transfer of labour from industries which will not, in the long run, absorb all the available labour. In several manufacturing countries, efforts to reduce unemployment have even led to an increased output of agricultural commodities produced at very high costs (See Ch. VI). Thus, to some extent, the maladjustment has been intensified. Reduction of output of wheat and other agricultural products has chiefly taken place in countries with low costs of production (See Ch. VI). One can hardly avoid the conclusion that the far-reaching adaptation and reorganization of economic activity and policy which is urgently required, will be possible only during a period of relatively good business conditions when employment is increasing rapidly in many branches of industry. As long as the depression lasts, it would be futile to attempt a radical change in the present commercial policy, which has done so much towards maladjustment - between productive capacity in certain export industries and their markets. To realize this, it is only necessary to consider what would happen to agriculture in many manufacturing countries, if the severe import restrictions were to disappear suddenly. Obviously, the removal of some of the obstacles to trade and the gradual transfer of labour from some branches to others will be only to the extent that the various countries succeed in emerging from the severe depression. All factors that tend to prolong the crisis also prolong restrictions and maladjustments. Hence, one of the first steps and one of the most important contributions to a reform of international economic relations in the direction of greater freedom should be internal action to end deflation and to bring about recovery in countries where it is not yet apparent,

under utilization of the experience gained in the more fortunate countries.

The policy of high and permanent protection, like efforts to cope with the crisis by the burning of commodities or the reduction of output, is based on a restrictionist mentality. The fundamental error of the latter is to suppose that recovery and prosperity can be obtained by the cutting down of supplies which is certainly true only in a few industries, which have a larger capacity than is needed even during prosperous times. On the other hand, the call for greater freedom in international economic affairs springs from an expansionist attitude, i.e. the belief that there is no constant market which each country must try to reserve for itself, but an ever-expanding market which under proper conditions will grow as fast as capacity to produce. It is wiser to organise expanding markets than to fight for a bigger share of an existing one. A national and international policy directed towards expansion of demand is the natural concomitant of efforts against excessive restrictions in the international field.

Summing up

To sum up the three main conclusions. 1) Deflation of prices beyond a certain point is disastrous for production and employment and incompatible with a maintenance of relatively free international economic relations. 2) Furthermore, a severe depression, intensified by deflation, makes the necessary adjustment of the industrial structure difficult if not impossible and leads instead to new maladjustment. 3) Therefore, what is required is a system of international economic relations which, first, does not compel nations to pursue a deflationary policy, and, secondly, is able to resist at least certain of the forms of international pressure such as the world has recently experienced, and is likely to experience again in the future. It goes without saying — which is a fourth point — that it would be preferable to devise a system which does not sow so many seeds of political conflicts as that which has existed during the last years. In brief, reconstruction of the world economic system should proceed on the following three lines : 1) Expansion of demand, i.e. a revival from the business cycle depression ; 2) Adjustment of supply to mitigate structural maladjustments ; first of all, an increased

supply of goods where demand is growing, so that a transfer of industrial agents from other fields is made possible ; 3) Reorganization of the institutions which go to make up the system of international economic relations, in order to give to them more stability, flexibility and tenacity. Adjustment and reconstruction only — developing hand by hand — can form the basis of a more general and stable recovery. But, in order to be possible, they must be preceded by a certain measure of revival.

CHAPTER III

Economic and Psychological Basis of a Re-Organization of International Economic Relations

Re-organization not the Same Process as Restoration

From what has been said in Chapter I, it is clear that the relatively free international intercourse before the war in the field of trade, capital movements and migration, was highly productive from the point of view of both world economy and the various national economies. In other words, it stimulated economic progress and tended to raise the standard of living, not only in certain countries, but in all states. Since then, however, conditions have radically changed, through the influence of the war and of the world depression, but still more perhaps owing to profound technical, political and psychological modifications. It is, therefore, by no means obvious that the sole purpose of economic re-organization should be the restoration of pre-war conditions or of those of the first post-war decade. Some economists go so far as to query whether international trade, credit transactions and migration will play more than an unimportant part in the economic affairs of the next ten or twenty years. This, of course, is absurd, at least as far as trade is concerned. But if certain aspects of international economic intercourse appear less essential and less useful than before the war, this may well have an important bearing on the reorganization of the institutional basis, e.g. the monetary system, on which such intercourse is founded.

The question may also be put as follows : Are the economic nationalism and the extreme protective measures of the present day merely symptoms of a passing phase — due largely to the war and the depression — or are they due to more fundamental and lasting causes ? Were the enormous advantages of the truly

international system of economic relations of the pre-war period derived from certain special conditions which no longer exist ? If the latter question be answered in the affirmative, should we passively accept a continued autarchical tendency as the inevitable corollary of certain changes in the basic conditions ?

Comparison with the Pre-war System

To throw some light on these questions, it may be interesting to compare the pre-war economic system, analysed in Chapter I, with certain fundamental tendencies of the present day. We may start with the following quotation from Professor Alvin Hansen's « Report on International Relations » (page 103) : « In the nineteenth century there developed a highly inter-dependent world economy. The equilibrium of world economic forces was based on an international division of labour which had slowly and gradually evolved. The world had become a closely knit, integrated economic structure with inter-dependent parts radiating from a central point. That centre was the manufacturing belt of Northwestern Europe, erected on the basis of rich mineral resources. London was the commercial and financial heart of the whole system. Around this centre, spreading in ever widening circles, were areas of intensive animal husbandry, grain production, and forestry, and, in the remoter parts, the extensive production of animals, food, cereals, and fibers. The closely articulated trade of quality products at the centre rested upon the possibility of drawing the needed raw materials from the periphery of the integrated world economic structure. This localization of industry and the interchange of products between nations and regions were a direct consequence of the unequal distribution of material and human resources. First and foremost was the unequal rate of progress in mechanical techniques and skills. Of these England retained well high a monopoly until the third quarter of the nineteenth century. »

Meanwhile, however, modern machine technique spread over the entire globe, aided, in the first place, by migration and capital movements. Professor Edie has aptly described this movement in the following terms : « What the export of capital has fundamentally meant has been the export of the industrial revolution from the industrialized countries to the « undeve-

» loped » countries. The automatic machines dispensed in the main with the necessity for skilled labour, and thus made possible the operation of machinery by the untrained labour masses of such countries as India, China and Japan.» (*Economics: Principles and Problems*, p. 660.) England's hegemony in manufacturing industries disappeared as the United States and a number of European countries gradually developed large manufacturing industries during the last thirty years of the nineteenth century. To quote Professor Hansen again : « The rising industries of these newly industrialized countries very naturally sought and obtained the protection of a tariff wall surrounding the home market. Thus emerged in the closing decades of the nineteenth century a growing tendency toward economic nationalism. This was the inevitable by-product of the expansion and diffusion of the new industrial technique to other parts of the world. The ensuing intensified nationalism steered headlong into the World War, and the disturbance following therefrom in turn enormously reinforced the trend toward highly nationalistic policies. » There is much truth in this statement. But even if protection in « young » manufacturing countries is to be considered as a natural response to the spread of machine technique, this is so only when it is limited to the first stage, i.e. the growth period of their industries. Such protection takes the form of assistance during the first stage of industrial development and should not have a permanent character. There is nothing in modern machine technique that calls for permanently high protection anywhere. Thus, the fact that tariffs were not only maintained, but raised in the beginning of the twentieth century, cannot be explained as a rational response to technical changes.

Economic Nationalism and the Spread of a New Technique

Let us consider the countries which are at present « young » from the point of view of industrialization, namely those which produce and export chiefly primary commodities. The rapid process of industrialization in these countries naturally received a considerable stimulus owing to the war, when the supplies of European manufactured goods were cut off or reduced. Psychological emancipation during the war also strengthened the desire for economic independence, or, at least, for a position of equality

with the older manufacturing nations. Economic nationalism in these young countries is, as Professor Hansen terms it «the backwash of the racial emotionalism of industrially backward nations against the tide of economic imperialism. Eagerly sought by racial or nationalistic ambitions, modern science has brought economic nationalism nearer the point of possible realization». Here again, however, as far as economic factors are concerned, there is nothing that calls for the maintenance of permanently high protection after the first phase of industrial development. In so far as the quotation above serves to justify protectionist tariff policy, the explanation is of a *psychological* rather than economic character : it does not prove that such policy is possible without serious losses, i.e. lower national income than otherwise attainable.

Many economists accept this conclusion and, accordingly, maintain that the change in economic conditions is not such as to justify international trade barriers from the economic viewpoint. Except in rare cases, permanent trade restrictions reduce economic efficiency in general and also the standard of living. What is however new, in their opinion, is that this reduction, i.e. the disadvantages attendant upon high tariffs and other obstacles to trade, is now less important than before the war. The possibility of producing in each country — mayhap not raw materials — but manufactured goods and foodstuffs at reasonable cost has increased owing to technical progress and the spread of the new technique to all parts of the world. Hence, the fact that the losses attendant upon economic nationalism are smaller than they would have been some decades ago has weakened resistance to a nationalistic economic policy largely due to cultural factors.

Less Need of Certain Trade

Is this true ? Undoubtedly, to some extent. Take, for instance, the influence of coal and iron deposits as regards the localization of manufacturing industries before the war. The widespread use of electricity and oil as sources of power has resulted in a reduction of this influence and made it possible to locate most industries with almost equal advantage elsewhere. New supplies of cheap fertilizers as well as new methods of cultivation and better seeds, adapted to the special conditions of

different regions, have enabled farmers to produce wheat, other agricultural commodities and manufactured goods in districts where power, soil and climate, up to a few years ago, made this impossible save at very high costs. Hence, scientific and technical progress has undoubtedly somewhat reduced the losses due to the restriction of the international division of labour. The older manufacturing nations are not quite so dependent as formerly on food supplies from abroad. And the younger countries are able to organize the domestic production of many manufactured commodities with a smaller increase of costs. Thus the need for certain exchanges of commodities has probably been somewhat reduced.

This, however, is only one aspect of the problem. There has been a growing tendency in world trade — already manifest before the war — to consist more and more in exchange of raw materials for manufactured goods. Such trade has been extremely profitable. Another and equally important fact is that highly industrialized countries are the best customers of one another. During some years of the first post-war decade, German trade was more active with Great Britain than with any other foreign country. There is no evidence that the gain from such trade was less considerable after than before the war. On the contrary, it would seem probable that in many, though not in all, industries, the economies due to large-scale production have increased. Specialization breeds skill. The idea that technical knowledge has now spread fairly evenly all over the world and has equalized the technical standards may cause us to lose sight of the fact that technical progress is still continuing. It is possible for any country to forge ahead of others, but only in limited number of branches of industrial activity. Hence, it is only by concentration and national specialization that technical progress can be maintained and the most up-to-date technique be utilized. In other words, specialization leads to more rapid technical progress and the more thorough utilization of new technical methods.

Losses Caused by Foreign Trade Restrictions

It is obviously impossible to furnish a quantitative estimate of the losses sustained by countries which reject international

division of labour. It is possible, however, to form some idea of its volume if we remember that even in countries where costs of production and external currency value are well balanced, relatively high protection duties of 30-40 % have proved unable to prevent the inflow of large quantities of foreign goods. In some cases even duties of 100 % or more have been necessary in order to achieve a considerable reduction of the importation of foreign goods. Now, if 100 % duties are necessary, the home industry needs prices that are about twice as high as those of the foreign producer. Hence, a country resorting to these methods obtains only half as large a quantity of these products by producing them at home, as it would have done, had it instead utilized its resources for the production of export goods in payment of its imports. Of course, if only one country changed its policy, it might be impossible to find a market for a larger quantity of exports at the same price. But the present argument is concerned not with that case but with a comparison between a situation where world trade is restricted by very high all-round tariffs and one in which tariffs are moderate. There can, be doubt that if almost all countries with high trade barriers were to reduce the latter, they would all be able to find large export markets and thus obtain much larger quantities of certain goods by importing them than by producing them at home. Thus the fact that very high tariffs are necessary in order to shut out foreign commodities is a conclusive proof that considerable profits would accrue as a result of a more liberal trade policy. If it were true that almost all goods can with equal advantage be produced almost everywhere, high tariffs would not be required to keep out foreign goods, except when they are dumped at prices much below costs.

A second proof of the productive character of international trade is that it has kept up so well during the depression. The value figures are somewhat misleading owing to the considerable fall in prices. It is preferable to regard the world trade quantum, which even at the lowest point of the depression, when production was considerably reduced, had only declined by less than 30 %. During 1935, it was 24 % lower than the 1929 figure. It is true that trade in foodstuffs and raw materials has been better maintained than that in manufactured products. But although the latter have been more severely hit by trade restrictions than raw materials, the world trade quantum for manufactured goods

was in 1935 probably almost two-thirds of the pre-depression figure.

It goes without saying that any change of industrial orientation is accompanied by friction and leads as a rule to temporary unemployment. The above analysis of the advantages of international trade is based on the assumption that, in the long run, productive resources are not less fully utilized under one sort of commercial policy — when trade is less restricted — than under another. There is no reason to expect that this should not be so.

The general impression conveyed by this analysis is that certain advantages of international specialization have disappeared or been reduced, but that others remain as potent as ever and that some have even increased in importance. (With the increasing standard of living and the growing consumption of many high-grade manufactured articles, it seems quite probable that the international exchange of specialities will be as profitable as ever before.)

Can Manufacturing Countries pay for the necessary Imported Raw Materials ?

The fear that economic and technical development may destroy the foundations of a large section of international trade is also derived from another series of considerations which call for brief analysis. Many countries which formerly imported manufactured goods and exported primary materials are now undergoing a process of industrialization. Is it not inevitable in the long run that they will no longer require foreign manufactured wares ? If this is the case, how will the European manufacturing nations be able to pay for the necessary raw materials ? Will they not be forced to produce as much of them as technically possible within their own territories ? Such questions are frequent, but it must be admitted that when so formulated the problem is not well put. The question whether countries producing primary commodities « need » foreign manufactured wares is apt to be misleading. It will always pay better for these countries to produce large quantities of primary goods than to put out only what they themselves require. Their productive resources, in comparison with those of the older manufacturing countries, are such that whatever their tariff policy, it cannot pay them to spe-

cialize in the production of all manufactured articles. As regards the primary industries, they have a relative advantage over the older manufacturing countries, and the latter have a relative advantage as regards certain manufacturing industries. The only thing that can happen is that the European and other manufacturing countries may have to offer greater quantities of machinery and other manufactured goods in return for certain quantities of primary commodities. At present, however, there seems to be little reason to apprehend a scarcity of raw materials and food-stuffs which would so force up prices as to make it necessary to produce these commodities in the manufacturing countries instead of importing them. There is no evidence that the continued industrialization of new countries will prevent the latter either from supplying large quantities of primary goods at reasonable prices or from demanding corresponding quantities of manufactured goods from abroad. Thus there is no ground for the belief that the industrialization of oversea countries must forcibly entail the reduction of international trade.

The Japanese Competition

Similar misgivings as to the future of world trade have also been voiced in connection with Japan's advance as a formidable competitor on the international market for textiles and certain other goods. It is only natural that a country with such one-sided productive resources and such a large quantity of labour should have to specialize strongly in certain lines of industrial activity. Increased exportation as regards certain wares and increased importation of raw materials and other commodities are in this case inevitable. Obviously, so long as this process lasts, it cannot fail to cause disturbances and to be attended with losses for countries which have hitherto exported commodities now faced on the world market with the competition of cheap Japanese goods. On the other hand, other industries gain from being able to sell greater quantities to Japan. Thus, Japan's growth as a manufacturing and exporting nation calls for the adjustment of the industries of certain other manufacturing countries, e.g. reduction of the export of textile goods from high-wage countries. There is no reason to believe that such processes of adjustment will lead to a decrease in world trade as a whole.

Greater production and purchasing power in Japan should in the long run have the same effects as such processes have had in the past, i.e. an increase of international trade. The fact that, unfortunately, disturbances cannot be avoided in certain countries does not affect these conclusions. It is to the common interest of Japan and other manufacturing countries that the adjustment of new conditions comes about slowly, for it is sometimes said that Japanese competition will force Europe and the United States to reduce their wage-levels to the Japanese standard. Such a statement is unfounded. A slow process of adjustment is always easier than a rapid one. The suddenness of the onset of increased Japanese competition, due to the extreme depreciation of the Japanese currency, since 1933, and not to the maintenance of a wage-level which has always been low — rendered extremely difficult the adjustment of certain industries of the old manufacturing nations — e.g. the British textile industry. A less violent depreciation of the yen would have made it possible to avoid many difficulties both for Japan and for other countries. Even in the textile industries, Japanese labour is not particularly efficient, and production elsewhere can hold its own economically even with a much higher wage-level. But the chief defect in the reasoning just touched upon is that it assumes that the older countries *should be able* to offer all goods at so low prices as to counteract the expansion of Japanese trade. This is absurd. Progress would, on the contrary, signify that Japan should succeed in obtaining a growing export market in fields in which it is relatively efficient. The older manufacturing countries should instead extend their output and exports in those fields in which Japan will need an increasing supply from abroad, or in which countries exporting more and more raw materials to Japan will demand increasing supplies. It is obvious that the Japanese export trade can only dominate in a few industries. The total output of manufactures of this country is but a small part of world output. Secondly, the more Japan sells, the more it buys, and the total world market is, therefore, in no way restricted, but rather expanded by Japan's progress. It follows that the European and American standard of living need not be depressed by Japanese competition. For the standard of consumption in any country depends upon the efficiency of production and on international trade conditions, and in neither of these respects is the situation in the long run made less favourable.

Social Legislation and International Competition

In this connection, it may be worth while dwelling a little upon a conception of world trade which has in recent years played an important part in the discussion of social legislation. It is often maintained that there would be no difficulty in supporting the burden of new social legislation, e.g. restriction of working time with a corresponding increase in wages, if only similar measures were taken at the same time in all countries. The standard of living would not be reduced. To this it must be objected that the standard of living depends primarily on efficiency of production. Either the introduction of the 40-hour week reduces the output per worker, and thus the standard of living of the working population, even if inaugurated everywhere simultaneously. Or the volume of output can be maintained despite the shorter working-hours, and (in this case, there is no reason why a single country should not proceed independently to this reform.) Its competitive power would not in this case be reduced. It is true, however, that a rise in the wage per hour — if not offset by increasing efficiency — will disturb the conditions of international competition, if it is confined to a few countries only. But, even if the hourly wage rise is general — in connection with a shorter working week — it will set up *internal* disturbances, until the national price levels have been adjusted upwards. Thus, the real wage per week — in terms of goods — will fall. The standard of living falls for all groups when production declines, except when certain groups can throw the whole burden on others.

An idea based on a similar misunderstanding is the belief that the existence of low-wage countries tends to prevent a rise in the standard of living in high-wage countries. International trade has never been based on equality of wages in different countries. On the contrary, the difference in supply and efficiency of labour and, therefore, of wages, is one of the greatest advantages of international division of labour from the point of view of profits. Increased efficiency in the older manufacturing countries permits of higher wages in the latter, even if they remain low in other parts of the world. It is quite another matter that increased productivity in low-wage countries, resulting in higher wages and purchasing power, will widen markets for foreign goods and thus lead to ex-

pansion of world trade. Therefore, the important thing, from the point of view of the older nations, is not that wages should be forced up in the new countries under constant conditions of efficiency in order to reduce the pressure of their competition. The solution of the problem lies in increased capacity of production as a means of widening markets and raising the standard of living. There can be no doubt that such a process is actually going on, and that it is one of the many factors which call for larger international trade in the future than in the past.

The Immediate Difficulties resulting from a continued Policy of Restriction

From the above analysis of long-run tendencies it will be seen that the arguments for international trade on a large scale are still very strong. Maintenance of the existing obstacles to trade would entail a standard of living considerably lower than that which could otherwise be reached. This becomes even more obvious when we realize the immediate difficulties to which the maintenance of the present restrictive policy would give rise. If the world had to adjust itself to such severe trade restrictions, a drastic economic reorganization would be necessary in the course of the next decade. This adjustment would be extremely difficult, in view of the fact that the depression, the industrialization of « young » countries, and the agricultural crisis already provide States with a series of other problems requiring solution during this period. Consider, for instance, the effects as regards the United States. Permanent reduction of international trade would demand a cutting down of wheat, tobacco and cotton growing, which could only be carried out with the greatest difficulty at a time when a far-reaching transfer of labour from agricultural regions to the cities is likely in any case to prove more difficult than formerly, except perhaps during special boom periods entailing falling unemployment. (The industrial population in the United States directly dependent upon export has been estimated at only about ten millions) (Evidently, even for a country like the United States, the disturbance which would be caused by a permanent reduction of international trade below the pre-depression levels would be enormous.)

Hence, the aim of international economic reconstruction

should not be stabilization halfway towards autarchy, but return to a system of larger trade, that would lead to an easier industrial adjustment to new « equilibrium » conditions and to an increase of the durable fairs from international specialization. This would mean, of course, that certain newly created branches of production and certain vested interests which have grown up here and there under the present restrictions would have to disappear. But there can be little doubt that this adjustment could be carried out with much less difficulty than that which would be necessary in the case of the maintenance of autarchical tendencies. Hence, consideration of the problem from the point of view of its distant as well as its immediate bearing, leads to the same conclusion. A policy aiming at the restoration of greater freedom of trade than at present harmonizes well with the fundamental world economic factors and conditions. Failure to pursue this policy, and acceptance of the existing policy as a permanent feature of world economy would result in immediate losses as well as in much less rapid economic development in the future.

State Intervention and Foreign Trade

Let us now turn to another fundamental change in economic conditions which has taken place during the recent decades and which cannot but affect international economic relations. For many reasons, State intervention in economic life plays a much larger part than formerly. This tendency existed before the war, but has gathered force owing to the war and the economic depression. Many observers agree with Mr. Cole that « it looks as if the Victorian epoch of « *laisser-faire* » were but a brief interlude between two long periods of collective regulation ». Even if it is certainly premature to accept this opinion, there can be little doubt that liberal individualism has gone and will not again predominate in modern society, for at least another decade or two.

This has important consequences as regards international relations. For, it goes without saying that internal State regulation in many cases presupposes official intervention in international trade and other international intercourse. In other words present internal regulation tends to cause deviation from the relatively liberal pre-war system of international relations. Further-

more, it is not only the State which has adopted a policy of increased intervention. Large industrial organizations have grown up everywhere, and aim at more or less complete control of the market. For many of them, the chief aim in view is the conquest of their own national market. In most cases, this can be brought about with the aid of public commercial policy, such as tariffs, which they often manage to obtain.

(In addition to State control and that of private organizations, a new social outlook leads to a demand for a social organization which reduces risks and difficulties and which provides a certain economic security for the individual as well as for firms.) If a social organization of this sort, which is a natural response to the reduced flexibility and increasing «stickiness» of economic life cannot exist in a system of free international intercourse, public opinion demands that the latter be modified. Hence, in considering the most practical and efficient organization of international relations, attention must be paid to this demand for a system which does not preclude certain forms of internal social policy. This is a concomitant of the fact which has already been dwelt upon, namely that international organization must allow for certain liberty of national action, permitting of measures to mitigate depressions.

Anti-dumping Measures

It would be entirely utopian to believe that international trade can under such conditions be as free as before the war. There are many other circumstances which support this opinion. Dumping is wider spread, partly because of the growing importance of high fixed costs and partly, also, because of the development of certain monopolistic organizations. Thus there is much more to be said in favour of a moderate anti-dumping duties than before the war. On the whole, it is reasonable to visualize an economic organization allowing now and then for State intervention, without leading to a continued piling up of trade restrictions.

The non-economic motives which influence national economic policy, e.g. considerations of national security and defence, play at the present time such an important part, that it is necessary, on their account, to reckon with the continued support of

certain unprofitable lines of home production. It is, however, important to analyse to what extent domestic production actually increases security and also to calculate as closely as possible the costs of home production, e.g. of such goods as oil, sugar, etc. If the costs were known, it is not improbable that, even from a military point of view, it would be considered preferable to produce less at home and to exploit economic resources in a different direction.

Conclusion concerning the Rôle of International Trade

The conclusions to be drawn from all these considerations is that the fundamental economic, political and psychological conditions which are likely to exist in the near future are not such as to invalidate the opinion that international trade is of the highest importance for continued economic progress. On the other hand, political and psychological factors make it fairly obvious that only a system of international institutions leaving a certain freedom of action to the different countries in the economic sphere, will be accepted and able to last for any considerable time.

Advantages of Free Export of Capital before the War

Let us now turn from international trade to the influence of fundamental economic changes on the rôle and volume of international capital movements. Before the war, the exported capital was invested chiefly in countries producing and exporting other goods than those sold by the lending manufacturing countries. Thus, competition in these goods was not intensified. On the other hand, there was an increased supply of other commodities, such as foodstuffs and raw materials, and a rapidly rising market for manufactured goods from the richer countries. As the primary goods were obtained at lower cost, the export of capital influenced the terms of trade in favour of the lending countries. In addition to this, greater quantities of goods were exchanged. These two circumstances were a source of substantial profit to the older nations and led to an increase in their standard of living. Furthermore, the interest and dividends on foreign investments exceeded very considerably what could have been

obtained at home. This also contributed to an increase of national income. Whether the home supply of capital was reduced by foreign investments or whether savings increased sufficiently with the rising income to make up for the export of capital is an open question. But as capital export was generally accompanied by considerable emigration, there is no reason for assuming that the distribution of income changed to the disadvantage of the working classes. These classes must therefore have their share of the advantages attendant upon growing international intercourse. It is evident that the general acceptance by all classes of free capital movements and relatively free trade had much to do with these obvious advantages.

Less Favourable Effects in the Future

The present situation differs in several respects. First of all, the investment of capital abroad by manufacturing countries of Europe and North America is much more likely to increase foreign competition with their industries. In many cases, the exported capital takes the form of the establishment of branch factories which, as a rule, directly narrow the market for goods from the mother country. Secondly, the requirements of new countries as regards foreign capital are less considerable, e.g. for the construction of communications reducing the costs of supplying primary commodities, as happened in the case of wheat in the nineteenth century. Hence, for the lending nations, the terms of trade may be affected in an unfavourable direction. Thirdly, the reliability of certain important debtor nations has proved smaller than expected. Losses from foreign investments have been enormous. It therefore appears much more doubtful than before the war whether the total net income from interest payments and dividends on new foreign investments will be greater than if this capital is invested at home. Fourthly, the fact that the borrowing nations probably devote only a small part of such capital to the purchase of goods from the lending countries suggest that large capital movements would involve more serious transfer problems than formerly, e.g. in the nineteenth century, when British capital was invested in the British Empire or in South America. Unless international capital movements are subject to some control, these transfer difficulties may some-

times prove very serious for the central banks and the monetary policy of creditor countries.

Capital Export and Unemployment

The most important consideration is probably, however, the fact that in most of the wealthier countries, there is still considerable unemployment, and that this is a factor which seems likely to persist in most countries even after some further business recovery. As long as this is the case, and large scale emigration is impossible, the home use of capital for new production will probably promote employment and increase national income in a larger measure than investment in foreign countries. Of course, in special cases, the granting of credit may help export industries or in other ways directly increase employment at home. But, in most cases, there is no such direct connection between capital export and increased employment.

Claim for Control of Capital Export

Hence, a claim for some control of international capital movements is not irrational under present circumstances. It cannot be denied that fundamental economic conditions are so different from what they were in the nineteenth century, that international capital movements will play a different and much smaller rôle than they did formerly, and that there are valid reasons for handling them in a different way. To say this is not to deny that from a world economic view-point, the advantages due to the promotion by far-reaching foreign investment of the economic development in certain parts of the world might more than outweigh the disadvantages to the wealthier countries of exporting such capital. This is quite obvious. But the question has to be considered from the point of view of the nations which supply capital. If, on their account, advantages and disadvantages are now differently balanced, the outcome will be a different policy. It is obviously necessary for economic and political leaders to analyze the rôle of international capital movements in the future without the pre-conceived idea that a return to pre-war conditions is the only right course.

International Migration and Unemployment

What has been said about capital movements applies also to some extent to migration. The existence of widespread unemployment has resulted in a complete change of the general view as to the desirability of immigration. In most countries, legal restrictions have been imposed, and there seems to be little chance of any substantial modification, except, perhaps, after a long period of prosperity and reduced unemployment. Hence, although it is true that a transfer of labour from some parts of the world to others, e. g. Australia, could do much to raise the standard in the former without reducing it in the latter, such a movement would not seem likely to fall within the bounds of practical policy for some years to come. It is impossible for psychological reasons. This problem will be dealt with in its less immediate aspects in the final chapter of this report.

Reconstruction presupposes Expansion

Such, then, is the background for a policy of reconstruction of international economic institutions at the present day. Reconstruction should be based upon detailed examination of what kind of monetary system and commercial policy that corresponds to the requirements of the situation. Secondly, it is necessary to consider the question of procedure. As regards the possibility of achieving results within a reasonable lapse of time, one condition dominates all others. Only in the event of an improvement of the world economic situation which restores fairly good business conditions, does it seem possible to carry out the necessary adjustments and reforms? Hence the desirability of international relations which do not stop expansion — which is the essence of recovery. National and international policy alike should be directed towards increasing demand, causing a growing prosperity of countries who are at present suffering from national or international disequilibrium. Needless to say, increased economic activity can also be encouraged by the reduction of artificially high prices which keep consumption at a low level. Price reductions which do not reduce monetary incomes, are a direct method of increasing production and trade. Like monopolistic restrictions and the maintenance of high prices, obstacles to

international trade which cause a high price level behind a wall of restrictions must be regarded as hindrances to veritable world expansion. In the long run, at least, unilateral expansion, in one country due to trade restrictions, is offset, even outweighed, by contraction elsewhere. The only possible basis for general economic expansion is an international one contributing to the growth of world markets instead of reducing them. The efficiency of international economic policy in the years to come will be measured in the first place by its ability to promote such expansion.

It would be a mistake to draw the conclusion that because international economic transactions may in the future be smaller, relatively speaking, than they were before the war, the international economic relations and the problems involved will be less important. These relations are apt to be less steady and can, therefore, influence national economic developments as much as, or more than, before the war. A solution of the problems of international economic reconstruction is vital to all nations of the world.

CHAPTER IV

The Monetary System and the International Capital Movements

In order to grapple with the practical problem of international monetary reorganization, it is necessary to begin by considering what kind of monetary system it is desired to introduce. Only when this has been elucidated, will it be possible to broach the question of the methods of procedure best suited to present and future conditions.

Can the Gold Standard Function under Present Conditions ?

For obvious reasons, it is natural to begin by querying whether the solution of the problem would lie in a return to the pre-war gold standard. Can that gold-standard or a slightly modified one be expected to function and to work satisfactorily under the new conditions existing today ? Is therefore an attempt to return to the pre-war monetary system desirable or not ? (For an interesting exposition of views which come close to answering this question by a simple «yes», see various writings by Professor Rist.)

It has been explained in the previous chapter that the conditions under which the gold standard worked with relative smoothness some decades ago no longer exist at the present day, did not even exist in the twenties and are not likely to return during the next decade. For instance, it is most unlikely that we shall see in the near future a degree of freedom of international movements of goods and capital similar to that which prevailed ten years ago, and it should be noted that even that measure of freedom proved insufficient. Moreover, erratic movements of capital, a disturbing rather than a balancing factor, are likely to take place in greater measure than before the depression. Psychological changes have also occurred, resulting in decreased

willingness on the part of Governments to defend the gold standard at all costs, and in less inclination on the part of citizens to shoulder a burden of increased unemployment due to a policy of deflation designed to maintain the external value of currency. It is probable that many countries will persist in a domestic policy of intervention which, in certain cases, may call for some degree of flexibility in the external value of their currencies. For these and other reasons, it will probably be more difficult under the present world economic conditions than formerly to restore and maintain the gold standard, or some other system of rigid fixed parities. Any attempt of this nature would be sooner or later doomed to failure.

Contradiction between Internal and External Stability

Another serious argument against a pure and simple return to former conditions of monetary organization is the following. Should it be possible, notwithstanding the above-mentioned unfavourable conditions, to maintain absolute external stability of the various currencies, it is probable that the only means of so doing is afforded by a policy which would from time to time exercise a strongly depressing influence on the industry of certain countries. Before the war, the adjustment of a national economic system to international conditions was comparatively easy as explained in Ch. I. But even at that time, recourse was had, in certain cases, to credit restrictions resulting in a national depression at a moment when conditions in other countries were relatively favourable. Such national depressions were, however, as a general rule, neither severe nor of a lasting character, as rapid adjustment was at that time possible. It is to be feared that similar processes would at the present moment cause considerably greater friction and would, accordingly, create greater difficulties. Even during a period when the wholesale price-level in most countries is relatively stable, certain countries might be compelled to reckon with industrial depression over several years for purposes of adjustment, for instance, in the case of a permanent reduction of foreign demand for some of their products. Thus, the internal stability of economic conditions and relatively full employment would have to be sacrificed to external currency stability. The fact that conflicts of this kind were not

so numerous before the war helps to explain why the gold standard was so generally accepted. It is obvious that, under present conditions, the risk of such conflicts is a powerful argument against the pure and simple return to the gold standard. The weight of the argument is increased by the circumstance that social changes have made it more important than ever to maintain internal stability, whereas the maintenance of external stability is perhaps less important than before the war, owing, for instance to the fact that international capital movements are likely to play a smaller rôle in the future than in the past.

Rigid Parities and Foreign Trade

Let us consider more carefully the question of the importance of fixed parities for international trade. Such a system obviously entails the elimination of certain risks. But, here again, there are two aspects to the problem. Any attempt to maintain so rigid a system as to render inevitable, sooner or later, its own breakdown and the ensuing currency disorder, makes for serious disturbances in foreign trade. Experience has shewn that currency depreciation does not proceed evenly and simultaneously all over the world, and that this circumstance breeds all kinds of trade restrictions. This might have a more unfavourable influence upon foreign trade than a system which would not attempt to maintain such rigid foreign exchange rates as the gold standard, but would guarantee that fluctuations would be kept within certain limits. Furthermore, an international gold standard of the rigid type, if not very skilfully managed by the leading central banks, might well result in a downward movement of world prices. This was the case in the 'eighties and it may happen again. The result would be a general industrial depression. Under such conditions, there is nothing more probable than increased restrictions to international trade. Thus, even if the problem is viewed exclusively from the angle of the creation of favourable conditions for the international exchange of goods, it might, in the long run, be best to envisage a more flexible currency system which — although less perfect from the point of view of external stability — would involve fewer risks of general disturbance, which might indirectly prove very damaging for foreign trade. On the other hand, it is obvious that a system per-

mitting of numerous, sudden and far-reaching fluctuations in foreign exchange rates would engender an instability which would, in all probability, lead to a more restrictive commercial policy than that which would be adopted under more stable monetary conditions. Thus, there are certain premises in favour of the adoption of a middle way between an extremely rigid system and one permitting of wide fluctuations of the foreign exchange rates. It has been said that the gold standard is a « fair weather standard », which breaks down when clouds arise on the horizon. A standard able to withstand a little bad weather may be preferable.

Similar conclusions are reached by considering monetary re-organization from the point of view of its consequences as regards international capital movements. Of course, the greater the stability of the foreign exchange rates, the greater also the security for long-term foreign investments. This, however, is so only on condition that a rigid monetary system does not reduce the chances of obtaining interest and amortisation payments on foreign loans and profits and dividends from shares and other active investments abroad. If a rigid system in certain circumstances forces a debtor country to deflate prices and to prolong a depression, the risks and consequences for the foreign creditor may be much more serious than in the case of moderate fluctuation of the foreign exchange rates. Hence, even in this case, it is necessary to consider to what extent the alternative forms of an international monetary system may increase or decrease risks of causing or prolonging depressions.

Short-term Capital Movements and Rigid Parities

As regards short-term capital movements, there are also great difficulties. If the foreign exchange rates are to be stabilized within the narrow margin of the gold points, will it be possible to avoid controlling these short-term credit transactions? In other words, can external currency stability be maintained without regulating the foreign exchange market? The movement of international securities and of floating funds is an element of instability which is much stronger than even ten years ago. Any political event or other cause of a change in general confidence or in opinion as to the future prospects of business may lead to considerable transfers of capital from one country

to others. This may result in large gold movements, which, in their turn, may in many cases lead to further diminution of confidence. To counteract the ensuing, undesirable fluctuations of the foreign exchange rates, important foreign exchange reserves may be needed. It is for this purpose, that certain countries have constituted enormous « exchange equalization funds ». It is possible however, that erratic capital movements can be kept more easily within manageable limits, if the foreign exchange rates are not absolutely rigid. On the other hand, there is of course, the great risk that flexibility of rates may become an independent cause of capital transfers of this disquieting kind. Evidently, it is necessary to study carefully the problem whether these difficulties are best overcome and general economic stability maintained by authorizing foreign exchange fluctuations within certain limits wider than the gold points, or by some other kind of policy. A possible but risky alternative might lie in a general return to the gold standard, conditioned by a certain control of international capital movements.

The Primary Aim : Internal Economic Stability

The general conclusion to be drawn from these considerations is that it is far from self-evident that a return to the pre-war gold standard should be regarded as the goal of international monetary policy. There are, of course, strong arguments in favour of such a system — e. g. that it has already been tested — but there are also many arguments against its restoration under existing circumstances. This being the case, it is necessary to approach the problem of monetary re-organization without preconceived ideas as to its solution. The first point should be to devise a system which would help to maintain the largest measure possible of internal economic stability in the different countries. This is of more importance for the various national economic systems than the slight increase of international trade that might conceivably result from more rigid measures. Besides, as already observed, it is by no means certain that a rigid system would in the long run result in the development of international relations. It is an illusion to believe that international relations are independent of the state of the home industry. A system which effectively helps to maintain *internal* stability will also promote inter-

national trade and other economic intercourse, even if *external* currency stability be to some extent sacrificed.

Necessity of Avoiding Both Deflation and Inflation

The first condition of a combination of both kinds of stability is naturally that the functioning of the international monetary system should not be such as to cause a considerable deflation of world prices. For if this happens, certain countries will find it to their advantage to cut loose from the international system in order to escape from deflation and the ensuing depression. It is, of course, equally desirable to avoid inflation from a position in which prices and costs stand in a balanced relation to each other. As there would appear to be no certainty as to the way in which the international monetary system will be managed by the leading central banks, it might be considered natural to leave each country free to take action in the event of serious impending inflation or deflation. Such an arrangement would imply that — by general agreement — every country, under the given circumstances, would be free to detach its currency from the international system, and that such action should be considered sound policy, the blame being laid to the door of the managers of the international system, or rather the countries which fail to counteract deflation or inflation. It is possible that a *force majeure* clause of this kind would make it easier for certain countries to adhere to the international system. Naturally, the greater the guarantee that the leading Central Banks will co-operate in the prevention of general inflation, and deflation, the greater the chances of the acceptance of the new system, and its maintenance. Such cooperation is one of the principal tasks of monetary reorganization, to which, fortunately, the Bank for International Settlements is directing its attention. When satisfactory methods of cooperation have been worked out, the time may come when it will be possible to go more thoroughly into the theoretical aspect of the problem, e.g. whether *slowly* falling or slowly rising prices are more conducive than stable price levels to stability in industry.

Secondly, it would be desirable to devise a system which works relatively well even if commercial policy, international capital movements and other circumstances do not develop as

required by the pre-war gold standard. This simply means that reduced flexibility and adaptability in certain parts of the economic system might, under these conditions, have to be replaced by greater flexibility in relations between different currencies. Certain adjustment of the relation between external currency values may be necessary if, e.g. internal price levels are everywhere to be kept stable. Foreign exchange rates must, of course, under all circumstances, be subject to some measure of control, otherwise it would be impossible to speak of an international monetary system.

A Two-blocks Monetary System

During the past few years, the embryonic stage of a new system has been inaugurated. (Cf. the memorandum by Dr. Hammarskjöld.) There exist, at the present day, two currency groups, of which the one maintains its monetary unit in a fixed relation to gold, while the other has changed to a paper standard. The pound sterling is the leading currency in the latter group. Within this so-called «sterling block», the foreign exchange rates are kept extremely stable, even more so than the gold standard would require. Only in the case of a major disturbance or change in the economic situation of a country which has its currency pegged to sterling is the rate of the latter altered. All that is necessary in order to restore a fair measure of external currency stability in the world is a certain stability in the relation between the pound and the leading gold currencies. As a matter of fact, variations since the summer of 1935 have been less than 2%. This is not to say that the existence of a sterling block has no longer any meaning, for, under certain circumstances, there can be no doubt that the relation between sterling and gold would undergo a larger change. With the present system, to create an atmosphere of security, it would obviously be necessary to reach some understanding as to the limits beyond which sterling should not be allowed to vary in relation to gold except under special conditions. One alternative would consist in a mere declaration by the monetary authorities in London to the effect that they would endeavour to keep exchange fluctuations within certain limits. In most cases, much smaller fluctuations would suffice, for instance, in that of speculative capital movements. Such an

understanding need by no means preclude wider variations in the external value of the sterling currencies under exceptional circumstances, if necessary to prevent an undesirable deflation or inflation of prices in the countries concerned. For instance, if the commodity price level in the gold group were to rise or fall considerably, such countries could not complain, if the sterling group were obliged to raise or reduce the external value of their currencies in order to retain some stability in their general price level. Under such conditions, the necessity of co-operation between Central Banks with a view to maintaining relative stability in the gold purchasing power and, accordingly, in the price-level of the gold countries, would be obvious even to circles who at present observe a somewhat detached attitude as regards this question.

It is an open question whether a system of this sort would not afford sufficient currency stability for the development of international trade. It should be kept in mind that, by means of the forward exchange market, it has been possible to reduce the difficulties arising from moderate exchange fluctuations. There are greater chances of the acceptance, during the next few years, of such a bilateral, flexible standard than of restoring the pre-war gold standard. Furthermore, it would be easier to maintain stable exchange rates between countries with close economic relations than between all countries in the world. Foreign trade would benefit by such limited stability. There might, however, in the long run, be some risk of a fall in sterling and other paper currencies in relation to the gold currencies. Historical experience indicates that the long-time trend of the value of paper currencies in terms of gold, is downwards. This — if prices were not falling in the gold countries — would mean a rising price-level in the sterling countries. However, this would be contrary to the desires of their central banks, which would therefore counteract tendencies in this direction.

Another reform which is worthy of investigation is whether, in the gold countries, *small* changes in the gold par value of their currencies — such changes being legally restricted within narrow limits — might not be practised in addition to changes of credit policy, in the event of external or internal adjustment being necessary.

Prerequisites of any International Monetary Reconstruction

It would exceed the scope of this report to analyze in greater detail the conditions for the most satisfactory functioning of a bilateral monetary system and measures for the realization of such conditions. It is possible, however, to set forth certain fundamental prerequisites of the functioning of any relatively stable international system. In the first place, adjustment of levels of cost of production and the external values of the different currencies would be necessary, both in the gold and in the sterling group. Some idea as to whether the external value of a given currency is at present too high or too low in relation to other currencies may be formed by comparing the percentage reduction of wages *in terms of gold* in the different countries since 1929. A comparison of wholesale price levels in different countries is, on the other hand, apt to be misleading. A fall in wholesale prices is not necessarily a sign of real adjustment. In certain countries — e.g. the gold standard countries today — prices are out of proportion to costs, a fact which entails a dislocation which is, in itself, an obstacle to recovery. In addition to comparison of wage-changes, there is a second method by which a rough approximation of the natural relation between costs and external currency values may be obtained. If it is possible in a given country, without considerable movements of capital and abnormal restrictions to international trade, to maintain the balance of payments in equilibrium, the external value of its currency is not unreasonable. It goes without saying that, if a country is normally an importer or exporter of capital and will remain so in the future, this must be considered as a condition of equilibrium. It is, of course, also necessary to take into consideration whether business conditions are more or less depressed in the said country as compared with those in countries with which it trades. Judged by this standard, the Japanese currency is too low in the sterling group, and the dollar is perhaps too low in the gold group. On the other hand, all gold currencies, except the Belgian franc are « over-valued » in comparison with the sterling currencies.

Adaptation of Cost Levels and External Currency Values

There are obviously several conceivable methods proceeding with the necessary adaptation. One would consist in a rise in costs in sterling countries with maintenance of about the present level in the gold block. As, however, in those countries, the *internal* relation between prices and costs is relatively normal and does not hinder profitable production, considerable inflation — a cost increase of less than 25 % would not suffice — would be most undesirable. It would lead to an excessive boom which would doubtless be followed by a severe depression. — A second method would consist in continued deflation of costs in the gold par countries — by a further 20-40 %. This would mean the intensification of the depression. The effects would not be quickly overcome, for a deflation of the income level would considerably increase the burden of internal indebtedness. What is most important from an international point of view is perhaps that such prolongation of the depression would end all hopes of a reform of commercial policy in a more liberal direction for some time to come. — There remains the third method of reducing the gold value of currencies which are too high, while maintaining that of sterling and dollar in the neighbourhood of the present position. This would have the advantage of bringing about a certain rise in prices relative to costs within the gold countries, but not in cost of living relative to wages. Such a rise is precisely what is needed in order to re-establish internal balance and to produce a revival similar to that which has taken place in the sterling block, in Belgium and elsewhere.

The Liquidity Problem and the Distribution of Gold

Let us now consider a second important aspect of monetary re-organization, namely, the international liquidity problem. It would facilitate the solution of this problem, if countries possessing exceptionally large gold reserves were to refrain from all action e.g. excessive protection, designed to prevent a negative balance of payments. Instead they would allow part of their gold to flow into other countries. Internal revival in these countries might be accompanied by a gradual reduction of their import barriers also. A more equal distribution of the gold reserves

would go far towards improving international liquidity. On the other hand, it is doubtful whether accumulation of large foreign exchange reserves would increase the stability of the monetary system. The experience gained during the depression, e.g. in 1931, shows that the transfer of such funds can have very disturbing effects. An alternative method consists in agreements between the different countries to grant each other credits when necessary. Co-operation between the exchange equalization funds might render similar services. The amount of floating funds which might suddenly be transferred from one centre to another would then be lower. Of course, under such conditions, importation and exportation of gold would become the normal means of settling international balances and not a method to be applied only in the last resort. The gold reserves would thus be used for international payments and not as a guarantee for the convertibility of notes or deposits. As a matter of fact, this observation is valid even for the pre-war gold standard. Hence, international movements of gold should be considered as natural and not as symptoms of weakness or strength. Legal rules of gold-cover which interfere with such movements are irrational. They contribute to the persistence of monetary superstitions and reduce the usefulness of gold reserves from a liquidity point of view.

The Foreign Debt Problem

Another aspect of the monetary problem is the settlement of outstanding foreign debts. Fortunately, international short-term indebtedness has been reduced from a maximum of 70 to 30 million Swiss francs. For most countries, therefore, it does not greatly exceed what is needed for the financing of foreign trade and for other normal financial transactions. Still, consolidation of short-term debts would be very useful in the case of certain nations. Long-term indebtedness has also decreased. Reparations and war debts can be regarded as liquidated. For some countries, however, e.g. in Southeastern Europe, interest and amortization payments are still heavy relative to their capacity to pay and agreements about interest reductions or other alleviations called for. But the improvement of the economic situation of countries exporting primary products has made it possible for most of the important debtor States to fulfil all their obligations.

There seems to be no reason for assuming that — in the event of further world recovery and adjustment of the external value of the German currency with a view to reviving the competitive power of the German industry — the same should not take place in Germany. This is, however, based on the assumption that a reasonable commercial policy is pursued in the lending countries as well as in Germany itself. The German annual foreign investment burden per head of population — if the stipulated payments were made — would not amount to five dollars. This is not much more than one fifth of the corresponding figures for Australia and New Zealand, and one third of the figure for the Argentine.

Foreign Exchange Restrictions

An adjustment of the above description — as regards both foreign debts, the relation of costs to external money value, etc. — would go far towards improving the financial situation of several of the weaker countries. It would thus pave the way for a gradual abolition of foreign exchange regulations. The first step would naturally be the re-instatement of a free exchange market for trade purposes, while keeping capital movements under a certain control. Both Austria and Ecuador abolished exchange restrictions a short time ago, thus proving that this reform is not as difficult as often suggested. In this respect again, continued world recovery would be the most important factor in promoting a more liberal system. In the first place, an economic revival in countries which are still in the throes of the depression, would pave the way for a monetary «normalization» whereas a revival, in its turn, presupposes an adjustment of external currency values.

New Foreign Investments

Long-term international capital movements have hitherto been touched upon only from the special angle of the functioning of an international monetary system. But it is also necessary to consider this question independently of these special monetary aspects. Foreign investments played an important part in international economic intercourse in the past. What will be their

rôle in the future ? A few words on the more general aspect of this problem may be added.

For the reasons given in the previous chapter, the suggestion that it may be possible to create conditions permitting of international capital movements of the same relative volume and importance as before and immediately after the war can no longer be entertained as practical. It is necessary to reckon with the fact that the scope of the international capital movements will probably be smaller in the future than in the past. Fortunately, there is a decisive difference between the rôle of such transfers and the functions of an exchange of commodities. The latter is a prerequisite of prosperity and economic growth, the former is not. The world can prosper even without considerable long-term investments — and with only relatively small movements in short-term balances. It is true, of course, that in certain parts of the world, economic development would be stimulated by foreign capital, and that this in its turn, might give an impetus to world economic progress as a whole. This is shown by the difference in interest levels. But compared with the influence which they exercised on economic development before the war, the effects of long-term capital movements would in all probability be slight. During the coming ten or twenty years, economic development will not be so dependent as formerly upon the discovery of new sources of raw materials, the exploitation of which demands large capital investments, e.g. for the improvement of transport facilities.

On the other hand, it should be admitted that a revival of international lending would materially assist in the adjustment of productive capacity in industry to the potential demand. In some lines of manufactures — e.g. certain capital goods — world capacity has grown so extensively, that a sufficient demand will hardly come forward unless capital is lent to some countries which would like to purchase such goods. Thus, some export industries in the old countries will meet great difficulties, if international capital movements remain insignificant.

Further discussion of this question is unnecessary here. As things are today, it is improbable that any economic reforms or changes would succeed in recreating the conditions necessary for a revival of long-term foreign lending on a large scale. To bring about such conditions, transformations would have to be far-reaching indeed, particularly in the political and psycholo-

gical domain. Examination of the changes necessary in order to increase international reliability and confidence without which it is hardly possible to resort to foreign investment on a large scale, would exceed the scope of this report. The principal consideration, as far as economic institutions are concerned, is the re-organization of a satisfactory monetary system, a question which has already been discussed.

CHAPTER V

Commercial Policy and World Trade Development

A. — EFFECTS OF THE PRESENT COMMERCIAL POLICY

The Fall in World Trade

A few general observations on the effects of the restrictive commercial policy of recent years have already been made in Chapter II. Before going more fully into the conditions subject to which this policy might be reformed, it may be worth while to examine more thoroughly its influence on foreign trade. It goes without saying that the numerous trade barriers which have been erected have resulted in a considerable reduction of the volume of international trade. During 1932-1934, this volume was, as already stated, about 3/4 of the pre-depression figure. According to the computations made by the Secretariat of the League of Nations — published in its report on « World Trade » — the trade « quantum » rose slightly from 74 % in 1932 to 77 1/2 % in 1934. It increased further by a few percent in 1935. The relative constancy of these figures reflects the tightening up of the restrictions, for otherwise the recovery in production since 1932 could not have failed to lead to a considerable increase of trade. During 1932-1934 importation and exportation of manufactured goods rose only from about 60 to 64 % of the 1929 level. This figure should be compared with the indices for the world output of manufactured goods, namely 72 and 90 % of the 1929 figures. Output increased further in 1935, and practically equalled that of 1929, but there was no corresponding increase in the volume of the international trade in manufactured goods.

Industrialization of « Young » Countries

A second effect of trade restrictions was an increased tendency towards rapid industrialization in certain countries which are « young », from the point of view of the development of manufacturing industries. In the second half of 1934, these countries produced 20 % more manufactured goods than in 1928. This increased production of formerly imported goods is, however, to some extent a natural re-action to the import restrictions imposed on foodstuffs by the older manufacturing countries. There has been some unwillingness on the part of the latter to admit this fact and to realize that one cannot have one's cake and eat it.

Regional Groups

A third effect of recent commercial policy is the relative increase in international trade between countries belonging to certain regional groups such as the British Empire or France and her colonies. Preferential treatment has come to play an increasing part, both explicitly — as in the cases mentioned — and implicitly, owing to the fact that the practical application of certain quantitative restrictions is almost necessarily of a selective and preferential character. The influence of British preferential policy is clearly seen in the fact that imports into the United Kingdom from other British countries increased from 29 % of the total in 1929 to 37 % in 1934. The share of French overseas territories in French trade rose from 12 % in 1929 to 25 % in 1934 as regards French imports, and from 19 to 31 % as regards the French export trade.

Bilateral Equalization of Trade Balances

Perhaps the most characteristic feature of international trade policy of the present day is the effort to balance the value of imports and exports from country to country. In the beginning, this policy did not reflect any new attitude as regards the usefulness of multilateral or « three-cornered » trade. The tendency, to reduce the latter arose simply from the fact that each country was anxious to avoid reprisals and, accordingly, imposed res-

trictions mainly on imports from countries with which it had a passive trade balance, i. e. larger imports than exports. Recently, however, it has become almost a fashion to preach the necessity of balancing trade from country to country. Why this should be considered as a natural policy, is difficult to understand. May be the idea that to import the products of a foreign country is to confer a great favour upon the latter has something to do with it. What can be more reasonable than a request that a beneficiary should offer an equivalent return ? This would appear to be the philosophy behind many clearing and compensation agreements.

Such views obviously rest on an insufficient understanding of the character and rôle of an international division of labour. International trade means that each country exchanges its home products for foreign goods. The former are the means of paying for the latter. If countries supplying the raw materials required, for instance, by Sweden, do not need a corresponding amount of Swedish goods, but prefer to buy British products, it is to the advantage of all parties that Sweden should be allowed to pay for its imports by means of a surplus exportation to Great Britain.

In many countries, the bilateral equalization policies are not the outcome of mistaken philosophies. They are the result of overvalued currencies and great scarcity of foreign exchange, like in Germany. Dr. Schacht has, against his wishes, found himself obliged to « substitute the normal play of exchange and credit with a terrible bureaucracy », adding — in an interview — that « it is barbaric to be forced to barter machines for cereals or radio apparatus for tobacco, like a negro, who exchanges his ivory for glassware or his rubber for cotton goods ».

Productivity of Multilateral Trade

The truly productive character of such multilateral trade is due not only to the fact that it enables many countries to acquire the necessary raw materials and other goods at lower real cost than otherwise possible. It also permits new countries which have developed their productive resources by means of borrowed capital, to pay interest by means of commodity exports to other countries which are in greater need of their products than the lending nations. If multilateral trade is eliminated, the ability of such debtor States to continue interest and amortization payments

will be considerably reduced. (See the penetrating analysis by Mr. Hilgerdt in the successive memoranda on « World Trade », League of Nations, Geneva.) No student of economic progress in its relation to international trade during the last hundred years can fail to realize the immense importance of multilateral trade for the smooth functioning of the mechanism of international capital movements. Great Britain, for instance, has invariably collected a considerable fraction of the revenue from its foreign investments in the form of an import surplus from the United States and European countries.

The extent to which the advantages derived from foreign trade can be reduced by bilateral agreements is shown, for instance, by the German experiment. During the recent years, Germany was compelled, by the working of such agreements, to import luxury goods which might without great difficulty have been produced at home and which were not much needed in any case. At the same time, the supply of foreign exchange was so scarce, that the importation of raw materials at certain times had to be curtailed to the detriment of several German manufacturing industries. There can be little doubt that the conclusion of numerous clearing agreements in the first half of 1934 contributed to a reduction in the European purchases of raw materials from overseas countries. This resulted in a decline in both prices and volume of their exports and interrupted the process of restoration of more normal conditions of trade.

Bilateral Equalization and the Volume of Trade

It is inevitable that a policy of bilateral equalization of trade balances, which often pays insufficient regard to the existence of so-called invisible items in the balances of payments, should reduce the total volume of world trade. If country *A* cuts down its imports from country *B*, the latter is obliged to reduce its purchases in country *C*, and so on. Even in countries which are but remotely connected with the original bilateral policy foreign trade tends to decline. As a matter of fact, the reduction of *A*'s import surplus from *B* in this way — say it be 10 million pounds — has a much more depressing influence on world trade, than if countries *A* and *E*, which have an « even » trade balance, reduce their purchases from one another by 10 million pounds.

Furthermore, it is obvious that the more closely the foreign commercial transactions of different countries are inter-related, the greater the disturbances which are caused by new obstacles.

The tendency to eliminate all multilateral trade has, therefore, been particularly harmful. During 1934, the trade of the European continent showed a downward trend, while that of other continents expanded. This difference was partly due to the bilateral policy of the European countries.

But it should be added that not all barter and clearing agreements restrict international trade. Some of them reduce risks of selling on credit to financially weak countries and, thus, actually help to maintain trade. This has been so in the case of many private barter or clearing transactions which have proved a means of overcoming the difficulties caused by the abnormally high external value of certain currencies. But there can be no doubt that, at the present day, the majority of the agreements based upon equalization of imports and exports between two countries exercise a restrictive influence on trade. On this point, the conclusions reached by the League of Nations Committee on Clearing and Compensation Agreements are convincing.

Fortunately, this bilateral policy is not yet strong enough to have succeeded in abolishing multilateral trade altogether. The Secretariat of the League of Nations has compiled tables showing that in 1933 the volume of multilateral trade fell to one fifth of the volume of bilateral trade, compared with one fourth in 1929. But in countries having extensive recourse to the quota system, the reduction is far greater. In Switzerland, for instance, the relative importance of multilateral trade has fallen to one sixth of its former figure.

Effects of Foreign Exchange Regulation

In many instances, foreign exchange regulation has been the principal instrument of the application of a restrictive policy of the bilateral type. Yet it would be a mistake to believe that such regulation has worked exclusively in the direction of a diminution of foreign trade. In the absence of a regulation of the foreign exchange market, the depreciation of many currencies would have been far more radical and exchange fluctuations probably more erratic. Monetary disorganization of this kind

might easily have led to the erection of still higher trade barriers than those which at present exist. On the other hand, it is evident that the policy of foreign exchange regulation has made it possible to maintain abnormally high external values, mainly in the case of certain currencies which are still on the old gold par, or of currencies which, until recently, only depreciated to a relatively slight extent. It is obvious that the ability of such countries to export goods and to assure their foreign debt service has suffered from « overvaluation » of their currencies. The result has been the « freezing » of more international debts than necessary and the spread of a mistaken conception as regards ability to make payments abroad under more reasonable conditions. A second effect of foreign exchange regulation is the growth of all kinds of measures to stimulate exportation. The use of bounties, like regulation itself, presupposes far-reaching control of importing and exporting firms and, in general, tends to lead to various forms of Government intervention in business. A third more fortunate consequence has been to emphasize more clearly the necessity for each country to admit foreign goods in order to secure interest and debt payments from abroad. Foreign exchange regulation may thus have helped to pave the way for saner views than those prevalent ten years ago.

Shipping

The influence of commercial policy on shipping has been twofold. It is evident that the decline in world trade has resulted in a reduction of the volume of transport, although relatively smaller than in the quantum of world trade, since trade in heavy and bulky primary commodities has been better maintained than that in other goods. In the second place, protective policy has resulted in the introduction of a series of measures designed to guarantee that as much as possible of the foreign trade of each country shall be carried by its own ships. These measures have been completed by subsidies with a view to increasing the competitive capacity of the merchant marine. Thus, shipping has come to a plight not very different from that of many export industries. The outlook for shipping may be relatively favourable, if the revival of business continues. In the autumn of 1936 practically all efficient tonnage is in use.

Character and Aim of Present Commercial Policy

It may be said that a general characteristic of commercial policy as it exists in 1936 is that it is no longer, as before the depression, chiefly directed towards the protection of certain lines of economic activity. It is aimed, in a large measure, at : 1. the defence of currencies by regulation of the balance of payments, 2. the promotion of export trade by barter agreements of various types, 3. autarchy in respect of certain products, and 4. the guarantee of payments from other countries for goods and in liquidation of interest and amortization obligations. Certain of these objectives cannot be attained at the same time as others ; e. g. the quota policy was initiated in order to protect industry and to regulate the balance of payments. It has become more and more an instrument of barter for the promotion of exports from high currency countries and, thus, has lost much of its protective influence.

Evidently, the aim of commercial policy is somewhat different from what it was. This is perhaps the chief explanation why the principle of equality of treatment of all countries has been discarded to such an extent. Its place has been taken by a policy of wholesale discrimination and of bargaining for special advantages in which duties have played a declining rôle. Quantitative regulations and a heterogeneous medley of administrative measures concerning goods, salesmen, or payment transactions have come to the fore, since they lend themselves more readily to a policy of discrimination. To say that international trade has thereby been transformed into « uncivilized warfare » is hardly an exaggerated statement. Even ardent protectionists have to agree that present circumstances are far from satisfactory, and that the re-establishment of standards of « fair competition » is of the greatest importance for international trade.

It is superfluous to emphasize the bearing of these questions on international political relations. Discriminatory policy breeds resentment and ill-will between nations, and frequently gives rise to international complications. Nationalist propaganda is thus provided with a ready weapon for stirring up national feeling against other countries. The forces which are striving to promote a friendly international atmosphere and the elimination — as far as possible — of all risks of war can hardly work under less favourable conditions.

B. — RE-ORGANIZATION OF INTERNATIONAL TRADE

The Goal

It is obvious that international trade is in need of re-organization. The essential aim, if economic activity is to develop, must be to create conditions permitting of trade expansion. It is by no means a foregone conclusion that the attainment of this goal depends upon more freedom of trade. On the contrary, it is quite conceivable that a more rational system of regulation than the present might lead to a greater expansion of foreign trade than could be achieved as a result of other policies which it might be possible to apply. Secondly, even if the abolition of obstacles to trade is the only reasonable measure in many cases, a premature attempt in this direction might cause much harm. Therefore, it is necessary to analyze the conditions in which a reform of commercial policy could best be carried out. A few observations of a general character follow below.

The Need of Domestic Expansion

Commercial policy is, of course, only one of the aspects of the circumstances governing international economic relations. It is improbable that any considerable and lasting improvement in the sphere of trade will be attained until some measure of monetary stability and a reasonable relation between cost of production and external currency values has been restored. Not only to these conditions exercise a direct effect upon trade, but there is very little chance of a rationalization of commercial policy except in connection with monetary re-organization. Moreover, since restrictive policy is to a large extent a result of the depression, it is necessary that such action should be preceded by some measure of general economic revival. Fortunately, from the point of view of world business, economic revival has been well on its way during the past few years, notwithstanding increasing difficulties in certain countries. The policy of financing armaments by borrowing seems to have played only a minor rôle in this recovery, at least up to the end of 1935, except in a few states. When the policy of economic contraction and

deflation, which is still being pursued in some parts of the world, has been reversed, and when a general upswing in business and employment is to be noted in these countries also, then it is that the time may be ripe for a reversal of the general trend of commercial policy. What is desirable is a policy of a less discriminatory character than the present one and one directed towards *trade expansion*.

Less Discrimination

It is unnecessary to emphasize the importance — both economic and political — of reducing discriminatory tendencies. The advantages reaped in the coming years from an increase of trade would exceed the ordinary advantages of the international division of labour. They would be all the greater in view of the fact that the productive machinery for export trade already exists, but would be of but few services if output were to remain subject to the present restrictions. Moreover, inconvenient and wasteful transfer of labour and its adaptation to new tasks would become superfluous.

The realization of both aims — less discrimination and more trade — depends upon more freedom of trade, i. e. the relaxation and simplification of regulation and protection. Certain other aspects of alternative methods of commercial policy will be touched upon below. But, on the whole, rational reform should consist in the easing of restrictions, although not necessarily in the removal of all new measures.

How can such reform of commercial policy be brought about? Under what conditions and by which methods? In order to throw some light on these questions — detailed consideration would demand a more comprehensive analysis than is possible in these pages — let us first examine some of the general difficulties which stand in the way of the reduction and simplification of the existing barriers to trade.

Influence on State Revenue

When, during the first decade of the post-war period, efforts to reduce tariffs met with but small success, one of the principal objections was that tariff reductions would have reduced public

revenue. This factor carries less weight at the present day, when the most important thing is to remove or mitigate quantitative restrictions, which give the State little or no income. Moreover, increased international trade would result in a larger volume of traffic both by rail and by sea. Losses financed by the State and subsidies to the transport system would thus decline. It is also evident that general economic recovery, stimulated by a more rational trade policy, would increase revenue from taxation. Considerations of public finance are, accordingly, not opposed to such policy; on the contrary, they speak strongly in its favour.

Erroneous Opinions an Obstacle

Another difficulty, which also existed before the depression, has, unfortunately, gathered more weight. Erroneous opinions as to the nature of foreign trade and nationalist sentiments based on such opinions stand in the way of a saner policy, which many people believe would only « benefit the foreigner ». Among such mistaken views is the idea that a passive trade balance is unsound. Even more harmful is probably the belief that importation reduces home employment. While it is true that this may be the case under certain conditions, it is also true that, in the long run, imports pay for exports. The importation of foreign wares thus provides employment in the export industries. Even viewed from the standpoint of immediate effects, it is far from true that curtailment of imports invariably increases home employment. An experienced negotiator of trade agreements has stated that, in his opinion, an increased market for export goods in times of depression corresponds to a net increase in production, while curtailment of imports seldom leads to any considerable increase. If this could be brought more clearly home to the general public, politicians would more readily accept a more liberal orientation of commercial policy. For it would in this case be more difficult to appeal to national solidarity against purchases of foreign commodities by the use of such slogans as « Employ the children of our workers », etc. National feeling being a factor with which every Government must reckon, an economic education of public opinion, which would destroy the effects of crude arguments against foreign trade, would be extremely desirable.

Another way of making public opinion more alive to the

importance of international economic relations is to demonstrate the limited and unstable character of national economic recovery in the event of the depression persisting in certain countries, a situation in which the economic intercourse between the latter and other nations would remain on a low level.

Progress in the settlement of political conflicts would also exercise a favourable influence on economic relations. « Disarmament, regulation and control of munition industries, the World Court and other international institutions facilitating consultation and settlement of disputes — these are problems that concern international economic relations no less vitally than trade agreements, stable exchanges and foreign lending » (Alvin Hansen, *op. cit.*, p. 158). The present wave of competitive armaments tends to reduce international confidence and to make recovery insecure. Another political factor, the interference of foreign Governments in the policy of dependent or weaker nations breeds hatred and boycott movements.

*A Beginning should be made by Financially
Strong Countries*

Let us now turn from these psychological and political considerations to a more technical discussion of the conditions under which a less restrictive commercial policy could be introduced. In this connection, it is necessary, in the first place, to revert to a general observation which has already been made. Financially weak countries are not in a position to repeal quantitative restrictions or foreign exchange regulations without sacrificing their monetary stability. The load must therefore be taken by countries with a strong international liquidity. The latter alone are in a position immediately to relax their import restrictions without detriment to their currency stability. By increasing their imports or by more liberal foreign lending, provided satisfactory security is offered, they can help other nations to reach a position in which they would be able to reduce foreign floating debts, to increase their gold reserves and, thus, gradually to ease their trade restrictions, e. g. foreign exchange control for commercial transactions. In brief, if countries disposing of large gold reserves were to consent to a passive orientation of their balance of payments and to the export of gold, they would thereby contribute to the creation of a more healthy state of international

finance, which would have a favourable effect upon commercial policy. This method was applied in the pre-war days for the ordering of financial relations under a gold standard regime. It is difficult to see how any international monetary system could be made to function unless a similar adjustment is allowed to take place whenever called for. Therefore, the initiative with regard to an easing of trade restrictions and lowering of duties rests to countries which, like the United States, France, Great Britain, Holland and Switzerland, possess enormous gold reserves. Unfortunately, certain of these countries have been debarred from such action by the abnormally high external value of their currency. After an adjustment of monetary conditions, however, an understanding between some or all of these nations to move in the direction of freer trade might be followed by relatively speedy results and, in the course of a couple of years, radically change the conditions of international commerce. The United States have already expressed their willingness to pursue a policy of this kind, and, by a series of trade agreements, have obtained certain results.

Autonomous Action

Autonomous action on the part of one nation — for instance, as regards the enlargement of quotas — is, of course, feasible in many cases. So-called tariff quotas might perhaps furnish a practical method of transition to ordinary tariff policy. This system would consist in the fixing of a certain quantity for the total importation, from all foreign countries taken together, of a certain commodity at the regular duty. If or when the total imports of the said commodity exceeded this quota, a higher duty would be automatically applied. By gradually enlarging the quota, one could slowly return to normal trade conditions. Another method would consist in the immediate replacement of quotas by higher duties. This, however, would have the disadvantage of increasing the risks of a permanent and substantial re-inforcement of the tariff walls.

Non-discriminatory Bilateral Agreements

Although, as already observed, it is possible for the stronger countries to proceed alone with a reform of commercial policy,

it is nonetheless probable that negotiations between them and other nations on the subject of mutual concessions might help to widen the field of freer trade. Let us begin with a few remarks on *bilateral agreements*. This term is here used to define the ordinary trade agreement between two parties. It is based on the unconditional m. f. n. clause and is therefore bilateral only *in form*. It must be distinguished from treaties which are bilateral in a more real sense in so far as the agreed tariff reductions and other stipulations concern only the contracting parties and do not apply to other countries.

The former category should be taken as including cases in which most favoured nation treatment is accorded also to countries with which the contracting parties have no trade agreement, but which do not discriminate against them. In so far as all privileges are automatically conferred on all countries according «equality of treatment», it may be said that bilateral treaties thus become collective conventions. It was this system, more than anything else, which contributed to the relative stability of political trade relations before the war.

Lead of the Great Powers

Under what conditions can a commercial policy of this kind lead to a progressive lowering of import restrictions? To answer this question, it is worth while recalling the period after the middle of last century when this very process took place. The decisive factor in the 'sixties would appear to have been merely that during a period of rising prices and prosperity, two great nations — France and Great Britain — were determined to bring about a reduction of the obstacles to international trade and carried out their negotiations with different countries in that spirit. At present, the United States have shown by their actions that they are similarly minded. It would accordingly seem quite probable that if one, or still better, two, of the leading countries, were to join with the United States in this policy — after a monetary adjustment — the outcome would be a worldwide movement towards freer and, therefore, larger trade. One condition is, however, that world prices have rather a rising than a falling trend, thus leading to a state of relative prosperity. The risk that currency depreciation might radically change most relations

and thus destroy the basis of the new agreements might to some extent be met by a special « depreciation clause » in all treaties providing for immediate liberty of action on the part of the contracting parties in the case of depreciation exceeding certain limits. Such clauses have been inserted in several of the new American treaties.

Quotas and Equality of Treatment

It is far more difficult to handle the quota policy in a manner implying full equality of treatment. Individual quotas for each country, on the basis of a certain percentage of importation during some earlier period, are, perhaps, reasonable in most cases. But with changing conditions, even such an arrangement becomes relatively more detrimental to the export trade of some nations than of others. However the inevitable discrimination, can be insignificant, if quotas are administered in a spirit of equality. It is therefore extremely important that the most favoured nation clause in all treaties should be so widened as to guarantee as far as possible equality of treatment whatever the nature of the restrictions applied. A policy based on this interpretation might help to discourage discrimination. Countries which discriminate would not receive most favoured nation treatment abroad. If only certain of the leading countries were to agree upon this strict application of the principle of equality of treatment, other countries would probably be much more willing than at present to renounce discrimination. But this naturally presupposes that none of these leading countries demand that other nations discriminate in their favour.

The difficulties are still greater in countries which use foreign exchange regulation as a means of controlling their foreign trade. This means the application of a kind of « value quota », but such quotas are determined in each individual case and seldom accorded for definite periods.

The general impression to be gained from such considerations is that a change of attitude on the part of a few powerful nations, and a slight technical reform of treaty methods might permit of very considerable progress on the basis of a treaty policy of the type prevalent before the war, especially during a period of rising prices. Fortunately, the gold supply and some other

factors make it quite probable that prices will have a rising trend in the coming years.

Discriminatory Bilateral Methods

It is only wise, however, to reckon with the possibility that a majority of nations may desire to maintain the basis of a policy of discrimination for several years to come. The question therefore arises whether present methods can be so applied or reformed as to result in an expansion of international trade. Three aspects of the present situation must be borne in mind. A domestic policy of intervention prevails, and is likely to continue to prevail to a considerable extent for instance, in agriculture. Many countries demand that each foreign country should buy from them as much as it sells to them. Lastly, in their present circumstances of unsatisfactory international liquidity, many countries are able to ease up their import restrictions only if other countries do so at the same time; or if expansion of their export is guaranteed as a direct corollary of their increased imports. In the event of the continued prevalence of these three factors, how can Governments and public opinion be made to accept measures which would lead — not to *freer trade* — but to an expansion of the volume of trade?

Direct Connection between Imports and Exports

In financially weak countries, more particularly, Governments tend to take a short view of the effects of commercial policy. This is not to say that this attitude is peculiar to these countries alone. Hence, such countries are only likely to take steps to let in more foreign goods, if such steps form part of an arrangement which is believed to involve increased home production. There must be some *guarantee* for this result. Under these conditions, there are two categories of imports which are considered more desirable than others. First, foreign materials and instruments of production which cannot be produced at home — or only with the greatest difficulty. Secondly, imports which provide an outlet for increased exports. The consequence is bilateral discriminatory agreements, usually on a basis of bartering. Country *A* increases its purchases of certain goods from

country *B* which, in its turn, increases its importation of other goods from *A*. It is not to be denied that in this way trade can be made to expand. It is therefore a matter of some importance that, so long as a policy of discrimination continues, it should be applied as part of a general policy of expansion and not as a method of contraction. This means that efforts should in the first place be directed towards an increase in the output of the export industry where it is most needed and not towards stimulating production for the home market. Private clearing between business interests in the different countries is an example of measures which, under certain conditions, lead to increased exportation.

Reduction of three-cornered Trade

There is nothing in such truly bilateral, discriminatory methods *per se* that necessarily makes them «contractive». In practice, however, there are narrow limits to the expansion of trade which can be brought about with their aid. In the first place, multilateral or three-cornered trade is reduced. It is possible that this effect might be counteracted by means of some kind of international clearing institute, which could contribute to the necessary arrangements for three-cornered trade. Even if certain countries were to apply a narrow bilateral policy, others might combine certain import and export transactions with the former countries and thus be in a position to carry on more trade with them than would otherwise be possible. Secondly, bilateral policy which aims at balancing trade between two countries presupposes considerable regulation of international commerce. Such regulation and control alone tends to create difficulties which have a depressing influence on the volume of trade. In the long run, therefore, the only reliable method of trade expansion is to abolish bilateral discrimination. But, so long as many countries ask their weaker neighbours to discriminate in their favour, it is impossible for the latter to renounce discrimination.

A General Conclusion

The conclusion reached on the basis of these considerations is that the problem of methods for the promotion of world trade

is not identical with the question how to secure a commercial policy of a less interventionist character, based on equality of treatment, a reform presupposing certain changes in both economic and psychological conditions. The former problem also includes the question of the modification of forms and methods of application of the existing discriminatory policy with a view to transforming it into an instrument of a general expansion of international commerce. Further investigation concerning different roads to progress may well proceed along these lines. As regards the second question, it is obviously a matter of a certain importance that business leaders should use their influence to prevent regulation of national economic activity from interfering unnecessarily with foreign trade and, accordingly, from leading in the direction of autarchy. It is by no means a foregone conclusion that all measures of internal regulation must inevitably tend in this direction, but most of them are likely to do so, unless great care is taken when they are planned. How to make foreign trade expansion an important feature in official regulation of the various national economic systems is a question which demands the greatest attention at the present moment.

A New Discriminatory Policy

A third aspect of the problem of commercial policy is whether it is possible to devise and put into practice a new type of policy, based on consistent discrimination between countries applying reasonable measures and those resorting to excessive protection. Countries with a system of slight protection might agree to impose higher duties on and thus to refuse most-favoured nation treatment of imports from all countries belonging to the latter category, the object being to make it worth while for the latter so to reduce their import restrictions as to fulfil the conditions for most favoured nation treatment. Thus, the division of nations into two categories would no longer be governed, as before the war, by criteria of discrimination or non-discrimination, but by the question whether or not they refrain from unreasonably high protection or other excessive interference with the importation of foreign goods. Unfortunately, such classification would present considerable difficulties, and it is, therefore doubtful whether such a policy could be successfully applied. Still, it may be useful to make it a subject of further analysis,

in particular, as regards the possibility of reducing the risks and difficulties thereby entailed.

Multilateral Agreements

It is obvious that this policy has certain features in common with multilateral agreements. There are many theoretical arguments in favour of regional co-operation. It is natural to assume that nations with close economic and cultural relations understand one another better, and are in a position to conclude reasonable agreements more easily than others. Therefore, if countries belonging to certain natural groups were able to exchange certain privileges, the benefit of which would not be extended to outside countries giving nothing in return, it might be possible to constitute large areas of relatively free trade. Such a system has hitherto been regarded as incompatible with the most favoured nation clause except when, as in the case of the British Empire, the contracting States form parts of a single political entity. The problem therefore arises whether this clause could be differently interpreted so as to render possible multilateral agreements permitting of freer trade within a given area, provided any outside country were entitled to adhere to the group on equal terms. If such an interpretation were generally accepted and some such groups formed, a movement towards the gradual widening of such relatively free trade areas might set in. In other respects also, it is by no means impossible that this might contribute to a reversal of ultra-protectionist tendencies. Moreover, it may be argued that such limitation of the implications of the most favoured nation clause would promote rather than impede efforts to re-instate this clause in its former position as one of the corner-stones of commercial policy. This would, however, presuppose the concomitant extension of the clause with a view to providing guarantees of fair and equal treatment, not only as regards import duties but also as regards quotas and exchange regulation.

The question of the future character and position of the most favoured nation clause merits the most careful attention, as does also that of regional co-operation. It is by no means impossible that such measures may eventually play an important rôle, e. g. in the case of : 1. the Danubian States ; 2. the Scandinavian States, Belgium and Holland — constituting the so-called Oslo

group — ; 3. the Baltic States, and perhaps 4. Italy, Austria and Hungary. Multilateral agreements provide a method of reserving good treatment for countries affording such, while retaining certain of the advantages implicit in the most favoured nation clause.

On the other hand, it is clear that it would be difficult to avoid certain dangers and disadvantages. The constitution of regional groups would be based, in part, on political considerations, and trade would, to some extent, be diverted into artificial channels. The danger of a clash between powerful groups of nations in the event of a conflict of economic interests also deserves consideration.

International Cartels

The question of the rôle of international cartels and producers agreements will not be discussed in the present report. It is the opinion of the author that their importance for an international economic reconstruction is relatively slight. This is not to deny that in certain cases, they contribute to an easier adjustment of supply and demand in such a way that violent price changes are avoided. On the other, they have frequently been handled in such a way that they have only put off a necessary price reduction and led to mounting stocks and an unstable situation. The most important consideration is, perhaps, that they should be organised in a spirit of expanding markets at reasonable prices and not to acquire monopoly profits.

CHAPTER VI

The World Agricultural Crisis

Introduction

It seems hardly necessary to emphasize the fact that no stable recovery in international economic relations is possible failing solution of the problems created by the world agricultural crisis. Despite widely differing opinions as to the character of the depression which broke out in 1929, it is generally agreed that one of the main causes of its exceptional severity was due to the plight of agriculture. Unfortunately the difficulties with which agriculture has to cope have not yet disappeared, although they have become less severe. They will continue as long as the agricultural price level is at variance with that of manufactured goods and with the debt burden of the farmers. This affects the world economic situation in general. Many of the agricultural countries are debtor states, and the weakness of their position exercises an unfavourable influence on international finance, on interest and amortization payments and on new capital transactions. Moreover, the abnormally low prices of agricultural produce on the world market lead to excessive measures of agricultural protection on the part of the food-importing countries, while the food-exporting countries retaliate by raising their tariffs for manufactured goods. This results in a dislocation of the natural currents of trade. Hence in the sphere of monetary policy and international trade, the agricultural crisis prevents a rational state of affairs. Internal and external trade consist in a large measure in the exchange of foodstuffs and raw materials for manufactured goods. As long as this exchange takes place in unbalanced conditions, it is hardly possible to expect that the disturbances from which trade is suffering will disappear.

Origin of the Crisis

The origin of the agricultural crisis dates back to the war of 1914-1918 ; the chief cause of the crisis is to be found in the production of cereals, in particular, wheat, which played a decisive part. The area under cultivation declined in Europe, while constantly increasing in the United States, Canada, Australia and the Argentine, from 32 million hectares during the five years immediately preceding the war to 46 millions during the period 1926-1929. The extension of the area under wheat in Canada, Australia and the Argentine even during the post-war decade was due to technical progress. The cheapness of the power supplied by the tractor reduced costs of production chiefly in grain-exporting countries with relatively extensive cultivation. The combine reduced the costs on *large* farms, which were mainly to be found in non-European exporting countries. Furthermore the introduction of new varieties of seed made it possible to extend the area of profitable cultivation and dry-farming methods brought many advantages in their train. Despite the circumstance that cheap fertilisers were a more important factor in the old farming countries with intensive cultivation than in the new ones, it is safe to say that technical progress played a relatively unimportant part in the European agriculture of the 'twenties, whereas it enabled the overseas exporting countries to increase their output at lower costs than before.

The European wheat production recovered, however, little by little. The fact that no « over-production » was recorded until 1928 was due to the circumstance that Russia exported next to nothing and that the world crops of 1926 and 1927 were below the average. 1928, however, was a bumper crop year, and, in 1929, Russia resumed her important rôle in the wheat export market. This resulted in an enormous surplus. But it should be emphasized that the surplus offered concerned wheat alone, and that the increase in the average output of vegetable foodstuffs during the pre-depression years — compared with pre-war conditions — did not exceed that warranted by the growth of the world population. The increase in the stocks of cereals — which for wheat reached in 1929 a figure representing more than twice the average for 1921-1926 — was therefore due partly to a fall in the per capita consumption of bread cereals in countries with a high or rising

standard of living, partly also to the extension of the area under wheat. Thus, the excessive capacity of production was confined to wheat alone. The following figures, which shew the areas (in thousand hectares) under wheat, rye, barley, oats, maize and rice are most illuminating.

	<i>Wheat</i>	<i>Other cereals</i>	<i>Total</i>
1909-1913	63,500	131,200	194,700
1920-1924	69,000	130,400	199,400
1925-1929	74,300	133,800	208,100

Over-capacity in Wheat-growing

Evidently, in the years following the war, the production of wheat tended to exceed the quantities that could be sold at prices affording farmers the customary returns and standard of living. This was not, however, realized until 1928-1929. But, even then, no attempt was made to adapt the output to the new conditions. Hence, it must be asked : How is it that the bumper wheat crop of 1928 did not lead to a far-reaching reduction of prices, and thereby to a shift in production and a smaller acreage under wheat ? The answer is not difficult to find. Part of the crop was withheld from the market by the Canadian Wheat Pool, which succeeded in raising quotations towards the end of 1928. Moreover, many speculators appear to have regarded the slow drop in wheat quotations since 1926 as due to causes of a temporary character.

But 1929 saw the onset of the world economic depression lead to an aggravation of the agricultural crisis. It is interesting, however, to query in what way agricultural conditions would have developed if there had been no general industrial depression. It is clear, in the light of present knowledge, that the above-mentioned circumstances would, even without the depression, have led to a considerable slump in the wheat prices, which, in its turn, would have spread to the other cereals. Live stock breeding would have become relatively more profitable than the growing of bread cereals. Fodder production would have expanded, especially in mixed-farming districts, and efforts would have been directed towards the production of meat, dairy produce etc. Whether wheat prices would have fallen to such an extent as to create a major agricultural crisis is, of course, impossible to say.

If the price of wheat falls below a certain relation to that of fodder, wheat is immediately used, in large quantities, for feeding purposes ; this exercises a certain stabilizing influence. Moreover, low wheat prices appear to stimulate consumption in China and in the Tropics. It should be noted that a shift in production from wheat to fodder cereals is relatively easy in many parts of the world. Besides, taken as a whole, the excess capacity in cereals was relatively small, judging by a comparison of population and production figures. Even the large wheat stocks of 1929 were small in comparison with one year's output of cereals.

Development of Agriculture in the absence of an Industrial Depression

In view of the elasticity of the demand for animal foods, it is quite possible that a small price reduction would have enabled producers to dispose of the increased supply resulting from the above-mentioned shift in agricultural production. But it is also possible that only a reduction of the agricultural population coupled with a rapid expansion of manufacturing industries, trade and transportation could have brought about — during a period of rapid technical progress in agriculture — an adjustment of foodstuff supplies sufficient to prevent a sharp fall in the relative prices.

This, however, seems improbable, since the rising standard of living of a rapidly increasing world population would have brought in its train a growing demand for the more expensive foodstuffs. As a consequence, a considerable reduction of the acreage under bread cereals would have taken place. According to the estimates of the United States Department of Agriculture, the acreage needed for certain number of calories is as follows : potatoes 76, corn meal 79, wheat flour 145, milk 395, pork or lard 440, beef (dressed) 1380.

A study of the increase of the output of rice, coffee, tea, and agricultural raw materials like wool and cotton confirms the impression that, except in sugar and coffee growing districts, the adaptation of agriculture would have been possible without serious disturbances, provided there had been continued and rapid expansion in other economic fields. This conclusion is necessarily somewhat hypothetical, but nevertheless offers a certain interest in its bearing on the agricultural situation as it appeared

during the depression of 1932-1934. The above argument suggests that if the difficulties of world agriculture appeared insuperable, this may well — except in the case of sugar and coffee — have been due to the industrial depression and that alone — fortunately a temporary and passing phenomenon — or to the agricultural policy introduced during the depression.

It is well to bear this possibility — or probability — in mind, when discussing the effects of a departure from the policy pursued in recent years.

Coincidence of Industrial and Agricultural Depressions

The interplay of the industrial and the agricultural depression and their intensifying influence upon one another has been discussed in an earlier chapter. It was but natural that the severe crisis in the manufacturing industries should have resulted in a considerable fall in the prices of mineral and agricultural raw materials. But what differentiated this crisis from the pre-war depressions — 1900 and 1907 — was that the prices of vegetable foodstuffs also declined rapidly. This is to be explained by the conditions of supply which we have touched upon earlier in this chapter. The general depression reduced in some quarters the willingness and the ability to carry stocks. The resulting offer of wheat and other vegetable foods brought down the prices of these commodities. On the other hand it is hardly likely that the reduction of the purchasing power of workers in the manufacturing trades exercised any considerable influence on the demand for cereals for consumption purposes, at all events during the first years of the depression.

The drastic fall in prices was not followed by any « automatic » adaptation of supply. The restrictive influence exercised by low prices is generally much smaller in agricultural output than in the manufacturing industries. In agriculture, the response to lower prices and income is frequently — especially where one-family farms play a large rôle — an increased output due to an effort of the farmer and his family to compensate lower prices by harder work. As a matter of fact, it is not easy to reduce labour power even on larger farms. Even when there was considerable unemployment in all branches of manufacturing industries the transfer of agricultural labour to other occupations proved impossible.

The prices of animal foodstuffs being relatively well maintained, their output was increased. The world milk output index rose by 8 % from 1929 to 1932. Owing, however, to the general depression and loss of purchasing power among the urban population, the increased supply soon resulted in a decisive fall of the prices of these products. Until the end of 1931, the relatively widespread cheapening of fodder made it possible to sell butter and bacon on the world market at prices which were satisfactory to the efficient producer. But even for these commodities, world prices soon fell to unremunerative levels.

Policy of Restriction and Price-raising

What greatly contributed to depress world market quotations for animal foodstuffs was the fact that in most countries the consumer did not benefit by the lower world market prices. On the contrary, national prices were maintained in order to protect the home farmer, thus the consumer was unable to increase his consumption to the extent that would have been possible if the home prices had been lower. That a very considerable increase of consumption would have ensued, if retail prices had been allowed to fall, is seen from the development in Great Britain, where owing to lower prices the per capita consumption of butter rose from 17.8 kg. in 1929 to no less than 25.2 kg. in 1934.

The hindrance to a similar development in other countries was a wave of protection. In the immediate post-war period, which mainly affected manufactured goods, but it was now followed by a veritable orgy of import restrictions of all kinds, directed towards the maintenance of home market prices for foodstuffs. This naturally resulted in a further flooding of the relatively free markets with still lower prices. The old protectionist countries accordingly increased their import restrictions on foodstuffs still further, while other countries introduced new restrictions. In June 1935, the import duty on butter reached the figure of 187 % in Germany, 163 % in France, 138 % in Italy and 108 % in Switzerland (WRIGHT, *Butter — A World Staple Index*, 1935). The discrepancy between domestic and world market prices reached appalling dimensions. In several countries, wheat, butter and sugar were sold wholesale at prices which amounted to about three times the « free » world market price.

The Output of Cereals

In many of the manufacturing countries, one of the results of the high cereals prices was an expansion of output. In Europe, the area under wheat increased from 29,800 to 31,400 during the period 1930-1934. The whole burden of adaptation was cast on exporting nations with the lowest costs of production. The following figures illustrate this tendency :

Wheat production in 1930 and 1934

(In 1,000 hectares and 1,000,000 quintals)

	<i>Europe</i>		<i>Canada - United States</i>		<i>Argentina</i>		<i>Australia</i>		<i>Total</i>	
	<i>Area</i>	<i>Output</i>	<i>Area</i>	<i>Output</i>	<i>Area</i>	<i>Output</i>	<i>Area</i>	<i>Output</i>	<i>Area</i>	<i>Output</i>
1930	29,800	370.3	35,400	356.6	7,900	63.2	740,0	58.1	805,00	848.2
1934	31,400	421.4	26,900	210.3	6,900	65.5	510,0	36.3	702,00	733.5

These figures show that restriction of output was confined to the exporting countries — the unfavourable weather conditions in the United States and Canada increased the effect of the reduction of the acreage. Europe on the other hand, had in 1934 a 7 % larger area under wheat and produced quantities exceeding by 14 % those of the five years immediately preceding the War. This expansion of the European area under wheat during the depression period is of course confined to the industrial nations. From 1928 to 1934, the wheat output of these countries increased by more than 20 %, whereas it decreased by one third in the Danubian regions. The consequence is that the European manufacturing countries have lost the greater part of their importance as importers of wheat. France, Germany and Italy, importers in the 'twenties of 200 million bushels of foreign wheat per annum, have during the last few years bought practically nothing.

The Output of Animal Foods

Turning to the question of animal foodstuffs, we find much the same development from 1931 onwards. In most of the manufacturing countries, high import duties and other restrictions have raised prices and lowered consumption. The high prices — aided by direct and indirect subsidies — have stimulated domestic output not only in regions where costs are reasonable but also in

other districts. Thus output has expanded while consumption has been discouraged. In Germany and certain other countries, the *total* consumption of *all* foodstuffs declined during the period 1929-1932. The German per capita consumption of fats fell from 42 lbs. in 1932 to 34 lbs. in 1934. On the European continent, in 1934, the largest purchasers of beef and veal reduced their imports to 1/4 of the 1925-1929 volume. As regards butter, the development was different. Whereas Germany cut down her pre-depression imports by half and Switzerland virtually ceased to buy foreign butter, Great Britain — notwithstanding a new duty — considerably increased its purchases of butter at extremely low prices.

It is clear that these developments have been a severe blow to the exporting countries. Some of them have been compelled to depreciate their currencies — e.g. Australia, New Zealand and Denmark to 20 % below parity with sterling. Many of the less important exporters have resorted to export bounties, thereby depressing prices on the « free » markets while raising them at home. « There is, in fact, a veritable network of subsidies and special advantages granted for such important commodities as wheat, sugar and butter. The markets in these commodities, cut up as they are into non-competing areas by reason of trade restrictions, are rendered more artificial by the widespread use of bounties and subsidies » (*World Economic Survey, 1934-1935*, p. 85).

Policy has counteracted tendencies to adjustment

The results of this policy which has been so energetically pursued by the manufacturing nations of Europe are as follows :

1. It has prevented a downward adjustment of the supply of cereals and sugar in those parts of the world where costs are high;
2. Hence, a reduction of output has been forced on in the low-cost countries ;
3. The restriction of the importation of foodstuffs from agricultural countries has reduced the ability and willingness of the latter to import manufactured goods and to effect interest and amortization payments. The consequence of this is that the purchasing power of the manufacturing countries and their ability to increase their consumption of animal foodstuffs and expensive vegetables have been adversely affected ;
4. The high prices of these foodstuffs on many protected markets have been

directly instrumental in maintaining consumption at a lower level than necessary. It is therefore clear beyond doubt that this policy has impeded an adjustment of world agriculture which would have furnished a more stable basis for international economic relations than the present one. On the other hand, it is obvious — and corroborated by income figures — that the said measures have for the moment brought some alleviation of the agricultural depression as far as the manufacturing nations are concerned. To the extent that financial breakdown of the agricultural credit system has thereby been avoided, moderate agricultural protection may have had a favourable influence on general economic conditions in such countries. But the exaggerated measures of protection applied by certain manufacturing countries have resulted not only in the creation of excessive supplies of foodstuffs with the attendant difficulties of stocking and the necessity for costly export bounties ; these measures have also through a reduction of the income of agricultural nations, led to a narrowing of the export markets for manufactured goods in a most unfortunate manner. As a matter of fact, in spite of this high agricultural protection in European manufacturing countries there has been no increase in agricultural employment — at the most, reduced unemployment — to compensate the serious decrease of employment in the manufacturing export industries. Thus, *even in the short run*, excessive protection has exercised a most pernicious effect on the manufacturing countries, while proving, naturally, extremely detrimental to the interests of agricultural countries. The more distant effects of the system appear even less desirable, since, as already explained, it tends to modify the world economic structure on lines of reduced efficiency and stability. Finally, it should be added that the agricultural policy has an unfavourable effect upon the public finances of certain countries. Subsidies weigh heavily on the public purse. Marketing schemes which impose high prices on the consumer reduce his ability to pay taxes. The financial situation is aggravated.

Better Conditions in 1934-1936 : Animal Foods

Notwithstanding these unfortunate policies in the food-importing countries, the years 1934-1936 were a considerable improvement in the exporting countries over the preceding period. The widespread recovery in manufacturing industries all-

through the world — with a few exceptions — whereby world production rose to above the 1929 level, brought in its train an increase of purchasing power and an increased demand for animal foodstuffs as well as fruit and vegetables. International production figures are not as yet available, but it is certain that there has been a considerable increase compared with 1929. Yet, this has not prevented the world market price of butter from increasing by 30 % during the past two years. On the other hand, the rigorous import restrictions on bacon have prevented any considerable rise in the world market price of this commodity. The impression gained from a study of the animal food market is that, if all countries were to keep their price-raising measures within a limit of e.g. 25 % of the free world market price, the demand for such foods would expand heavily. It would probably raise the world market prices to a level which would afford sufficient remuneration to efficient exporters. The farmers in the importing countries obtaining somewhat higher prices would then — except in certain countries with overvalued currencies — probably obtain reasonably satisfactory incomes. The crisis would as far as animal foods are concerned have to a large extent disappeared. Thus, the world agricultural crisis in animal foodstuffs — originally caused by the industrial depression and intensified by protectionist policy — may now be said to be due chiefly to the continuation of this policy alone.

The Present Position of Vegetable Foodstuffs

As regards vegetable foodstuffs — such as bread cereals and sugar — the situation is more complicated. This was to be expected, since the agricultural crisis originated in this field. An inspection of the figures for world output (excl. U.S.S.R.), published by the League of Nations, conveys, *prima facie*, a very favourable impression. The world output fell from 105 in 1930 and 1933 to 100 in 1935 of cereals the reduction is considerably greater. Thus the quantity of vegetable foods produced during the last two years was smaller than in any year since 1927. It is probable that the 1936 figures will be even somewhat lower than those of 1935. As the world population has increased by 10 % during the last eight years, the output of the past few years falls short of consumption and stocks have been considerably reduced.

The impression that may be gained from these figures —

namely, that the decline is due to a necessary adjustment — is unfortunately misleading. As already stated, the decline in recent years is entirely due to reduction of output in the United States and Canada caused by extremely unfavourable weather conditions — severe drought — and also induced by Government subsidies for limitation of production. Furthermore, the production of sugar has been restricted under the International Sugar Convention, and large stocks of coffee have been destroyed in Brazil. Thus, there has been very little adjustment as regards *capacity* of production for vegetable foods. In the absence of subsidies and other restrictive measures, and with normal weather conditions, supplies would again shew an upward movement, provided price quotations covered the costs of the majority of producers and their accustomed standard of living was thus assured.

Thus, if we envisage this development from the point of view of its more lasting effects, we shall see that the adjustment of production is apparent rather than real. But its immediate consequences are radical enough. The world carry-over has fallen from 1,162 million bushels two years ago to 650 million bushels on August 1st, 1936. Before next summer, the United States will probably have to import considerable quantities of wheat, while Canada will export less than during the preceding years. The outlook for next summer is therefore that world stocks will fall below what is considered as normal. It is hardly surprising that wheat quotations have risen to levels which are 40-50 % higher than two years ago. Towards the middle of August, both Chicago and Winnipeg quotations exceeded one dollar per bushel.

Sugar

Developments on the sugar markets have been somewhat different in character. In 1928-1929, the situation in the sugar industry was in many respects similar to that of wheat. « The stimulus to production outside Europe given by the war, the technical progress which reduced costs only in certain regions, the refusal to let prices drop and lead to a restriction of output in regions with high costs, the consequent limitation of the free world market and the increase of stocks under the influence of efforts to maintain prices are aspects common to both industries and of importance as affecting their position and prospects in the

followings years. » (*The Course and Phases of the World Economic Depression*, Geneva, 1931, p. 58.)

Notwithstanding the existence of an international restriction scheme, which has reduced from about 50 % to 30 % the percentage share of world output in countries adhering to the scheme, the world market price of sugar is lower than in 1932 and less than one half of what it was in 1928 ; this can hardly be considered as a symptom of stability. Furthermore, in this case as in most cases of regulated output of staple commodities, it is the production in the low-cost regions that has been cut down . While the output of cane sugar has declined from 17,823 thousand tons in 1932-1933 to 15,810 thousand tons in 1935-1936, the production of beet sugar has increased from 7,896 to 9,802 thousand tons during the same period. There are still considerable stocks of sugar, coffee and tea, all of which commodities are regulated internationally. But sugar stocks fell from 7,090 thousand tons in 1932 to 4,166 thousand tons at the end of September 1935 — about one third more than the 1928 figure.

Mitigation of the Agricultural Crisis

As long as such regulation continues, maintaining prices and preventing catastrophic falls, it exercises a favourable influence on the income of the producers, although it may well prevent an adaptation which is necessary in the long run. Following the recent increases in prices of unregulated commodities, such as butter and wheat — the influence of the international wheat regulation of 1933 has been negligible — the position of the farmers in most countries is far better than two or three years ago. To judge by the income of the farmers, the agricultural crisis has been considerably mitigated, although sugar and coffee producers are still grappling with considerable difficulties. The improvement in the position of the farmers is due not only to better prices but also to lower interest rates, State assistance for the conversion of debts and other measures of this kind. Thus, if we confine our survey to the present and to the immediate future, it may be said that the world agricultural crisis has almost ceased.

The Future Outlook

But, as already indicated, the outlook a few years hence is unfortunately much less promising, unless steps are taken with a view to the rational re-organization of international economic relations in this field. The root of the trouble still lies — probably — in the wheat situation. For this commodity, the capacity of production is much too large. The reduction of the area under wheat in the United States is largely due to government subsidies. Under normal weather conditions, and without subsidies for limitation of output in the United States, a price exceeding one dollar per bushel would certainly lead to a large increase of production. In view of the fact that the growth of population in the wheat-consuming countries is slowing down, while the per capita consumption is falling, such increased production would almost certainly result in a rapid fall in prices. Thus, the fact that farmers in the exporting countries could command prices affording reasonable returns — judged by accustomed standards — would in itself lead to excessive supplies and thereby to a fall in prices. In the absence of output regulations, a similar situation would arise as regards coffee and sugar.

Over-capacity is the greatest difficulty. A second and serious problem is constituted by the fact that the manufacturing nations have adapted their agriculture to an abundant output of *cereals* at very high costs. It is difficult for them to adjust their agriculture even to a price which is extremely satisfactory for the exporting nations. Thus they cannot do without permanent protection. We know by experience how great is the temptation — in this situation — to apply not moderate protection, but such rigorous import restrictions and to induce such high prices that the entire domestic consumption can be assured by home production. The basis for an international division of labour — the exchange of exported manufactures for imported foodstuffs — is thus destroyed.

Autarchical Tendencies as regards Food Supplies

A third obstacle to a fundamental readjustment is the desire of the formerly importing nations not to depend upon other countries for their supplies of animal foodstuffs. This tendency has led

many of them to maintain such high prices as to keep the consumption of animal foods at a much lower level than necessary. This creates the impression that there is no market for larger supplies and that an adjustment of agricultural conditions involving decreased production of cereals and increased output of fodder and animal foodstuffs would not be feasible. It is not generally recognized that lower animal food prices would probably result in such an increased demand for such commodities, that a considerable shift in production, whereby the output of cereals is reduced, could be effected without diminishing employment in the farming industry. But such a shift and the sale of animal foods at reduced prices, can only be effected with profit if bread cereals and fodder, home and foreign grown, are sold in these countries at cheaper prices than is at present the case under the influence of import regulations. While such a change of agricultural policy would not necessarily reduce the income from animal husbandry, it would — at least temporarily — lower the revenue of the larger farms for which the sale of bread cereals and fodder is an important item. It is therefore but natural that large and medium farmers should defend their vested interests, whereas the smaller farmers fail to realize that high cereals and fodder prices are not to their advantage and use little or no political pressure to bring about a change. Besides, the political influence of the export manufacturing industries is weak in most countries. The political conditions for a change of policy are therefore lacking, at all events as long as such re-orientation is left to the individual initiative of the different countries and is not agreed upon internationally.

A fourth and unfortunate aspect of this present situation is that the maintenance of excessive food prices constitutes an obstacle to an improvement in nutrition conditions. In particular, the prices of health-giving, so-called protective foods are maintained at too high a level for a large section of the poorer classes of the population.

Conditions of Solution

The author of this report ventures to express the opinion that a *durable* solution of these problems will depend upon an adjustment of agricultural conditions in the following direction.

I. — *A Relative Decline of the Agricultural Population.* —

There must be a relative decline of the agricultural population in particular in industrialized countries. Total world population is growing less rapidly, while technical progress appears to be increasing in agriculture at a faster rate than before. Thus the percentage share of the total national resources utilized for food production will probably tend to decrease more rapidly than during the past decades. Some decrease is in any case inevitable.

This is not a matter for regret — on the contrary. A rising standard of living — which is never confined exclusively to an improved diet — involves the utilization of a smaller percentage of productive resources for nutritive purposes, thus setting free an increasing percentage for the production of goods and services designed to meet other requirements. Ever since the war, engineers, chemists and biologists have united in successful efforts to improve agricultural technique. The results of this labour are only just beginning to be evident. It therefore follows that technical progress on the farms, e.g. in the production of animal foods is more rapid than formerly. The pace of this development is so high that, in many countries, not only a *relative decline* but a reduction of the total farming population is virtually inevitable.

To illustrate the technical improvements, it can be mentioned that in nine European exporting countries the production of butter rose by 75 % from 1923 to 1934. In the United States, the number of dairy cows has increased by 50 % since pre-war times. The yield per cow has increased by 40 % in the United States, Australia and New Zealand. Such figures make it seem probable that with a constant number of farmers the supply of animal food would keep pace with increased consumption. But it is clear that this also depends upon the development of the purchasing capacity of the consumers and the level of the retail food prices.

A policy envisaging reduction of the farming population has frequently been criticized as contrary to the interests of the farmers. The very opposite is the truth. In the long run, the only safe way to high and rising farm income lies not in soaring prices but in expanding output per farmer. The farmer will then command an increasing income, while offering his products to the consumer at a price which the latter is able to pay. Efforts to maintain excessive food prices and to increase the farming population will — at all events in many countries — result in so large an output that they will defeat their own ends and give rise to all

sorts of difficulties, while preventing an expansion of manufacturing industries which might otherwise have taken place.

II. — *A Higher Standard of Consumption.* — Another prerequisite of a rational policy for emerging from the present dilemma is that it should aim at an *increased standard of consumption*. This standard, of course, depends in a large measure upon the income obtained from other occupations. There is ample ground for the belief that a higher general income level would result in an increased demand for certain kinds of food, in particular, the more expensive foodstuffs, the production of which, as already stated, requires much land and a large amount of agricultural labour. Family budget material — corroborated by national consumption figures — shews that countries with a high standard of living consume smaller amounts of cereals, potatoes and margarine, but larger quantities of meat, dairy produce, sugar, fruits and vegetables. Within each individual country, the high income sections of the population consume more of these latter foodstuffs than do the lower income sections. The low consumption figures for the poorer group reveal the urgency of higher standards of nutrition. There is not only malnourishment, but much undernourishment in all countries (See *Workers' Nutrition and Social Policy*, Int. Labour Office, Geneva, 1936). The number of calories per day obtained as an average for poorer countries and in the low income sections of almost all countries is insufficient. In Poland, the figures for the different sections — reckoned per unit of consumption — vary from 2,200 to 3,140 and in Sweden from 3,120 to 3,480. But the Swedish budget material, like that of most of the other countries, comprises, generally speaking, workers with a relatively high standard of living, and, therefore, gives too favourable a picture of the actual conditions. Even in a rich country like the United States, the calories for the lowest income sections only amount to 2,130. « In general... it may be concluded that the consumption of calories continues to increase, even in industrially advanced countries, as the workers become better off economically. This again indicates that there is a considerable potential demand for food, which would materialize in effective demand, if the necessary purchasing power were put at the command of the groups concerned. In the lowest income groups it even appears that the number of calories is inadequate to satisfy the bare physiological requirement. »

(*Workers' Nutrition and Social Policy*, p. 69.) It is also estimated that the increase in the cultivated area necessary to secure for the great majority of the population of the United States the diet which is actually enjoyed by a skilled worker would be about 25 % of the present area.

Sir John Orr estimates the cost of raising the diet of the British population to a satisfactory standard at no less than two hundred million pounds per annum. Simply to avoid serious nutrition difficulties, an addition of half this sum to the food budget of the nation would be required.

The raising of the real income standard of the population — which might increase the demand for food — is a slow process unless food prices are reduced. Yet it has been shewn above that such an increase may play a considerable part in the solution of the agricultural problem. The rapid development of manufacturing industries and trade and rising incomes in all occupations are of the greatest advantage to the agriculturist. It follows that a certain specialization and division of labour between food-exporting and manufacturing countries, resulting in increased efficiency of human effort and increased national income, must in the long run lead to an increased demand for the more valuable foodstuffs and a healthier state of world agriculture. Such indirect but important connections between the different aspects of the economic problem have often been ignored when the agricultural crisis has been studied from the point of view of agriculture alone.

Cheaper Food. — An improvement in standards of consumption would be brought about much more rapidly if food prices were reduced. In particular, the demand for the more expensive foodstuffs appears to be extremely elastic. It follows that a reduction of prices would not necessarily result in a reduction of the income of the farmer. The proportionate expansion of his output might more than compensate the reduction in prices. A man who rears 60 pigs a year instead of 50 can manage with a smaller margin between the cost of the fodder and the sales value of the pig.

Note that, if a rise in the average price level of all goods takes place in the future, it is not necessary to reduce food prices in their relation to farm debts. A relative cheapening of food may come about through a smaller rise than in other prices. A reduction of taxes on food would also largely contribute to a cheapening of

the food supply. If, for financial reasons, indirect taxes or duties are required, they can be levied on other commodities. — The cost of distribution is also an important factor. Improved distributive machinery, reducing the margin of retail and wholesale costs, helps to stimulate the consumption of food. The same applies to systems for supplying food at particularly low prices to certain classes of consumers, e.g. cheap milk for school children.

It is unnecessary to emphasize that a fall in prices, when offset by lower costs of production, does not entail a reduction of the farming income. But if such reduction of costs is due to the utilization of labour saving devices, the need for a transfer of labour from agriculture to other occupations is increased and not reduced. It is estimated that the technical improvements in the agricultural industry of the United States would have involved the displacement of two and a half million workers during the period 1919-1927, if the volume of production had remained the same. Measures for reducing costs of production, on the other hand, which do not simultaneously entail a reduction in the demand for labour, contribute directly to the establishment of a better balance between agriculture (which at present disposes of excessive labour power) and other industries ; for if the lower costs are followed by lower prices, sales will increase.

III. — *Reduction of the Area under Wheat.* — A third factor in the adjustment of agricultural conditions would be a *reduction of the area under bread cereals* compensated by increased fodder-growing and, in certain countries, by a larger output of animal foodstuffs, finer vegetables and fruits. It would be absurd to reduce the area under wheat in the low-cost regions, where adjustments of production are more difficult than in the mixed farming industry of the manufacturing countries. But a transformation of conditions in the latter countries presupposes re-orientation of their agricultural policy, as already pointed out above. From an economic point of view, the natural aim would be — not to produce *all* food at home — but to give full employment and reasonable and rising incomes to the groups of the population — probably declining in number — which are engaged in the farming industry. Production of milk, vegetables and eggs would accordingly be expanded. These are the natural products of mixed European farming and relatively difficult to transport over long distances. On the other hand, it would be possible to cut down

the production of cereals, sugar and fodder, and also of fruit in certain countries. The importation of wheat, maize, meat and butter would be increased. This would result in an expansion of the markets for manufactured goods in the countries exporting the said foodstuffs. Not only would their purchasing power be increased, but, in exchange for large food sales, they would be willing to reduce duties on manufactured articles.

It is clear beyond doubt that such a policy would permit of an increase in the national income of the European manufacturing nations. A temporary fall in the income-level of their farming population — or of certain sections of this population — could be avoided by direct subsidies or other measures, so organized that they would not interfere with the requisite adjustment of industry and trade. The ideal would, of course, be to do away with all subsidizing of producers, but if subsidies there must be, such direct measures are infinitely preferable to the maintenance of high prices by excessive protection which keep consumption down and disorganize markets by making it necessary to accord export bounties for the dumping of surplus output abroad.

IV. — *Industrial Expansion is essential.* — As a fourth point, it may be suggested that measures to increase wheat consumption in China and in tropical countries might also prove helpful. Even without special measures, the growth of the population in these regions and the industrialization of the East may serve as a stimulus to the consumption of wheat. This being the case, it would be contrary to the interests of agriculture to place obstacles in the way of such industrialization.

In considering the conditions under which it may be possible to proceed with the necessary adjustment along the lines indicated one impression outweighs all others. Such adjustment can only take place during a period of rapid expansion in the manufacturing industries, transportation and trade. Otherwise, it would hardly be possible to transfer farm workers to industrial or commercial occupation. Furthermore, there is little hope of a re-orientation of agricultural policy in a less protectionist direction until a period of relatively full employment has been inaugurated. It is, however, possible that in the presence of a prolonged scarcity of industrial labour, the Governments of manufacturing countries will be less averse to considering a policy which might reduce the volume of agricultural employment to a certain extent,

the more so as such a policy is, for many countries, the sole means of raising the standard of living of the farming population, while at the same time making foodstuffs available for the whole population at prices which permit of the desirable standard of nutrition.

The above argument proves that agricultural policy and development are closely interlinked with economic policy in general. In the long run, the principal factor in the solution of the agricultural crisis would be a monetary, financial and commercial policy creating the necessary conditions for a rapid expansion of the manufacturing industries and trade. It is by no means improbable that a gradual rise in the general commodity price level during the next decade would provide a favourable basis for such expansion. Moreover, a rise in prices, e.g. to the neighbourhood of the pre-depression level, would result in an alleviation of the debt burden on agriculture. This would almost certainly weaken the resistance to an agricultural policy aimed at a rapid increase in the volume of food consumption. It is proved by history that protection increases during a period of falling prices, while rising prices, as in the 'sixties, invariably constitute an inducement to freer trade.

Military Considerations

It is hardly necessary to emphasize that considerations of national defence play a large part in the unwillingness of States to envisage a policy of increased imports of foodstuffs. An impartial analysis of the problem of food supplies during the war shows, however, that for most of the countries in question, self-sufficiency, i.e. the elimination of all importation, is not attainable. The mobilization of large armies involves a drain on man power and labour that must invariably result in a decline of production. Secondly, the supply of phosphates and other fertilizers is in most cases insufficient. Stocks of wheat and phosphates may in war-time result in a greater supply of food at a relatively low cost than that achieved by wasteful attempts to maintain production in times of peace permanently at a level covering the whole domestic consumption. Concentration on the production of animal foods rather than vegetable foods in manufacturing countries also brings the advantage that intensive animal husbandry requires a soil in relatively fertile condition, which, therefore, retains a part

of its productive capacity during the war, even if fertilizers are unobtainable in sufficient quantities. It should be added that large herds, in themselves, constitute a valuable food reserve. Conditions naturally differ in the various countries. But it would seem probable that, even from the point of view of national defence, a policy of international division of labour would prove more effective than a food policy aimed at complete self-sufficiency.

CHAPTER VII

Raw Materials, Markets, Overpopulation and Colonies

THE TWO PROBLEMS

In the course of the more recent discussions on international economic questions, two of the problems which have commanded the most attention concern the supply of raw materials and the dangers of overpopulation. It is a widespread belief that the stabilization of world economic relations depends in a large measure upon the removal of the existing difficulties in these respects. Whether or not this view is justified, the mere fact that it is widely sustained makes it necessary to devote some consideration to these problems in any analysis of eventual methods of international economic reconstruction. For, as regards international economic relations, *public opinion* exercises a powerful influence on individual and Government action, both in the economic and political domain, and must therefore be considered as an independent and important factor.

More often than not, the solution of both these problems — raw material supplies and overpopulation — is considered to lie in the acquisition of colonies by countries which are but poorly endowed in this respect. We propose to examine, in the following pages, the possibilities of a solution on these lines as well as those offered by other methods. It would be outside the range of this report to dwell upon the purely political and psychological aspects of the colonial problems, e. g. the desire for power and prestige, considerations of equity, etc. But it is certain that a clear and veritable comprehension by all nations of the *economic* aspects of the problem would in all probability do much to allay the existing dissatisfaction and misunderstandings in this respect, and thus also contribute to the settlement of political conflicts.

A. — RAW MATERIALS, MARKETS AND COLONIES

Let us consider first the question of the supply of raw materials in times of peace, and the difficulties with which countries which do not possess colonies have to grapple. The term « colonies » is used here and below in the wider sense of « non-self-governing » areas.

High Raw Material Prices

It is sometimes stated that the prices paid by such countries for imported raw materials are too high. As a matter of fact, however, the prices of these materials have, since the war, been very low in proportion to reasonable costs of production. And they have been available on the world markets to anyone willing and able to pay the price. The success of restrictive price-raising schemes has not been such as to bring about an excessive increase in the average profits of primary industries — in the colonies or elsewhere. Nor have discriminatory export duties or other practices, resulting in a cheaper sale of colonial raw materials to the mother-country than to other states, had any considerable influence on world economic conditions. It is safe to say that all experts are agreed on this point.

But the past is one thing. The future is another. There is undoubtedly the *risk* that states controlling the supply of certain raw materials may resort to methods of discrimination. Goods might be reserved for the sole purposes of the domestic industry or sold to foreigners only at high prices. France in particular makes a growing use of preferential export duties in her colonies. Moreover, it is by no means impossible that an unreasonable increase of prices may be brought about by international schemes of restriction, often semi-official in character.

A Non-discrimination Agreement

The view that there is a risk of such policy being pursued over a long-term period and having a lasting character is, however, not supported by experience. But the tendency in many quarters to exaggerate the extent of such risks and the

development of discriminatory practices invests them with a certain importance, since they are calculated to call forth resentment and, eventually, conflicts between the nations. It is therefore possible that some measure of appeasement might be sought in an international convention, signed by all colonial powers, to the effect that they undertake not to discriminate in the marketing of raw materials. It is true that endeavours to reach multilateral agreement on questions of tariff policy have so far met with little or no success — a fact which may breed scepticism in regard to the feasibility of international economic conventions in general. Still, it is worth while pointing out that, in other fields, the results have been more promising. For instance, it has been possible to conclude multilateral conventions on the subject of waterways, postal traffic, etc., which have worked in satisfactory manner. It is by no means out of the question that a multilateral agreement on raw materials should be concluded and applied with far greater facility than one on tariffs. Secondly, a registration of all international restriction schemes and cartels, e. g. at the League of Nations, and a continuous analysis of their effects by the League's economic section might do something to discourage unreasonable price policies, which would be condemned by public opinion.

*Most Raw Materials are produced in Non-colonial Areas :
a Political Transfer of Colonies would not provide a Solution*

An alternative solution, which has often been suggested, would consist in the transfer of colonial territories from certain States to others. It is, however, evident that the problem cannot be solved by political redistribution of the territories in question. Within its own colonies, each country would produce only certain raw materials, and would continue to be exposed to all risks of discrimination. Even in the hypothetical and extreme case of the pooling of all colonies, the supply of raw materials therefrom would remain incomplete. As regards lead ore, coal, asbestos, potash, jute, flax, linseed, manila hemp, and other commodities, less than one per cent is produced in the colonies. As a matter of fact, the majority of raw materials are produced mainly in non-colonial areas. The only important exceptions are rubber and tin.

At the present moment, no country draws from its own colonies sufficient or anything like sufficient raw materials to make it self-supporting in this respect. The Dutch colonies furnish no cotton, jute, copper, nickel, lead, zinc, chrome ore, sulphur, potash or pyrites. Even the British Crown colonies — to which, of course, the Dominions and India do not belong — are far from providing sufficient raw materials to make Great Britain independent of other supplies. For lead, zinc, nickel, tungsten, chromium, magnesite, oil, asbestos, potash, cotton, silk, flax, hamp, timber and other commodities, Great Britain depends largely or exclusively on importation. These facts make it impossible to escape the conclusion that no redistribution of colonies would go far towards providing all or any countries with a secure supply of raw materials at reasonable prices and without discrimination.

Importance of Colonial Markets

What is, however, clear is that an increase of colonial territory may present economic advantages of a different character. When raw materials or other goods are bought from abroad, they have to be paid for, directly or indirectly, in foreign exchange. Purchases from one's own colonies, on the other hand, can be paid for by the mother-country in national currency. This, it is often maintained, is the chief advantage of colonies, at all events for countries which have difficulties in obtaining sufficient foreign exchange in return for their exports to other countries. In view of the prominence given to this argument in many influential and competent quarters, it is necessary to analyse it in more detail.

In the first place, however, it should be observed that, in the case of the colonies which have come under consideration in the recent discussions concerning political transfer, the amounts in question are small. The total exports from all the German colonies before the war was less than 1 % of the total German imports of raw materials.

The Real Source of Gain

The chief point to be borne in mind is that imports from colonial territories have to be paid for by the mother-country

just as well as goods bought from other countries. The payment consists as a rule, of manufactured goods sold to the colony in the first case, to foreign countries in the second. An exchange of goods takes place, and domestic currency or bills are but the medium of such exchange. Thus, the fact that it seems easier to pay for raw materials imported from colonial territories may be explained by the circumstance that it is easier to sell manufactured goods to these colonies than to foreign countries. Here and here alone lies the advantage! The whole argument under consideration does not so much concern the actual supply of raw materials as the gain from a secure preferential market in colonial territory. If a country were to succeed, by other methods, in obtaining corresponding sales of manufactured goods, the foreign exchange received in return for such sales would enable that country to purchase the requisite raw materials with equal facility (see below).

Under present conditions, the advantages of a preferential market may be considerable. The preferential treatment in the colonies of goods from the mother-country is a factor which has increased in importance since the war. On the other hand, we must not lose sight of the fact that a great many colonies — as already observed — import so little, that even definite discrimination in favour of the mother-country is a source of relatively small profits.

Preferential Policy of Today

France, Great Britain and the Netherlands have colonial empires of such magnitude and wealth, that for these countries preferential policy is a factor of considerable importance. This is particularly true in the case of France, a consistent adherent of this policy in so far as her international obligations do not debar her from pursuing it. In 1933, about 32 % of all French exports went to the French colonies, protectorates and mandated territories. No less than 79 % of the total imports into Algeria came from France. Morocco, notwithstanding a treaty which precludes preferential tariff treatment bought almost one half of its foreign goods from France. Compared with these figures, the preference accorded to British goods in British colonies, mandates, and protectorates is less important, but, still, by no means negligible. In 1931 — the last year of non-preference —, 26 % of

the total imports into the colonies came from Great Britain. The increase of that figure in the last years has been moderate. Italy, on the other hand, has taken the same line as France. In 1932, almost three quarters of the total imports into Tripoli consisted of Italian goods.

Obviously, the political control of rich colonial territories is a source of considerable advantages. On the other hand, the former German colonies and the present Italian colonies are poor, and their markets of little importance. Furthermore, for any country acquiring *new* control over colonies, advantages in the form of a saving of foreign exchange are unlikely to be considerable for at least the first ten or more years. In the case of a colony with a certain degree of economic development, foreign firms are certainly already established in the territory. The new «mother-country» will be faced with the necessity of drawing upon its foreign exchange reserve in order to buy out these firms, for if they remain under foreign control, they will tend to uphold the trade between the colony and their respective country. On the other hand, an undeveloped territory can neither buy nor sell large quantities of commodities. It requires capital, equipment and technicians. It is by no means certain that the whole of its equipment can be imported from the mother-country; one of the results of the acquisition of a new colony may well consist in an increase rather than a fall of imports by the mother-country from other countries.

But even rich colonial territories are not invariably a source of unmitigated advantages for the mother-country. Colonial defence is an important factor in the military budget. More ships are required in order to protect the transport routes. Were it not for special interests of this kind, it would doubtless have proved easier to reach an agreement on the reduction of naval armaments, a consummation which would admittedly have been welcomed by all the states concerned.

Conclusions

The main conclusion to be drawn from the above is that any redistribution of colonies — within the bounds of what is actually possible or compatible with an «equitable» arrangement — would result in but small net advantages to the countries acquiring

them; for it is hardly probable that any scheme of transfer would give to *each* of the manufacturing nations which have little or no colonies a considerable part of the wealthier territories of the British, French and Dutch colonial empires.

Secondly, even if *all* colonies were in some way distributed among all manufacturing nations, the benefit accruing to each country from preferential treatment in its own colonies would be so minute, that it would not constitute a material aid to its economic development. Taken together, the colonial markets are too small, less than 10 % of the total world export markets.

Thirdly, no redistribution of colonies would succeed in establishing equality as between the great and small manufacturing nations, which in their own opinion require colonies.

An Alternative Solution

A solution must therefore be sought on other lines, if colonial markets are to prove a material aid in the economic growth of all manufacturing nations. The obvious alternative to discrimination in favour of this or that state is the «Open Door» or equality of treatment. Provided no discrimination as to sales or purchases exists in virtue of legislation, tariff policy or other official action, the colonial markets would be open to all on equal terms. An international «Open Door» agreement in all colonies, protectorates and mandated territories, subject to adequate international supervision, would afford countries which are at present poor or altogether lacking in colonial territories much greater advantages than any feasible political transfer of colonies could do. Even before the war, similar agreements existed in certain cases, e. g. the 1906 Morocco Agreement. The powers holding a mandate under the League of Nations for the administration of certain colonial territories have in most cases undertaken to pursue an «Open Door» policy, and to make the welfare of the native population the principal aim of their mandate. They are responsible to the League for the administration of these territories and present an annual report to the League Council. It would not seem to be beyond the bounds of possibility to develop and extend this method with a view to securing — more effectively than at present — true and complete equality of treatment, not only as regards trade, but also in regard to the granting of concessions.

In that way an outlet would be provided for commercial and industrial enterprise from the « have-not » countries. It is self-evident that the population of such colonies would then be able to purchase foreign goods on cheaper terms than at present. Consideration of their interests militate in favour of an « Open Door » policy. The fact that it would prevent the colonies from joining any regional or other multilateral tariff union seems to be of relatively little importance.

*Where lies the interest of the « have-nots »
(states poor or altogether lacking in colonial territories) ?*

It is also certain that countries like Japan, Italy and Germany — which at present belong to the dissatisfied group of « have-not » powers — would derive considerable benefits from such a policy. Pre-war experience is illuminating. The Open Door policy pursued during that period in certain British and other colonies resulted in a rapid growth of the German trade with these regions, as seen from the following figures :

German Exports to African Colonies (in mill. Marks)

	1900	1910	1910 (in of % 1900)
German colonies . . .	16.8	43.8	261
British colonies . . .	21.4	72.1	337
French colonies . . .	2.4	4.8	200
Portuguese colonies . .	4.9	13.8	274
Belgian Congo . . .	1.2	1.2	100

Notwithstanding the fact that the *total* trade of the young German colonies increased more rapidly than that of the British colonies, the relative growth of the German export trade was greater with the latter. This would seem to show that, subject to the honest and consistent pursuance of an Open Door policy, political control exercises relatively little influence on trade.

Post-war developments in mandated territories and colonies pursuing this policy support this conclusion, although it must be confessed that secret discrimination plays a more important part than formerly. In 1934, 42 1/2 % of the overseas imports into the British Cameroons (a former German colony) came from Ger-

many, and 80 % of the Cameroon exports went to Germany. It is a wellknown fact that Japanese trade is developing rapidly with the British mandated territories and the Dutch colonies. The Japanese trade with Java is greater than that of the Netherlands.

Interests of the Colonial Powers

There can be not doubt therefore than an Open Door policy in all colonies, whether the question is considered from the standpoint of the native population or from that of countries with few or no colonies, would be preferable to a political transfer of certain colonies. On the other hand, the great colonial powers would have to renounce certain advantages which are at present derived from discrimination in favour of their exports. Against this must be set the economic advantages — not to speak of political benefits — that would be secured by the removal of the causes of political conflicts inherent in the existing situation. It is dangerous indeed in a rapidly changing world to base policy on static conceptions and to refuse to accept peaceful alterations. Again, from the point of view of world business as a whole, the division of labour between colonial areas, on the one hand, and the older manufacturing countries, on the other, would become more natural and effective. With the system at present in force, it is quite impossible to obtain rational division of labour between the different mother countries and the colonies. A share of the advantages derived from such division of labour would accrue to the countries which at present control the largest and the wealthiest of the colonial territories, and would give them a certain compensation for their sacrifice in accepting Open Door. For instance, an increase in the Japanese export trade with certain colonies would make Japan a better market for British, French and Dutch goods.

Access to the World Market All-important

The above argument carries two corollaries : first that a political transfer of a few colonies to certain countries would exercise but little influence on the supply of raw materials in the latter ; secondly, that an Open Door policy would result in greater

advantages, more security and fewer risks of political conflicts. But there is a third conclusion which even those will be bound to accept who are unable to agree with the second, or consider that there is hardly any chance of its being realized, and who therefore continue to regard the political transfer of some colonies as a more practical proposition. The supply of raw materials in manufacturing nations depends on the possibilities for the sale of their products on the different world markets. Markets in the self-governing states are from the point of view of export industries more than ten times as important as access to the colonial markets. The recent difficulties encountered by certain countries in securing sufficient foreign exchange to pay for raw materials depend largely on the fact that part of the currency received in payment of their exports to certain other countries cannot be used to pay for commodities from any country from which they may desire to buy, but has to be spent in the countries to which they have exported their products. Bilateral tendencies, such as clearing agreements and other forms of barter, are an important source of trouble. It is to the definite interest of countries deriving negligible quantities of raw materials from their own territories to combat these bilateral tendencies, a fact which has not invariably been borne in mind. The greatest step forward that could be taken to remove all risks of scarcity of raw materials in certain countries — which are poor in foreign exchange — would be to free world trade from the fetters of bilateralism!

Importance of Freer Trade and Balanced Currency Conditions

It is needless to emphasize that both these and other countries would also secure considerable advantages — and be more certain of being able to pay for the requisite imports — if international trade could be re-organized on lines of reasonable freedom and discrimination reduced. As already observed in Chapter V, a tendency in this direction may well arise, provided world prices continue to rise and monetary questions are adjusted. Countries poor in raw materials and with a weak international liquidity could do much to assist the development of such tendencies. But it cannot be stressed too much, that a beginning must be made by the financially strong countries.

It should, however, be borne in mind that ability to export,

and thus, to pay for raw materials and other foreign commodities, depends upon costs of production, or rather on the prices at which export goods are offered on the world markets. Countries which maintain the external value of their currency at a level which is incompatible with the relation between the cost levels in their own territories and abroad, should not complain if the high prices at which their goods are offered makes it impossible to sell sufficient quantities. Most of the foreign restrictions placed upon exports from these countries also hit goods from other countries, which nevertheless, owing to lower price levels, are able to find a readier sale abroad. Thus, the difficulties are not caused exclusively by the foreign commercial policy. A monetary adjustment with a view to the reconstruction of the export capacity of countries with «over-valued» currencies is one of the means of increasing their ability to buy foreign raw materials. Scandinavia and Czechoslovakia find no difficulty in paying for their raw materials. There is no reason why other countries with few or no colonies should not achieve a similar position.

Colonies and the Standard of Living

From whatever angle the problem be envisaged, it is clear that supplies of raw materials and economic growth in the individual countries have very little to do with the political control of colonial areas. It is indeed a striking fact that there is no correlation between the standard of living of the different nations and their command of colonial areas. In Scandinavia, the standard is at least as high as in Great Britain and the Netherlands, and higher than in France, not to speak of Portugal with its vast colonial possessions.

Raw Materials in War-time

In the foregoing pages we have considered the problem of raw materials in time of peace; in respect of war conditions, there is not much, however, to be added. No redistribution of colonies could confer upon manufacturing nations anything like self-sufficiency as regards the supply of raw materials. The control of the transport routes is of greater importance than the poli-

tical command of certain colonies. States which possess the mastery of the seas can obtain raw materials from other sources, and do not need colonies. If a state is cut off from overseas trade, it obtains little or no assistance from its colonies. Thus, for most countries, stocks of raw materials are a more important factor in war-time than the possession of colonies.

Only when, in international conflicts, non-belligerent countries apply sanctions by refusing to sell to a certain state but without interfering with the latter's own trade, does it offer considerable advantages for this state to have colonies of its own, from which raw materials can be obtained.

B. — OVERPOPULATION, EMPLOYMENT AND TERRITORIAL EXPANSION

Closely related to the questions above are the economic problems raised by the rapid increase of the population in many countries. In the following pages, we propose to undertake a brief survey of certain facts and tendencies in this connection.

It is unnecessary to enter into a detailed analysis of the present movements of population, the principal aspects of which are more or less a matter of common knowledge. (For detailed information, see Carr-Saunders's forthcoming work : *World Population*.) We shall confine ourselves to a few observations.

Density of Population and « Over-population »

In the first place, it should be pointed out that great density of population is by no means « over-population ». The latter term is used in current literature with very different meanings. As it is obviously impossible, in a brief analysis of the prevailing ideas on the subject, to avoid the use of the term altogether, we propose to employ it in this report in the following sense : Over-population is beginning in a country when any further increase of population, proceeding at the actual rate of increase in that country, would inevitably lead to a *considerable* reduction in the standard of living. Overpopulation exists where this has already happened. It should be noted that this somewhat loose concept is *not* related to the concept « optimum of population ».

Secondly, the speed of technical progress is highly relevant whereas density of population is not. Many densely populated countries have demonstrated the possibility — during a period of technical progress — of further increasing their population, while at the same time raising the standard of the living of their citizens. It would therefore be wrong to say that Belgium, with about 700 inhabitants to the square mile, and the Netherlands, with about 625, are « over-populated », whereas Japan, Germany and Italy — with the respective figures of 435, 370 and 360 — are not. Quality of soil, climate and wealth of mineral resources are, of course, important factors in this connection. The fundamental reason, however, why figures based on area and resources per million inhabitants are apt to be misleading is that the industry of any country can utilize foreign raw materials and specialize in occupations such as manufacturing, which require but little space. Good transport relations with foreign sources of raw materials and the principal foreign markets have made, for instance, certain parts of Holland manufacturing centres in which the standard of living is extremely high. The greater the technical progress and the greater the decline in the importance of the primary industries from the point of view of employment, the less does it matter whether conditions for primary industries — i. e. production of raw materials and vegetable foods — within the individual countries are favourable or not. The standard of living and the wealth of a country are in direct relation to its ability to organize on an efficient basis the secondary industries and transportation.

Growth of Population

It does not, however, follow that countries with a *rapidly* growing population will not experience difficulties in providing sufficient employment without a lowering of the standard of life. In Russia, the annual growth of the population is about 3 millions. This can hardly fail to create a serious situation in a country which is primarily agricultural. An extremely rapid accumulation of capital will be necessary to ensure a development of the Russian manufacturing industries which will prevent the overcrowding of agriculture with its inevitable corollary, lower standard of living notwithstanding technical progress. Even

the enormous industrial development of the past ten years — based on the «forced saving» of a large part of the national income — has only provided employment for a small proportion of the annual increase in population.

In countries like Japan and Italy, the situation is somewhat different. In these countries, further expansion of primary industries, i. e. output of raw materials and vegetable foodstuffs, would seem to be difficult. The annual net increase of the Japanese population is about one million, that of the Italian population, 400,000. In these cases, it is still more evident that the solution of the employment problem is absolutely dependent upon the rapid progress of the manufacturing industries.

Emigration

However, it is clear that emigration might alleviate the pressure from a rapidly increasing population. For there would appear to be no reason to assume that emigration would merely increase the prolific tendencies of the home country and thus provide only a temporary relief from the strain. But, as is well known the severity of the immigration restrictions applied by practically all countries since the war has resulted in a far-reaching decline of international migration. The only recent exceptions in recent years have been the influx of the Chinese into Manchukuo and the return home of Poles, Italians and Spaniards from France and certain American States. The latter movement has aggravated the difficulties, more particularly in Spain, where the repatriation of half a million nationals, most of them unwilling to work on the land, has resulted in wide unemployment and considerable social unrest in the cities.

In view of the present attitude of the potential immigration countries, there is hardly any hope of a sufficient freedom of international migration, during the next ten years or more, to influence to any considerable extent the economic position of the more prolific nations. Even a prolonged «boom», resulting in in scarcity of labour in the immigration countries, would probably conduce rather to the lowering of trade barriers than to the removal of obstacles to immigration, except perhaps in Australia and one or two other countries.

Net reproduction rate

It is therefore necessary to seek a solution of the employment problem on different lines. Before entering into the details of this question, it should be observed that, if regarded from the standpoint of a more extended future period rather than from that of a period limited to a few years, the figures concerning the present growth of the population are apt to be misleading. Differences between birth- and deathrates furnish no estimates for the procreative force of a population. In many countries the deathrate is relatively low and the birthrate relatively high, only because of a peculiar and temporary age composition of the population. Hence, even if the birthrate remains constant, the coming relative decline of the size of the fertile age groups will reduce the number of births, whereas deaths will increase. Hence the surplus will decline or disappear. Furthermore, it would seem to be a fact that birthrate is declining in almost all countries. There is nothing to indicate that the enormous decline in the birthrate which has taken place in most European countries since the war — except in certain eastern and southeastern countries — is passing phenomenon. The efforts made by certain states to check the decline and raise the birthrate were to some extent successful during a few years, after which the decline was resumed. The German efforts in this direction since 1933 are too recent to permit of any conclusions bearing upon the birthrate over a longer period.

For the formation of an opinion as to the long run tendencies of population growth, the best index is the *net reproduction rate*. Roughly speaking, this index shews how many daughters 100 newly born female children are likely to have, if the present mortality and fertility rates remain constant for each age group. Obviously, if the net reproduction rate is below 100, each new generation — according to the assumptions made — will be smaller than the preceding one. This will be the case even if, e.g. an increase in the high age groups temporarily raises the total population figure. Unfortunately, statistics of net reproduction rates are not available for all countries. In 1933, the figures were 82 for France, 74 for the United Kingdom and about 70 for Germany. In these countries, therefore, the fertility was much below the level required for the maintenance of a stable population in the long run. For these countries, the problem of « over-

population » does not exist. Instead has come the question of the economic effects of a decline in population.

The « over-population » problem in Germany, Italy and Japan

It is true that the German birthrate, under the influence of improved business conditions and various official measures, rose by a little more than one fifth from 1933 to 1934. But this does not mean that a corresponding increase of the net reproduction rate has taken place, an unusual number of the children being the first-born of new marriages. A concentration of marriages in certain years naturally results in a number of such births, but this does not signify a corresponding increase in fertility. It is therefore certain that the German net reproduction rate is still far below 90, probably under 80. Pending a change in this respect, the « overpopulation » problem is not likely to arise during the next two decades in Germany, any more than in France, Great Britain or Scandinavia. What is probable, on the contrary, is that during a certain number of years, the population will remain at about its present level and thereafter decline.

In Italy, on the other hand, fertility is far above the level of 100. The net reproduction rate in 1931 was 121. A decline in fertility began immediately after the war, continuing in recent years at a more rapid pace ; it is therefore probable that the 1936 rate is much below that of 1931, but still well above 100. The outlook for Italy is that the population will increase rapidly during the next decades, even though the actual annual increase may be falling. The same holds good for Japan, for which country detailed figures are not available.

It would carry us too far to discuss the implications of such figures in relation to the number of persons of a working age. This number continues to increase for ten or more years after the net reproduction rate has fallen below 100. Certainly, in countries like Italy, Japan, Russia and certain of the Balkan states, it is at present growing so rapidly as to constitute a serious problem from the point of view of employment.

Employment without Territorial Expansion

It is often suggested that the solution of this problem cannot be sought otherwise than in the acquisition of new territories by

countries with a dense and rapidly increasing population. This question was touched upon at the beginning of this chapter, when we suggested that density of population had but little bearing upon the matter in hand. It remains for us to consider the conditions subject to which employment can be provided within the borders of given national frontiers. The economic history of the last hundred years contains many lessons in respect of countries in which such development has taken place without any territorial expansion. It may be worth while to compare what happened in these cases with the development which might take place if countries with a rapidly increasing population were able to acquire new territories. This comparison may enable us to form an opinion as to the actual value of such acquisition of territory.

It is quite clear that the employment of an increasing number of individuals on a area of land with given resources leads to diminishing returns per individual, so long as (1) production is confined to the primary industries — vegetable foods and raw materials — and (2) technical methods remain unchanged. Even with improved technique, there are strict limits to the amount of fresh labour that can be employed without a decline in its reward, i.e., the standard of living.

As already indicated, this does not apply to the secondary industries — e.g. the finishing industry — where land and other natural resources play a minor rôle compared with skill and organizing capacity and conditions of transport. If the supply of capital keeps pace with the increased quantity of labour, the output per head does not decline. On the contrary, it tends to increase with economies of large scale production and industrial concentration. With the development of technical progress, per capita production and the standard of living may even be subject to a rapid increase. This is what took place in all the industrial countries of Europe during the last half century before the war, including those which acquired no colonies.

The natural line of development for a nation whose population has reached a size at which returns in the primary industries tend to fall decisively, is concentration on secondary industries. The output of vegetable agricultural products and of mineral raw materials will then absorb a decreasing proportion of the working population, while manufacturing industries, transportation and various services will employ an increasing proportion.

Terms of exchange

Owing to the continuing advance in technique, this is quite compatible with a rising standard of living. Much depends, however, upon the terms of the exchange between imported primary products and exported secondary products. If the former become more and more expensive in terms of the latter, this will counteract the tendency towards a rising standard of living. But, in the absence of such a change in the terms of trade, an increase in population does not by any means act as a reducing factor as regards the standard of living. This is a fact which is frequently forgotten when the question of « over-population » is discussed. Economies of large-scale production and technical progress exercise their beneficial effects without counteracting tendencies, provided the supply of capital increases *pari passu* with the number of labourers.

As to whether countries with a growing population, e.g. Italy, must necessarily reckon with less and less favourable terms of trade between primary and secondary products, as their supply of the latter increases, nothing can be said with certainty. It is possible that both categories of products may have to be transported over longer distances, a circumstance which would increase the price of raw materials in the Italian ports, but would reduce the f.o.b. value of Italian manufactured goods. Previous experience, however, shows that such changes in terms of trade are not likely to be considerable. The competition between goods from the various industrial countries is so keen and costs of sea transport so low, that terms of trade — judging by the development prior to the depression — are unlikely to change so much to the disadvantage of any large country with manysided production as to constitute a real danger for its standard of living.

Importance of reasonably free trade

Previous experience was, however, accumulated, during a period of relatively free trade. If bilateralism continues to grow and obstacles to international trade continue to increase, countries with a swiftly rising population may not be able to find foreign markets for an increasing output of manufactured goods unless they are prepared to offer such commodities at very low and fall-

ing prices. On the other hand, the greater the freedom of trade, the more the chances for such countries to avoid an unfavourable shift in the terms of trade. Thus, Italy, Japan and other states with rapidly growing population have perhaps a greater interest than others in the removal of the fetters with which international trade is loaded and, more especially, in checking the spread of bilateralism. For these nations an autarchical policy would be even more absurd than for others.

Provided international commercial policy does not remain of too restrictive a character — not much more so than in the 'twenties — growth of the population in Europe and in extra-European industrial countries would not appear to be incompatible with a rising standard of living for all nations. This would, of course, depend upon the non-occurrence of a check to economic progress in the form of political events such as wars and so forth, and also upon the necessary accumulation of capital, as heretofore.

The conclusion, therefore, is that territorial expansion is not necessary. On the other hand, the spreading of part of the population of densely populated countries over certain fertile and rich regions in other countries would naturally contribute to economic efficiency. Just as it would help — once the adjustment had been carried out — if world trade could be re-organized on as free a basis as before the war. Unfortunately, neither of these hypotheses appear to fall within the bounds of practical possibilities in any future worth considering.

Influence of new colonies

Let us now examine the influence which a political transfer of certain colonies to countries, grappling with difficulties of a rising population, would have on their economic development.

It has been explained, earlier in this chapter, that it is illusory to hope that such a transfer will prove the means of providing cheaper supplies of raw materials. What is more probable is that countries having obtained new colonies would prefer more expensive raw materials coming from them to the cheaper materials offered on the world market.

More real are the advantages to be derived from preferential treatment of the goods exported to such colonies. It has, however, been demonstrated that the existing colonies, with a few excep-

tions, are such poor purchasers that their markets are of but small interest for the mother country, even if such colonies — to the detriment of the colonial population — are compelled to discriminate in favour of exports from the latter. The situation was a very different one at the time when India, for instance, had colonial status and bought mainly British goods, to the great advantage of the British industry.

Emigration to colonial districts

It remains to be considered whether emigration to colonies would materially ease the situation resulting from the pressure of the increasing population in certain countries. Analysis of the figures in respect of white settlement in colonial areas furnishes a definite proof that such expectations are but ill-founded. Only 40,000 Europeans and Americans have settled in the British colonies in Asia. The number of white settlers in the British African colonies — not including Rhodesia — is about the same. For Rhodesia, the figures are slightly higher. Figures for the French colonies in Asia are similar. The only colonial areas which have taken a large number of immigrants, are the French colonies in Africa. They are inhabited by no less than 1 1/3 million whites (more than 900,000 in Algeria and 200,000 in Tunisia).

Compared with these figures, the white population in the former German colonies in Africa before the war was insignificant — about 20,000. The same is true as regards the Italian colonies. In 1931, the four Italian colonies in Africa were inhabited by about 57,000 whites. The results of the recent energetic attempts to settle Italian farmers in Tripolis only amounted to a few thousand per year.

If we now turn to the Japanese migration problem, we find much the same story. Twenty-five years after the Japanese conquest of Korea (in 1905), the Japanese population in that country — troops not included — only numbered about 200,000. This figure should be compared with the annual growth of Japanese population — about one million. It is also interesting to compare it with the number of immigrants which, since the beginning of last century, have settled in the United States, namely 37 millions, and in some other independent immigration countries. (See ch. I above.)

The explanation is that the areas in the colonial territories, which are inhabitable for the white races, are now relatively densely populated. Hence, there is little room for white people to be employed in agriculture or in other primary industries. There is nothing to be gained by establishing large secondary industries in these territories. It is preferable to do so in the mother-countries where climate and communications are much better.

Growth of the Native Population

Another important point to be considered is that the colonial native population tends to increase with the effective organization of the colonies and their improved economic development. This tendency is particularly evident in all colonies of the warm belt. For example, the Javanese population has increased tenfold during a hundred years of Dutch régime. This is one of the reasons why there are so limited opportunities for white settlers who demand a certain standard of living. Unskilled labour and some skilled work are supplied much more cheaply by the natives. Even if political measures are used to support white employment and settlement, chances remain small ; they are nowhere in present colonial areas of any importance so good as they have been in Algeria.

The natural field for immigration from the industrial nations is in the temperate zone, where there are hardly any colonies, for instance, North and South America, Australia and Siberia. Here, unfortunately, political factors constitute an obstacle. It is nevertheless clear that *the question of the more rational distribution of the world populations is not a colonial problem.*

Investments in Colonies

Certain students of the question, who agree on this point, emphasize however that colonies may provide an outlet for capital from the manufacturing countries. Political control, they state, may reduce the risks involved in such investments. This is true. But this fact can hardly contribute on the solution of the economic problems of nations with a rapidly increasing population, for the latter require for home purposes all the capital they can accumulate. If such nations invest large amounts of capital in

colonies, where employment is provided mainly for the native population, this will result in a corresponding decrease in the opportunities of remunerative employment in the home country. In many cases, the amount of capital invested in the colonies per head of white settler — in British Kenya no less than £ 10,000 — appears to have been several times larger than the sum which would have been required to employ them at home.

It is true, of course, that high profits may be derived from such export of capital by the corporations and concerns engaged in exploiting a colony. But, from the national angle this cannot be considered as an advantage, if it makes for less favourable conditions of employment in the home country.

Not Colonies, but Industrialization a Necessity

The conclusion that may be drawn from the above argument is in the first place that the possession of regions which are at present colonial is not such a powerful factor in the economic prosperity of the manufacturing countries as to warrant the hypothesis that a more even distribution of the political control of such territories would materially further the solution of the « over-population » problem. The situation was totally different when the British Dominions and India formed part of a colonial Empire which was of the greatest importance for the industrial development of the United Kingdom.

A second conclusion is that rapid growth of the population — during a period of technical progress and of large capital accumulation — need not constitute an obstacle to an increase in the standard of living. The solution of this problem lies in the industrialization of the countries with increasing population and in the exportation of manufactured goods in order to pay for primary products. Political control of colonies is not an important, still less an indispensable factor, as shown e.g. by the Scandinavian countries. It is a great mistake to imagine that rising prosperity depends upon the more or less even distribution of the population over the surface of the globe or over the wealthier areas of the earth. In any case, this cannot be obtained by white emigration to present colonial areas ; although it is true that a suitable spread of population contributes to economic efficiency, it is also certain that international trade is an excellent

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substitute for migration. Scantly populated districts which are rich in natural resources export their primary products, whereas the densely populated areas export their manufactured goods, the production of which absorbs a large amount of labour. Exchange of commodities is therefore an indirect exchange of the agents of production, each nation exporting large quantities of goods which, in their turn, contain relatively important quantities of the agents of production of which it possesses an abundant supply.

Industrialization depends on International Trade

The prerequisite of such international trade organization is that goods can move throughout the world without encountering too many obstacles and that the supply of capital increases with the growth of the population, either through domestic saving or through an influx of foreign capital.

Thus, it is of vital interest for rapidly growing nations that international trade should be allowed to fulfil this function. The creation of economic, political and psychological pre-conditions permitting of the international movement of capital may also become an important factor. Nations of rapid growth would lose more than others if the existing state of world trade and finance were to become permanent. They have more than other nations to gain from a liberal Open Door policy in all colonial areas and from the elimination of discriminating and bilateral tendencies from world trade. For they are more dependent on supplies of raw materials at reasonable prices and on possibilities of increasing their foreign sales of manufactured goods. Their economic growth depends on such conditions infinitely more than on the political control of certain colonial districts.

Different Problems can be solved on the Same Lines

One striking conclusion emerges from our investigation of problems of raw material supply and over-population. The very organization of international economic relations which would be calculated to afford immediate economic relief and to create conditions for the gradual dwindling of the agricultural crisis, would, at the same time, also provide the most suitable basis for

the solution of the two questions discussed in the present chapter. Such an organization would also appear calculated to reduce risks of serious political conflicts and, accordingly, of war. The increased possibility of a pacific solution of the burning political problems of the day is also of vital importance from an economic point of view. The costs of a war are for the belligerent nations higher than any profits they may possibly derive from the results of such operations. And they render the solution of all economic problems still more difficult.

Importance of international understanding

It is needless to state, however, that the mere organization of international economic relations is not in itself sufficient to remove all risks of political conflicts based upon economic problems. The spirit behind such organization has also its word to say. What is important is that all nations should give up envisaging international economic problems from an exclusively nationalistic point of view, considering only *immediate national gains and losses*. For each nation, it will often, in the long run, be more profitable to take a wider view of the situation and to devote some attention to the interests of other countries. The community of interests between nations is much greater than is assumed by most people. A general understanding of the existing interdependence of the economic interests of all the nations of the world would doubtless further efforts with a view to the re-organization of commercial and monetary policy as well as the solution of the agricultural and colonial problems.

Dangers of Discrimination

It is hardly believable that any nation should take the initiative in provoking a general war in order to secure economic advantages in the form of colonies. But a feeling of unfair treatment may breed resentment and thus create a situation in which war is difficult to avoid. It is therefore of vital importance that discrimination as regards treatment of goods and men, both in colonial and other territories, should as far as possible be avoided. Preferential treatment, state-aided dumping, etc., all these methods are calculated to foster national antagonism.

The diplomatic support of concerns which compete with foreign companies for international orders is likely to have a similar effect. The institution of a « Code of economic good manners in international dealings » (André Siegfried) might do much to reduce friction and controversies. A useful point in the application of such a code would be always to deal with economic problems in a business-like manner and to reserve outspoken national sentiments for sport competitions and the like.

It may also be pointed out that resentment is often caused not so much by real economic conflicts as by *supposed* ones, or, in any case, matters of relatively small importance. Education of the general public, which would enable it to grasp e. g. that colonies are of infinitely less importance for prosperity than commercial and monetary re-organization, would reduce the risks of ill-feeling and conflicts between nations.

Respect of Contracts

Finally, a word may be said on the importance of respect of contracts in international, as in national dealings. Decline of such respect and numerous breaches of contracts are apt to impair the functioning of our existing economic machine, indeed of any economic system. Furthermore, if breaches of contract concern international business transactions, Governments may be compelled to intervene. Thus, business transactions of moderate magnitude may easily become the cause of serious political conflicts.

This is not to say that situations may not arise in which the fulfilment of international contracts is impossible. In such cases, friendly negotiations for the temporary or permanent revision of such contracts are the best policy for all parties and infinitely preferable to unilateral denunciation.

Declaration and proof by all nations of their willingness to respect existing contracts, as far as lies within their power, and to agree to the revision of contracts which can no longer be carried out, would go far towards assuring the lasting success of international economic reconstruction.

August 1936.

(Signed): Bertil G. OHLIN.

The Reports of the Experts to the Joint Committee : A Personal Survey

by PROFESSOR T. E. GREGORY

Introduction

This is a personal analysis based on the separate memoranda of the experts submitted to the Joint Committee. Another writer might perhaps have emphasised different points of interest. Further, it should be made clear that the method of analysis adopted here is not identical with that chosen by the writers of the original memoranda — matters which are the subject of separate treatment in these memoranda are necessarily often grouped together here.

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I. Monetary Problems

A. PROBLEMS OF CAUSATION

The starting point of all the memoranda is necessarily the depression and the changes which it has brought with it. To stress the connection between the depression and the collapse of the currency systems of the world, the institution of exchange controls of various degrees of rigidity, etc. is only to stress obvious facts. The importance of the memoranda is that they push the immediate factors making for currency disorganisation somewhat into the background and emphasise the fact that major influences antagonistic to stabilisation are in reality much more profound in their nature — in other words, that it is a mistake to suppose that the present currency situation can be explained solely or even mainly in terms of the depression. The depression has intensified the forces making for an absence of stabilisation, but it is not yet clear that the specific influence exerted by the depression will not disappear in time.

It remains the case, of course, that, under the influence of the various measures adopted since 1929, various vested interests have grown up which will exert an influence in the direction of maintaining the present unsatisfactory state of affairs, but even making allowance for this very important practical factor, it is possible to imagine that the specific influences exerted by the depression may be mitigated in the course of time. Supposing, however, that they were completely eliminated, the other factors would remain.

At this point it is necessary to sub-divide the discussion into appropriate sub-heads:

(1) *Underlying changes in the world situation,
making for dislocation and lack of stability*

(a) The first point which is made clear by one of the writers, i.e. Professor Mortara, is that there has been a tendency in the past to exaggerate the extent to which the factors at work in the pre-war situation necessarily made for fundamental equilibrium. In his view the movements of capital characteristic of the pre-war situation did not necessarily lead to a reconciliation of all the various interests concerned. On the contrary the export of capital resulted, in certain cases at least, in an intensification of international competition, and therefore in the displacement of industries in the old countries resulting from the rise of new competition in the capital-importing areas. His argument is summarised in the passage here quoted:

« It must be remembered that a considerable portion of the international loans contracted during the last hundred years, has been used by new or industrially backward countries for purchasing from older or industrially more developed countries the necessary material for their own economic equipment. With the capital of old countries, new countries have built railroads, roads, factories, and have purchased the material and the machines necessary for the operation of the latter. This development was facilitated by the fact that the States investing capital in new countries were so attracted by the prospect of immediate profits on these investments as to lose sight of the possible and probable effects of the said development as regards their own trade. Thus British capital was responsible for the development of industrial spinning and weaving in India, which subsequently caused serious prejudice to the British textile export industry; American capital contributed to the development of the Canadian hydro-electric industry, which resulted in the decline of the American coal exports to Canada; German capital promoted the development of an Italian chemical industry, to the detriment of German chemical industries. It would be easy to multiply such examples. During the initial stage, it is certain that the encouragement by capital exporting countries of the industrial development of new countries considerably stimulated the industrial exports of the former and, at the same time, cleared their way to ampler, more accessible and cheaper supplies of raw

material and foodstuffs. But, during a second period, the development of the productive capacity of new countries, due to financial assistance from older countries, led to the emancipation of the new countries which were thus transformed into competitors; this, in its turn, has, in certain cases, led to a complete change in the direction of commercial currents, as, for instance, in the commercial relations between Great Britain and the United States. But, even if we except the latter, which has become the greatest industrial country of the world, we still find, at the present moment, many examples of new countries able to produce in their own territory, not only every species of consumers' goods, but also industrial equipment (machines, etc.). Technical progress enables new countries to produce goods received in the past from older countries or to replace them by other goods which they are in a position to produce. In many cases, a further influx of foreign capital would but hasten their evolution in the direction of economic independence and would further diminish the already reduced exporting possibilities of older countries as far as these markets are concerned. »

(b) Professor Predöhl in his memorandum points out that, behind the crisis phenomena with which the world has been most concerned in the last six years, profound changes in the attitude towards agriculture in the older communities of the West have been taking place, and, further, that it is impossible to overlook the tendency towards a more complete degree of self-sufficiency in modern countries arising out of a changed political attitude towards the problems of stabilisation and particularly towards self-defence in economic matters. It is therefore inadvisable to over-stress the temporary factors at work at the present time and to suppose that if they are removed, the problems under discussion would *ipso facto* be eliminated:

« It would be a mistake to conclude that those steps taken in the direction of economic autonomy since 1929 or 1931 have necessarily any claim to permanency. Any such idea is given halt by their lack of system and uniformity; it is finally refuted by the fact that the measures in question are by no means equally anchored in tradition. Quite a number are obviously mere emergency measures, unrelated by any system to the general line followed by economic policy or practice of the past. There are others, however, with a history going back decades. They were first prompted by the Great War and received new and stronger

impetus through the world economic crisis. But they are doubtless rooted in long-term economic evolution. We need but mention those sweeping reversals, described in caption as the industrialization of the agrarian countries and the return to agriculture of the industrialised, a development going back to the earliest defections from free-trade. Nor is the almost universal national regulation of agricultural markets a result of blind chance. It is rather the logical consequence of older experiments which aimed at the removal of the chaotic condition in which agriculture lay, under the rule of advance capitalism.

« The increasing immobility of the national levels of real wages has been arrived at by a long process of evolution. And the same applies to the diversion of national capitals, for investment in the national interest, into the hands of ever more centralised authorities. This last feature may even be observed in those countries, which have in other respects left ample scope for the free interplay of economic forces. Even the very recent and very activist stimulation of the trade-cycle cannot at this hour be regarded as a mere phenomenon of crisis. »

This attitude receives support from a writer who in general takes up an attitude towards economic problems very different from that maintained by Professor Predöhl himself. Mr. Hubert Henderson in his memorandum points to the profound changes which have been taking place in the field of population and makes the point that these population changes would necessarily affect the position of the overseas world, even if there were not other elements in the situation working in the same direction:

« A profound change has taken place in the conditions which underlay this pre-war economic development. The populations of Western European countries are no longer increasing rapidly: many of them are now virtually stationary and are likely to decline in the comparatively near future. The consumption of food increases comparatively little as the result of a higher standard of life, so that when numbers cease to grow the demand for food increases only at a very slow rate. Accordingly the Western European demand for many agricultural products has ceased to expand with its old rapidity. On the other hand, the progress of agricultural technique is now proceeding at a more rapid rate than formerly, especially in the agricultural exporting countries. In the case of many agricultural commodities accordingly the growth of productive power resulting from

technical progress is now more than sufficient to keep pace with the growth of demand that can be expected, without any further expansion of productive areas. One of the outstanding features of the world economic crisis of recent years has been a severe and widespread agricultural depression marked by the phenomena of overproduction and redundant capacity which were previously regarded as essentially industrial phenomena. The severity of the world agricultural depression is no doubt largely attributable to special circumstances, which represent the aftermath of the Great War, and the incidence of the depression on the exporting countries has been greatly aggravated by the development of agrarian protectionism in the importing countries of Europe. But the development of high agrarian protectionism is itself an indication and a symptom of more fundamental changes. Increasing imports of food no longer wear in Europe, not even in Great Britain, their former aspect of a welcome means of satisfying an imperative need: the aspect which is most prominent to-day is the menace which they present to the stability of domestic agriculture. »

(2) *Abnormal Technical Feature in the Working
of the Monetary System*

The present position of the stabilisation problem is affected, not only by the presence of philosophies tending in the direction of instability, but by the circumstance that the monetary system is working in an environment which differs in many respects, even from the narrowly technical point of view, from that of the pre-war world.

The first point which requires mention here is the presence of international indebtedness not directly associated with the necessities of particular countries for capital for productive purposes — or to put the matter in another way, one of the most significant features of the post-war world has been the importation into the problem of « extraneous » political factors, of which one, in the opinion of some of the authors under consideration, is of special significance — that is, the growth of unilateral international indebtedness, associated in the past primarily with the payment of reparations. Professor Predöhl has again summarised the matter as succinctly as possible:

« Of these extraneous political factors, which run as contrary to the international marketing-system as they do to the principles of autonomy, all owe either their existence or at least their form and tendency to one primary factor. (On this point, one can speak of unanimity of opinion among theorists and businessmen alike.) That primary factor is unilateral international indebtedness, political or of political origin. »

Mr. Henderson, in his memorandum, although he does not particularly emphasise the significance of political debts, does emphasise two other features of the capital market which in his opinion make for continued instability.

The first of these is the growth of a semi-speculative psychology among large classes of the population, formerly in the habit of investing in fixed-interest-bearing securities. This makes, of course, for increased mobility in the movement of capital, both short term and long, between the various money markets of the world. But more important than this in Mr. Henderson's analysis is the growing lack of correspondence between the movements of goods in the modern world and the movements of capital:

« Meanwhile the presumption that international movements of money will be associated with corresponding movements of goods has become far weaker than it was. The capacity to produce machinery or other capital goods is now widely distributed throughout the world and it cannot be assumed that a country which raises a loan abroad (unless stipulations to that effect are expressly made), is likely to use it to purchase goods from the lending country. Similarly, it can no longer be assumed that the normal effect of the loan will be to increase the future capacity of the borrowing country to export goods from to the market of the lending country, or indeed to other world markets.

» There has been, moreover, a striking development in recent years of capital movements which have no direct relationship to any movement of goods. The traffic between the leading stock-exchanges of the world in existing securities or shares has assumed larger dimensions. At one time, investors or speculators in Great Britain or on the European Continent may buy heavily in Wall Street; while at another an opposite movement may develop. Such transactions affect the exchanges in precisely the same way as a new foreign loan, unaccompanied by a corresponding movement of goods. Finally, in recent years, we have seen

emerge the phenomenon of large floating balances of short-term money, which may be moved from one centre to another in accordance with fluctuations of confidence.

» These developments, in my judgment, greatly increase the difficulties and disadvantages that might result from re-establishing the gold standard. It is of the essence of the gold standard system that if a country is losing gold on a considerable scale and for any length of time, it must apply the corrective of a higher Bank rate, or a curtailment of the volume of credit. Such action is necessarily deflationary in character, detrimental to the internal trade activity of the country concerned. But, under the conditions that prevailed in the nineteenth century, it was usually not unreasonable to assume that the fact that a country was losing gold was an indication that its balance of trade had become unfavourable and that this in turn was an indication that its costs of production had become too high relatively to those of other countries. Thus a slight deflationary pressure might serve to correct what lay at the root of the trouble, and restore equilibrium not merely in the exchange-rates by attracting short-term money from abroad, but in the international trade balance also. »

Other features stressed by various writers are as follows:

(a) The influence of United States tariff policy in preventing a normal adjustment. In the past creditor states have shown themselves willing to receive payment of the sums due to them in those goods and services which the debtor states can produce. In fact, the organisation of the entire commercial world was such as to make it possible for the debtor states, then primarily producers of food stuffs and raw materials, to pay for the loans which they were taking up by export of such products to the growing markets of the creditor countries. This state of affairs does not apply in the case of the United States, and yet the rapidity with which in the post-war period America was making loans to foreign countries made the problem of debt and sinking fund repayment more urgent than ever. The refusal of the United States to accept payment in goods — a refusal marked by the constantly growing height of the United States tariff wall — simply led to a re-lending of the interest and sinking fund payments due and to the creation of a top-heavy international debt structure.

(b) In the post-war period the gold exchange standard has been functioning unsatisfactorily. Professor Mlynarski makes

the special point that the gold exchange standard has been a powerful factor, increasing the tendency towards gold hoarding and gold maldistribution :

« The situation deteriorated further owing to another defect of the gold exchange standard. The new system had a disastrous effect on private gold arbitrage transactions, which before the world war had played an important part as one of the factors regulating the distribution of gold. It could not be otherwise, for a central bank working under the gold exchange standard could take advantage, for instance, of a prolonged and abundant inflow of gold from London derived from arbitrage transactions, while an outflow of gold due to private arbitrage was never possible, because banks of such type could sell sterling cheques and bills at a stable rate of exchange, thus eliminating such fluctuations as would justify arbitrage transactions. From this point of view the central banks which had adopted the classical gold standard and which did not buy and sell foreign exchange found themselves in a less advantageous position. As a result of these differences in opportunities the distribution of gold became complicated, because one of its regulators, i.e. private arbitrage transactions, became one-sided. »

(c) A third feature, to which many writers rightly draw pointed attention, has been the increasing reliance upon international movements of short-term balances. It is pointed out by more than one writer that even in the pre-war world the movements of balances from one centre to another were a cause of potential disequilibrium, but in the post-war world the absolute sums involved are much larger, and the degree of confidence in the outlook has been much smaller than in pre-war days. The result is that there is general agreement that the problem of stabilisation has been and is greatly affected by the large mass of short-term balances which at present move under the slightest provocation from one money market to another. Professor Mlymarsi's view on this subject is as follows :

« The unusual increase of the accumulation of short-term funds in the gold centres, i.e. in countries with strong currencies, may be quoted as the third cause of a faulty repartition of gold. Already before the world war, during the second half of the nineteenth century, the role of short-term foreign deposits (as a factor exercising influence on the functioning of the gold standard) was gradually increasing in importance. Whitaker,

Laughlin and others drew attention to this phenomenon under the impression of the first disturbances caused by sudden large scale transfers of short-term funds from one market to another. This tendency was encouraged by the development of banking in general, and particularly of banking technique, supported by the invention of the telegraph, telephone, accounting machines and finally by the wireless facilities. After the world war, the role of liquid funds gained immensely in importance both on account of the increase in their volume and on account of the development of forward foreign exchange transactions. »

Further evidence of the importance of short-term balances, even in the pre-war situation, is furnished by the following passage from Mr. Conolly's memorandum:

« But the problem is not a new one and a reference may be found in Bagehot's *Lombard Street*, to the position in London over sixty years ago, when the large payments from France to Germany made over London caused the accumulation of a German deposit amounting probably to £ 40 million and of which Bagehot said « ... this foreign deposit is evidently of a delicate and peculiar » nature. It depends on the good opinion of foreigners, and that » opinion may diminish or may change into a bad one'.. In » proportion as we augment the deposits of cash of foreigners in » London, we augment both the chances and the disasters of a » « run » upon England. And if that run should happen the bul- » lion to meet it must be taken from the Bank... » There is little doubt, however, that such special deposits in London were exceptional before the War. But the growth of international trade with London as the « clearing » centre led to the growth of London's short-term position on foreign account : Bagehot says, « A large » deposit of foreign money in London is now (1873) necessary for » the business of the world... for the deposit at a clearing-house » necessary to settle the balance of commerce must tend to increase » as that commerce itself increases ». London was, before the war, probably the only market which had foreign short-term liabilities of any magnitude and these liabilities (and corresponding assets) arose naturally in connection with the trading activities of the country and London's central position as banker of the world. Shifts in the foreign position of the market, often arising from some disturbance thousands of miles away, were always a possible source of strain to London and this, combined with the slender gold reserves on which the structure was based, was a reason for

the frequent changes of bank rate (in 1873, for example, the Bank of England changed its rate on an average once a fortnight). More than once the London market turned for help to Paris which, with strong gold reserves and a less sensitive foreign position, was able by granting credits to tide London over its difficulties (as, for instance, in 1837 and 1890). »

It must be emphasised, in order to attain the correct balance of these complicated issues, that even writers like Professor Predöhl, who are in general sympathetic to the idea of a planned economy, do not categorically assert that « self-sufficiency » must mean a permanent lack of stability either in general or in the monetary field. On the contrary, as he himself points out, « ... Different degrees and forms of currency stabilisation may be linked with different degrees and forms of autonomy. Only empirical investigation can determine whether, or at what point, a synthesis is possible. The antithesis implies no verdict upon the value either of currency stability or of autonomy. »

The practical question is surely this: what is the cause of the autonomous measures demanded? Given that economists cannot determine what people *ought* to think in this matter, and fully recognising that a greater degree of autonomy may be called for by the political situation in which the world finds itself, economists nevertheless can point out that the adoption of a policy of autonomy necessarily involves sacrifice and that this sacrifice may be greater or less according to the circumstances in which particular countries find themselves. It would be going too far to enter into an elaborate discussion of planning in this place, but as the views of an author generally sympathetic to planning have been quoted in this section, it may be well to conclude by stressing what another contributor to the series has emphasised, namely the highly empirical and dubious results attained by « planning » so far. In his memorandum Professor Boehler sums up the matter as follows:

« Up to the present there is neither agreement in regard to the fundamental factors of cyclical variations, nor do we possess sufficient data to measure the variations of these factors and their relations, nor does there exist unanimity in the interpretation of these data. On the contrary, the diagnosis is made on the basis of the most contradictory abstract theories, the verification of which is by no means concluded. So the most modest predictions are discredited by reality, and we have practically no certain

knowledge as to the normal flow of economic activity which could form the scientific foundation of real planning. Therefore, the actual measures of planning have been undertaken on the ground of prejudices, political motives or human pretensions, with the result that the instability of the whole has been increased. In any case it is utterly unscientific to regard the phase of prosperity as the norm of economic activity, as is usually done by planners.

« Still more precarious is the situation of the great body of those who hold that man has the possibility to determine at will the flow and structure of economic life, because this supposition means that economic life does not obey any rule. But in an activity without rules planning would be an impossibility, because no certain or probable reaction could be expected on any measure taken by the state. In addition such an attempt would presuppose that the planning authorities would possess on the one hand a comprehensive view of total demand and total supply, a sure beforehand knowledge of the right prices and costs, and the ability to follow all variations of demand, supply, stocks and prices and that they have, on the other hand, the means to constrain all individuals to keep the prescriptions of the plan. »

B. PROBLEMS OF CURRENT POLICY

The investigation of the underlying philosophical trends of the time is intended to elucidate the nature of the more urgent problems of the present moment.

(1) *The influence of fluctuating exchanges as a means of helping the revival of foreign trade*

This is associated in various of the memoranda with the further question: how far fluctuating exchanges, so far from aiding recovery, are responsible for falling prices; or in other words, how far unstabilised exchanges act as a deflationary cause?

On the first of these issues at any rate there is a surprising amount of agreement among the writers of several memoranda, to the effect that, regarded as a general instrument of recovery,

the value of instability can be greatly exaggerated. In this respect the memoranda of Mr. Henderson, Professor Gregory and Professor L. Mises concur. It is admitted on all hands that, though particular countries may benefit, the benefit even to a single country is liable to be severely limited by the growth of protectionism indirectly induced in other countries.

In the view of some of the writers, also, falling exchanges, by forcing up exports, without necessarily providing an additional demand in the countries to which the exports are intended to go, actually work in the direction of reducing the level of prices in a period of depression. Two representative views may be quoted. Firstly Mr. Henderson writes as follows:

« I disagree with the view that foreign trade is likely to be stimulated by fluctuating parities as such. When the currencies of different countries are out of their proper relation to one another, when, for example, the currency of one country is seriously « over-valued » relatively to that of another, it may well be that a readjustment of parities which would correct this over-valuation would be on balance beneficial to international trade. This is the more likely in that the removal of such an over-valuation, by alleviating internal conditions of strain and depression in the country concerned, should serve to abate the disposition to raise tariffs or impose other trade obstacles which may otherwise be expected to arise. Again it is possible that good on balance may result to international trade from a reduction in the parity of a country which, although not possessing an over-valued currency in the ordinary sense, has suffered in an exceptional degree from a fall in world markets of the prices of commodities in the production of which it is largely interested. In short, the actual effects on international trade of an alteration in exchange parities will largely depend on the special circumstances of the countries whose currencies are reduced in relative value. In general, however, I am of opinion that fluctuating parities, by creating additional hazard and uncertainty, will be prejudicial to international trade, and there is no validity in my judgment in the arguments that have been put forward to support an opposite view.

» The above is subject to a possible qualification (leading on to the second question) if the alterations in exchange rates are of a character which involves a general devaluation in terms of gold. A devaluation in terms of gold has, or may be given, the

effect of increasing the money value to the gold reserves of central banks. It is possible that recovery from conditions of trade depression may be materially assisted by an increase in central bank reserves, and international trade may share in the general stimulus resulting from the general process of trade recovery. Subject to this possibility and to the others previously mentioned, I am of opinion that the influence of competitive exchange depreciation will be in the deflationary direction as the consequence of its prejudicial effect upon international trade. »

Professor Mises writes as follows:

« It cannot be denied that for a limited time a country's exports are stimulated by a rise of foreign exchange. In this respect the belief that fluctuating parities stimulate foreign trade is founded on fact. On the other hand the instability of the currencies of many countries, just because it stimulates artificially their exports, increases in other countries the inclination to make trade barriers higher and more effective.

» Depreciation means for a time increased exports and reduced imports. It enables a country for a time to undercut world market prices and thereby to aggravate the tendencies working for a decline of the prices of the goods exported. On the other hand the consumer whose income, in terms of foreign exchange or gold, did not increase at all or not in the same degree as the price of foreign exchange went up can no longer afford to buy same quantity of imported goods. Imports are decreasing because the consumption of imported goods drops. In this respect the belief that the depreciations which have taken place in the last five years contributed to the fall of prices on the world market is founded.

» However, the importance of this factor should not be over-rated. There have been other stronger tendencies working for the fall of gold prices. »

(2) *The Significance of the Position in Different Countries*

A great deal of attention has been devoted in these memoranda to the situation existing in different groups of countries in recent years. It is notorious that, in general, the economic experience of the countries of the sterling area has been more favourable than that of the countries belonging to the

so-called gold bloc. The first of the special memoranda devoted to these groups of countries which requires mention here is that prepared by Professor Charles Rist on:

(a) *The Gold Bloc*. The substance of Professor Rist's argument is contained in the following passage, which points to the fundamental dilemma imposed by the situation in these countries on their monetary authorities:

« To put it briefly, the effort of the gold standard countries to lower prices and reduce State expenditure has been thwarted by the contrary tendencies imposed by circles interested in maintaining income at the same level and by the additional expenditure entailed by this tendency. Consequently, the price-index of the gold standard countries, and, in particular, that of the cost of living have not fallen in the same proportion as these indices in countries such as England and the United States, and the difference between wholesale and retail prices, which has constantly been reduced in the latter, has remained at a high level in the gold standard countries. These general features having been set forth, it would seem useful to examine rapidly the special situation of each of these countries from the point of view of prices, production, unemployment, rate of interest and budget. I propose to do so briefly. »

He further points out that in so far as the difficulties of France and Switzerland are caused by the pressure of indebtedness, public debts are the cause of malaise in France and private debts the cause of difficulty in Switzerland. A general distinction can be drawn between the position in Poland and in the remaining gold bloc countries. Poland has been successful in its deflationary efforts to a quite unprecedented extent when compared with France or Switzerland, and, summing up the whole discussion, Professor Rist arrives at the following general conclusion:

« What conclusions can be drawn from this brief statement ? Poland, like all other countries, would derive the greatest benefits from a stabilization of currencies: in the first place, the assurance that it will not be compelled by currency depreciation in the countries in which the world prices are constituted, to renew a deflationary effort which it hopes to have terminated, in the second a revival of world trade by which its business circles will be able to benefit owing to the perfect adjustment of their cost prices. In Poland's case, contrary to other countries previously

considered, it would not seem that any currency adjustment is necessary, nor that any section of its economic structure is in need of special attention or far-reaching re-organization. But it is necessary also to emphasize that only the preponderance of agriculture and the relatively very modest standard of living of the Polish population made it possible first to experiment with deflation, secondly, to carry it through without encountering any appreciable resistance on the part of the social classes on which it fell most heavily. »

(b) *Czechoslovakia*. A special memorandum has been devoted to the case of *Czechoslovakia*, a country which has practised not only devaluation but also has instituted a system of exchange control. Dr. Basch in his memorandum makes the four following points:

Firstly, devaluation in Czechoslovakia was preceded by foreign exchange control.

Secondly, the direct problem with which the country was faced was the revival of its export industries. It might have been possible to attain this end by means of a freer commercial policy, « the object of which would have been to encourage the import trade, in particular from countries with clearing agreements, with a view to receiving compensation in the form of exportation to the said countries. But the political and agricultural situation precluded this solution ».

Thirdly, the fundamental problem with which the country was faced was the disequilibrium between internal prices in Czechoslovakia and prices elsewhere. It was impossible to solve this disequilibrium by means of deflationary measures. « In view of increasing unemployment and the decline in economic activity it was evident that even if deflation had been technically feasible, it would nevertheless have been impossible to proceed in this direction for political and psychological reasons. »

Fourthly, only a limited success is claimed for the policy of devaluation in the case of Czechoslovakia, as the following quotation from Dr. Basch's memorandum suggests:

« The main features of economic recovery in this country, subsequent to the devaluation, may be summarized as follows:

» Czechoslovakia resorted to currency devaluation as a remedy for the evolution of the internal price-level in relation to the world price-level or that of various countries. For economic,

political and social reasons, it was impossible for Czechoslovakia to adjust internal to external prices by means of deflation. Czechoslovakia therefore devalued in a proportion of 1/6 with a view to adjusting prices and to *avoiding a further rise*. The new monetary unit was immediately pegged to gold, since Czechoslovakia, in view of conditions prevailing in Central Europe, did not wish to run the risk of allowing its currency to fluctuate to auto-stabilization at any level. The essential purpose of the devaluation was therefore to eliminate the difference of level between internal and external prices, to cope with the decline of the export and to *create a new basis for the organization of economic recovery*.

» The Czechoslovakian devaluation was not accompanied by an upward movement of prices, as forecast by some; the actual increase, which intervened mainly in 1935, was due to the evolution of world prices and also to the corn monopoly and other action as regards the price of foodstuffs. The export trade has derived from this measure the expected benefits and has increased by approximately 1 1/2 milliards (1/4). This upward movement ceased at a moment when international trade as a whole entered upon a period of stagnation, owing to the large number of clearing agreements and the increasing obstacles to exportation. The Czechoslovakian exports are therefore directed towards the free markets. *Such are the effects of devaluation in Czechoslovakia; they could not be otherwise, since the whole object of this measure was to eliminate the difference of the price-levels*. In particular, there could be no question of devaluation being used as a stimulus to purchasing power or demand.

» Meanwhile, one of the effects of the relative tranquillity due to this measure was to stimulate saving, the constitution of new capital being facilitated by the fact that the depression is drawing to an end; at such moments, it is well known that money and financial markets are generally very easy. The Central Bank initiated a more active lending policy, while the Re-Discounting Institute, founded for the purpose, succeeded in rigorously controlling the market for securities with fixed interest rates, and autonomous organizations were more active as regards capital investments. With the upward trend of world trade on the one hand, and the favourable prospects afforded by the armaments race on the other, it is possible to state that Czechoslovakia is entering upon a period of economic recovery.

This revival is not the immediate result of the devaluation; but it is nonetheless true that a deflationist policy would have delayed or entirely compromised recovery.

» Devaluation, therefore, could not in itself bring about recovery in international price and business conditions, but it nevertheless served to abridge the disturbances attendant upon the abatement of a depression and to speed up the onset of recovery. It may be suggested that, if most countries had in 1931 devalued in a similar proportion or if they had pegged their currency to sterling, the effects and the length of the depression would have been reduced. No currency manipulation, not even devaluation, can provide a remedy for a depression of so complicated a character as the present one. In certain circumstances, which vary according to countries (e.g. in Belgium the situation differed from that in Czechoslovakia), devaluation may afford a measure of relief, it may shorten the period of depression, and, psychologically, may create an atmosphere of calm promoting the solution of various problems, which it would be much more difficult to solve under a deflationist regime. In Czechoslovakia, it was impossible to expect the devaluation to work miracles of economic recovery; this measure has nevertheless stemmed a further downward movement, afforded some measure of relief to the export trade, promoted the resumption of a market policy and stimulated research with a view to the improvement of industrial activity. »

(c) *United States*. A separate memorandum was devoted to the case of the *United States*. Dr. Pasvolsky's memorandum confines itself to an analysis of the facts of the case: it explains very clearly the revolution in United States administration and monetary policy which was involved in the adoption of the stabilised dollar in January, 1934, when the Gold Reserve Act passed through Congress.

(d) *The Sterling Area*. A separate investigation of the position in the sterling area was made in Professor Gregory's memorandum. The fact that the position in the sterling area was so much more favourable than that in the gold bloc countries is ascribed in part only to the comparative advantages derived from the decline in the external value of the British pound. Part of the advantages accruing to the sterling area may have been *at the expense* of the countries of the gold bloc. But more

stress is laid than is usually the case upon the following factors in the position of the sterling area:

Firstly, the monopolistic importance of Great Britain as a world buyer of food stuffs and raw materials;

Secondly, the favourable reaction of British public opinion to British monetary policy, which has made it possible for a policy of cheap money to be pursued, which in its turn has enabled a drastic cut in interest rates to take place and thus has stimulated the internal building boom upon which British recovery has so far largely rested.

(3) *The Neutralisation of the Defects of Currency Instability*

It is very frequently suggested that such evil consequences as follow from currency instability can be neutralised by the institution of a forward exchange market in the various unstable currencies. This highly important, though very technical problem has been specially investigated by Mr. A. A. van Sandick. His memorandum makes the following points clear.

Firstly, that it is impossible to expect the forward exchange market to work adequately in the presence of exchange restrictions. The following extract from his memorandum summarises this point:

« The main obstacle to a smooth functioning of the forward market is the existence of exchange restrictions. It does not seem likely that the governments can be brought to abolish these obstacles to trade. Perhaps the governments could be induced to abolish these restrictions as far as commercial transactions are concerned, but this would be of little help to the forward market proper. For it has been said already that as long as these exchange restrictions are maintained in the field of capital transfers, speculation as well as interest arbitrage cannot play an active rôle. Therefore a revival of the forward market cannot be expected so long as the exchange restrictions are not removed all along the line.

» If the exchange market was freed of all restrictions, trade would again be in a position to cover its claims and obligations in the forward exchange market, but under the present circumstances this would often be possible only against payment of a prohibitive forward margin. For the uncertainty as to the

future basis of some currencies must bring about a downward pressure on the forward rates of exchange, first by the activity of speculators and secondly by the attitude assumed of late by international trade itself, which in anticipation of monetary events supposed to materialize sooner or later, refrains from covering its requirements of the currency concerned. Consequently the forward market becomes extremely one-sided at times, as is clearly illustrated at present by the Scandinavian currencies and the currencies of the countries of the so-called gold bloc. »

Secondly, even where forward cover is available, a very high cost in the shape of a premium or discount to buyer or seller is sometimes involved. Examples of such high costs are given in the memorandum.

Lastly, Mr. van Sandick investigates the technical question of whether the forward exchange market could be strengthened if Central Banks intervened in that market as well as in the « spot » market. He makes the point, that, in so far as intervention by Central Banks can solve fundamental difficulties, there is no very great advantage to be gained by operating in the forward market as well as in the « spot » market ; the really important matter is that Central Banks intervention cannot deal with the main problem at issue for reasons which he sets out:

« Generally speaking a direct intervention in the forward exchange market from the part of the Central Banks will be of little use. And this stands to reason. For if forward margins are large, this proves, in nine cases out of ten, that confidence as to the stability of the currency is failing. A wide margin between spot and forward exchange rates is a symptom that confidence is lacking. A manipulation of the forward market might perhaps prevent this symptom from manifesting itself, but it cannot be denied that it is far better to think of means to strengthen confidence in the fundamental stability of the currency, under present conditions either by working the gold standard along orthodox lines (unlimited sale of gold at the upper gold points) or — in case of a free currency — by a liberal and not a restrictive exchange control in the spot market. »

stress is laid than is usually the case upon the following factors in the position of the sterling area:

Firstly, the monopolistic importance of Great Britain as a world buyer of food stuffs and raw materials;

Secondly, the favourable reaction of British public opinion to British monetary policy, which has made it possible for a policy of cheap money to be pursued, which in its turn has enabled a drastic cut in interest rates to take place and thus has stimulated the internal building boom upon which British recovery has so far largely rested.

(3) *The Neutralisation of the Defects of Currency Instability*

It is very frequently suggested that such evil consequences as follow from currency instability can be neutralised by the institution of a forward exchange market in the various unstable currencies. This highly important, though very technical problem has been specially investigated by Mr. A. A. van Sandick. His memorandum makes the following points clear.

Firstly, that it is impossible to expect the forward exchange market to work adequately in the presence of exchange restrictions. The following extract from his memorandum summarises this point:

« The main obstacle to a smooth functioning of the forward market is the existence of exchange restrictions. It does not seem likely that the governments can be brought to abolish these obstacles to trade. Perhaps the governments could be induced to abolish these restrictions as far commercial transactions are concerned, but this would be of little help to the forward market proper. For it has been said already that as long as these exchange restrictions are maintained in the field of capital transfers, speculation as well as interest arbitrage cannot play an active rôle. Therefore a revival of the forward market cannot be expected so long as the exchange restrictions are not removed all along the line.

» If the exchange market was freed of all restrictions, trade would again be in a position to cover its claims and obligations in the forward exchange market, but under the present circumstances this would often be possible only against payment of a prohibitive forward margin. For the uncertainty as to the

future basis of some currencies must bring about a downward pressure on the forward rates of exchange, first by the activity of speculators and secondly by the attitude assumed of late by international trade itself, which in anticipation of monetary events supposed to materialize sooner or later, refrains from covering its requirements of the currency concerned. Consequently the forward market becomes extremely one-sided at times, as is clearly illustrated at present by the Scandinavian currencies and the currencies of the countries of the so-called gold bloc. »

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(4) *Exchange Control*

The last of the subjects of special importance at the present time which are examined in the memoranda concerns the significance of methods of exchange control. A long memorandum was furnished to the Joint Committee by Professor Predöhl upon this particular subject. The first point that he makes is that it is not correct to treat devaluation and exchange control as logical contraries; there are frequent cases in which both methods have been adopted by one and the same country.

The second point to which he draws attention is that the significance of exchange control varies from case to case. He groups the various countries which have practised exchange control into three main divisions.

Firstly, countries which have adopted exchange control for the purpose of maintaining rates of exchange previously in force.

The second group is comprised of those countries which have practised exchange control for the purpose of trying to consolidate the position after devaluation has taken place. Whether exchange control takes the form of regulation of transactions in exchange, or whether it takes the form, as it does in Great Britain and the United States, of the institution of an exchange equalisation fund, is from this point of view irrelevant. The main fact is that exchange control has been adopted as a method of underpinning a previous devaluation.

The third group of countries is comprised by those South American States where « the object of foreign exchange was not the maintenance of earlier rates; nor can it be regarded as an auxiliary of foreign exchange policy; its purpose was rather to act as a brake. It was not intended to reverse natural developments, but rather to mitigate them and... to prevent the increased international debt charges by organising a section of the foreign exchange market on the basis of the former parities. »

Professor Predöhl is of the opinion that the philosophy of foreign exchange control has been very largely misunderstood. It has too often been regarded simply as an expression of mere state interventionism in the field of foreign exchange. From his point of view there is less difference between systems of exchange

control and the gold exchange standard than is generally supposed¹.

C. PROBLEMS OF THE IMMEDIATE FUTURE

There is general recognition among the writers of the various memoranda that, in spite of the difficulties presented by profound differences in the fundamental attitude towards the economic problems of the present time, and in spite of the intractability of the technical situation, a return to a more stable régime is a matter of the greatest significance and urgency. At the same time any return to more stable conditions involves a discussion of the difficulties of doing so. The first problem which arises is that of:

(1) *Flexible Parities*

The discussion of this particular device is combined in various memoranda with a discussion of the possibility of making a stable exchange system function more adequately through a widening of the so-called « gold points », a device which, although thought of in the first instance as appropriate to a restored gold standard, might equally well be combined with e.g. a universal adoption of sterling as the stabilising agency. Flexible parities would involve a *de facto* fixity of exchange without any legal compulsion permanently to retain the *de facto* rate agreed upon. Three memoranda deal directly or incidentally with this particular matter. The most outspoken opponent of flexible parities is Professor Mises, who takes the point of view that flexible parities in the modern world would simply serve as

¹ It appears that Professor Predöhl's argument is logically correct in so far as one of the possible objects of exchange control is the maintenance of parities of exchange which could not otherwise be retained. At the same time the argument overlooks the differences between the extraneous effects of the gold standard and those which result from the institution of exchange controls. One of these differences has been pointed out by Mr. A. A. van Sandick, namely, that exchange controls prevent the proper functioning of a forward exchange market. At the same time the direct effects of exchange control upon the free movement of goods and services in international trade are obviously much more serious than any which result from the indirect methods which are necessary to maintain the parity under the normal working of the gold standard.

an excuse for a continuous reduction in the external value of currencies:

« Flexible parities mean full power for the executive to alter or to fix the price of foreign exchange. Wide gold points limit this faculty by fixing two points which should not be exceeded. Compared with a system of boundlessly fluctuating parities it means a closer approach to stability. It would not at all however make the restoration of stability easier to attain. As soon as the price of foreign exchange has reached the upper gold point, the Central Bank or the exchange equalisation fund would have to follow exactly the same policy to prevent a further rise which it would have to follow under the orthodox gold standard. »

Mr. Henderson, whose attitude to currency problems would in general lead one to suppose that he would be more sympathetic to the principles underlying flexible parities, is in fact somewhat sceptical upon the whole matter:

« I turn to consider the expedients of « wider gold points » and « flexible parities », which are referred to in the Outline. The efficacy of wider gold points would clearly turn on how much wider was the margin between the gold points. If the margin were of the magnitude of 10 per cent., the fall of the exchanges of a country towards gold-export point would supply a powerful check on any adverse capital movements, since those withdrawing or exporting money from the country would incur thereby a substantial exchange loss. But it may be doubted whether the purposes of exchange stabilization would be satisfied, if so wide a margin were permitted. Indeed, if the exchanges were allowed to vary freely within such wide limits, the exchange variations that might ensue would perhaps be more disturbing to trade than those incidental to a more informal regime, in which a country attempts, so long as it conveniently can, to keep the exchanges steady at the existing level. On the other hand, with a much narrower margin between the gold points, it would become doubtful whether the prospect of a comparatively trifling exchange loss would provide a sufficient safeguard against the possibility of large-scale capital movements. It would not be easy, indeed, to determine how wide the margin would need to be to provide an adequate safeguard against this danger. I find it difficult to suppose, therefore, that the expedient of wider gold points could ever be regarded as both necessary and sufficient by itself. If the authorities of any country were to take the view

that it would be unduly rash to return to a fixed parity without the protection of wider gold-points, it is virtually out of the question that they would be content with slightly wider gold points; they would require the further safeguard of reserving their freedom, in the event of exceptional pressure, to make a more substantial alteration in the parity.

» This leads to the other expedient of « flexible » parities. If this is interpreted to mean that the authorities of a country would remain entirely free to alter the parities provisionally established, without being exposed to any imputations of bad faith, this would provide a complete safeguard against the dangers that have been indicated. The only question is whether such a system would be accepted as meeting sufficiently the purposes of exchange stabilization, as differing indeed enough from the present informal arrangements, to make it worth while to undertake the laborious negotiations, including an agreement on the provisional parities, that would be required for its formal enactment. This is a question which is unlikely to be answered in the affirmative for at least some time to come. It may be observed, however, that it might well be part of the establishment of a regime of flexible parities that the countries adhering to it would undertake to eschew a deliberate depreciation of their exchanges with a view to raising internal prices or improving their domestic trade, that they would undertake in effect only to alter their parities in a downward direction in response to an outflow of gold, and as an alternative to a curtailment of credit. Thus the initiation of a system of ' flexible ' parities might mark a renunciation of dangerous possibilities of exchange policy; and, in view of the movements of opinion that are developing in many parts of the world on monetary questions, circumstances may arise in which a general renunciation of this character would have a considerable reassurance value. »

Professor Gregory also deals with the matter in one of his memoranda and takes the view that the proposal must be rejected on the ground that it would result in an increase of uncertainty all round, and that it would be extremely difficult to state in any precise manner exactly what would be the circumstances under which a resort to flexibility could be sanctioned. He sums up his attitude as follows:

« In other words, the case for flexible parities is prejudiced by the circumstance that they are either dangerous or useless.

They are dangerous, in so far as the right to resort to a change of parity is a direct encouragement to make use of them more and more frequently, so that, in the end, fixity is sacrificed to flexibility. They are useless, in so far as experience shows that there are conditions of disequilibrium so grave as to require a departure from the existing parity. When such conditions arise, the existing parity will be departed from. But it makes a great deal of difference, psychologically, if it is recognised that the breach of parity « could not be helped ».

A second suggestion which has been much discussed in recent years concerns the possibility of gradually attaining a more stable system of exchanges through a provisional grouping of various currencies *inter se*. Thus one group of currencies might become linked with sterling, another group with the American dollar and a third with the French franc. A memorandum has been furnished by Mr. Dag Hammarskjöld on

(2) *Provisional Currency Groupings*

The author of this memorandum rejects out of hand most of the arguments currently advanced for the maintenance of flexible parity régimes. The only case, he thinks, for flexibility is presented by structural changes. « When structural changes call for a *fundamental* adjustment, the obligatory maintenance of the international value of the currency lays a stress on the home market which finally may force the country to leave the narrow road of absolute exchange stability. The importance of international stability is evidently so great, that *less considerable* structural changes, which it is possible to make by internal adjustment, ought to be made in this way. »

Given that, in general, stabilisation is desirable, his view is that the present groupings are too casual and that some kind of rationalisation of the existing currency groupings is desirable, and he makes the important point that in discussing a more rational system of groupings, it is necessary to pay regard not only to the economic but also to the political relations between the various states in question. His conclusion can be stated in his own words, as follows:

« To sum up, it seems justifiable to say that none of the difficulties immanent in a system based on provisional stabiliza-

tion along the lines discussed in this note are so serious as to make a solution of the stabilization problem in the way outlined too dangerous to be given a trial or attempted as a first step on the road to a more definite arrangement. As, further, the solution presented here has the obvious advantage of lying in the direction indicated by the development during the past few years the best policy would probably be to attempt a re-establishment of a satisfactory exchange system by inducing various countries to revise their monetary legislation in conformity with a system of provisional stabilization as well as to include exchange clauses in their trade and credit agreements so that guarantees be created against arbitrary changes in the rates of exchange and a rational grouping be furthered.

» A stabilization along these lines, starting from the smallest units and developed successively, seems preferable to a ready-made universal system, to which the countries are forced to adhere whether it is organic or not. If the stabilization is allowed to develop out of special regulations and special agreements as the time becomes ripe for a more definite move in one country or another, it follows that a long time will have to elapse before a general regulation, comparable with that realized under the post-war gold standard, becomes established. Even if a stabilization along the lines discussed here were to stop half-way towards a rational organization, this is better than attempting the impossible and afterwards having to retreat. In the long run it seems highly improbable that one could achieve a higher degree of international exchange stability by attempting a general stabilization than by proceeding by a slower and less formal method which would aim at a regulation of the rates of exchange compatible with a reasonable degree of internal stability. »

(3) *The Future of Long-term International Investment*

One of the difficulties of the present situation has been the strain imposed upon the balances of payment of debtor countries. The question arises whether in the future long-term capital movements will be of the same *order of magnitude* as in the past. This question has been incidentally discussed by Professor Mortara in his memorandum. He takes the view that the typical West European countries exhibit the phenomenon of declining

population and therefore suffer from a lack of *incentive* to save. On the other hand imperialistic and autarchistic tendencies are encouraging the *direction* of investment, so as to put home rather than foreign borrowers into a preferential situation. The result is that, whether the problem of long-term investment is looked at from the standpoint of supply or of demand, the "free" capital market is likely to suffer and the volume of international investment is likely to fall off.

(4) *Can a repetition of the situation of 1931 be prevented in the case of Great Britain?*

A further problem which has caused much anxiety to experts, in the London money market in particular, is whether anything can be done to prevent the recurrence of difficulties in a central money market, such as London, of a kind similar to those experienced in 1931. To this issue Professor Gregory devoted a separate memorandum. His answer to the question « Can a repetition of the situation of 1931 be prevented in the case of Great Britain? » is that the 1931 situation was the result of the combination of a number of very special adverse circumstances, which it is unlikely would recur in the same combination in the future. He sums up his conclusion as follows:

« It is quite impossible to guarantee that there will not be at some time in the future a repetition of this particular combination of circumstances, but it is improbable that the special historical circumstances of 1931 will repeat themselves in detail. It must be remembered that if the world chooses to peg permanently to sterling, the « rules of the game » will be in Britain's hand ; if on the other hand there is to be a return to the gold standard, a factor which was particularly unfavourable to Great Britain in the course of 1931, namely, the unsuitable rate of exchange, can be avoided in the future. »

(5) *The Menace of Short-term Capital Movements*

In the day-to-day working of a stabilised exchange, short-term capital movements present much greater difficulties than do long-term capital movements, because the quantity of funds which can be moved in a very short period of time is so great as

to overwhelm any reserves which might be maintained by the currency authorities. The actual situation has been discussed in a very careful memorandum submitted by Mr. Conolly in what he rightly describes as a new approach to the subject. An estimate of outstanding international short-term indebtedness is given for the end of each year from 1930-1934. This table shows that the volume of outstanding international indebtedness (including that incurred in the course of ordinary trade financing) has fallen from 70 milliards Swiss francs at the end of 1930 to 29 milliards Swiss francs at the end of 1934.

In milliards of Swiss francs	At end of year					
	1930	1931	1932	1933	1934	
Trade financing	22	15	11	9½	9	
Central banks holdings	14	7	4	3½	3½	
Foreign debt service	4	3	2	1½	1½	
	TOTAL	<u>40</u>	<u>25</u>	<u>17</u>	<u>14½</u>	<u>14</u>
All other	30	20	22	17½	15	
B. I. S. estimate of total ¹	70	45	39	32	29	

At the same time Mr. Conolly's memorandum makes it clear that the discussion of the problem of short-term credits has been « short-circuited » in the past by a lack of adequate analysis of the very complicated nature of the transactions involved. He comes to the conclusion that even though the situation is greatly improved, there is no final and ultimate guarantee against difficulties in the future unless there is a restoration of confidence:

« But even taking into account the improved prospects which these new factors foreshadow, it must be emphasized that the technical safeguards which may be adopted by central banks can never be sufficient to fight successfully against an extensive efflux of national capital. The only safeguard against such calamities must be the absolute confidence of the public in the currency systems. This can only be achieved and maintained when general conditions are such as to deserve confidence. It is

¹ Although this estimate applies only to Europe and the U.S.A. it may be taken to represent very little short of the world total. The B.I.S. estimates are made by adding together the data obtained and estimates made for the countries separately. The above table gives a new approach to the subject.

essential that parities with foreign currencies should be fixed at *fair* levels and that no country should attempt to obtain an unfair advantage of its neighbours. In addition, confidence will only be retained in the long run by a sound financial and economic policy which must be the foundation for a sound currency. In this connection the effective collaboration of central banks is of the highest importance, but the financial and economic policy of governments is also fundamental. »

The problem of indebtedness in Central Europe has been investigated in a separate memorandum by Dr. Basch. The position is much alleviated, but before Central European countries can return to the gold standard, a whole series of further measures would have to be taken; fictitious monetary parities would have to be abandoned and clearing régimes would have to be got out of the way; at the same time the consolidation of debts would have to take place:

« *It may be said, on the whole, that, in the countries under discussion, the problem of the frozen credits is far less acute than in 1931-1932. Whether it is possible for these countries to return to the gold standard depends on a whole series of international questions. Above all, it would be necessary to abandon the principle of fictitious monetary parities, in order to secure a certain adjustment which would in itself facilitate the solution of the problem. In this respect also, Austria might serve as an example. The currency rate constituted under these conditions would not be lower and would probably be higher than the unofficial rates at present existing in the various countries. At the same time, it would be necessary to abolish the clearing agreements and to re-instate liberty of trade, the automatic functioning of which might lead to the constitution of a trade balance and of a balance of payments necessary for meeting reciprocal commitments, subject, naturally, to the modification of the trade balance of the other countries. A further stage would consist in the consolidation of what remains of the international debts, by means of an agreement between debtors and creditors, less difficult now than four or five years ago. In view of the depletion of the metallic reserves of these countries, with the exception of Czechoslovakia and Austria, the principle established at Stresa is still valid, namely, that it would be necessary to procure for these countries a *Currency Stabilization Loan*, the principal effects of which would, in reality, be psychological and*

moral rather than material. Generally speaking, it would appear impossible to surmount the existing obstacles otherwise than by a return to liberty of trading and the parallel re-establishment of the automatic functioning of foreign exchange rates and prices.

» All these measures of consolidation converge towards one and the same goal, that goal which we have unceasingly before our eyes, namely the political problem. The clearing of the political horizon would appear the sole factor likely to facilitate the monetary and commercial consolidation of the debtor countries — together with the co-operation of the creditor countries, which may not weigh very heavily in the balance. But, in this case, it must not be forgotten that the economic structure of the countries under discussion has been transformed during the depression, that they constitute a relatively enormous reservoir of purchasing power and future initiative and that it would accordingly be logical, in view of the present economic situation in Europe, to invest foreign capital in these territories. »

Finally, in the last few years' much attention has been devoted to the necessity of raising the world level of prices before a return to stable conditions could be safely undertaken. This is sometimes put in the form of a demand for a return to some pre-defined price level, and consequently a memorandum was furnished on:

(6) *The Significance of a Return to the « Status quo ante »
as regards Prices*

In his short memorandum on this subject Professor Gregory came to the conclusion that, in consequence of the incidence both of rigid costs on the one hand and of indebtedness both public and private on the other, « general stability of price levels is a matter of much greater significance both from the standpoint of economic stability and from the standpoint of political pacification than it was 30 or 40 years ago ». Nevertheless the significance of any price level existing in the past diminishes in the course of time, in consequence of the continuous creation of new contracts formally and informally based upon a price level other than that taken as a starting point. He further comes to the conclusion that « to go back, as some authorities have urged, to a price level which is now 8 years old, would be to create a

new series of disequilibria almost as serious as the disequilibria which were produced in the course of the pre-depression boom and from the consequences of which we have been suffering ».

He urges also that the very fact of recovery points to some adjustment between the level of costs and the level of prices and emphasises that the progress of technique did not cease with the depression of 1929. A price level which was appropriate to the level of costs in the pre-depression era is not necessarily appropriate to the level of costs to-day, in view of the fact that these are falling with the continuous progress of technique.

D. LONG-TERM PROBLEMS

It is significant that the authors of the majority of these memoranda do not concern themselves with the ultimate problems which are likely to arise, if ever the world returns to a gold standard. The attitude taken up is, clearly, that provisional stabilisation does not, in the short run at any rate, involve a return to a gold standard of the more formal kind. Of the memoranda submitted to the Joint Committee only those furnished by Professor Mlynarski deal with what might be called the narrowly technical problem of a restored gold standard.

Professor Mlynarski's view is that any return to the gold standard without drastic revision of this technique would confront the world with the same situation which led to the disasters of the last few years. He therefore makes the suggestion that, if and when the world returns to a gold standard, two devices should be adopted. One is that the pressure exerted on the balances of payments of different countries should be mitigated by inter-Central Bank credits; the other is that there should be instituted a system of gold clearings between Central Banks analagous to the gold pool maintained at Washington, by means of which the various Federal Reserve Banks cleared their gold obligations towards each other.

II. Commercial Policy

A. . CURRENCY POLICY AND COMMERCIAL POLICY

That there is an intimate connection between currency instability and an increase in the volume of protection is obvious from a survey of the current world economic situation, and is, indeed, common ground in the various memoranda devoted to commercial policy. Increased protectionism is a temptation to other countries to resort to currency instability; on the other hand, when countries practice currency instability, they encourage others to retaliate by means of increased protection.

The intimate relationship between currency instability and tariff changes is emphasised in the following citations from the memoranda drafted by

1. Professor Jacob Viner:

(a) « Not only does currency instability constitute in itself a barrier to trade, but the existence of currency instability or of threats to currency stability leads in several ways to the deliberate establishment of restraints on imports, which, imposed though they are as emergency measures, tend to persist long after the situation which led to their establishment has passed away. »

(b) « I wish here only to emphasise that currency instability and trade barriers are mutually supporting, that each provides a pretext for the continuation of the other, and that it is unlikely that either problem will soon obtain even a partial solution unless they are both attacked simultaneously as inter-related aspects of a general situation. »

2. Dr. Pasvolsky:

« The absence of currency stability has an extremely detrimental effect upon the process of reduction of trade barriers. So long as no assurance exists as to the relative values of the national currency units, nations will hesitate to assume definite and far-reaching commitments with respect to the devices which they

employ for the protection of their national economies from foreign competition. The degree of reduction of customs duties will inevitably be such as to take into account the possibility of a sudden and substantial alteration in the terms of trade resulting from changes in the exchange rates. While such danger exists, there is little likelihood that the machinery of quantitative control will be scrapped, since its operation might have to be invoked on short notice to meet emergency conditions. For the same reasons, commercial treaties and agreements are likely to be of short duration or be made subject to denunciation on short notice. Alternatively, reservations with respect to change in the exchange rates are likely to be written into commercial treaties and agreements. »

3. The third writer who may be quoted in support is Professor Predöhl. His view is that it is impossible to expect an early disappearance of the characteristic modern form of protectionism, namely, the tariff quota, until currency instability has disappeared :

« The question of a mitigated use of the tariff quotas is closely bound up with that of the relation between currency-stabilization and trade restrictions. Both depend on the realisation of monetary stability, and the eradication of causes of crisis. So long as this condition remains unfulfilled, so long will tariff quotas remain indispensable means to equilibrium in the Balance of Trade and Balance of Payments. »

But in fairness to Professor Predöhl, it must be pointed out that he takes the view that even if currencies are stabilised, the idea that « tariff quotas may be generally abolished » is a conception « fit for a better world than ours. So long as the interests of the various countries lie in different directions, and the interest of each separate country lies in a certain distribution of its total import trade amongst the various branches, so long will the tariff quotas remain a necessary economic conception... Autonomous policy is assailable... only in so far as it is a product of crisis, not in so far as it is part of a process of evolution. »

B. THE BACKGROUND OF INCREASED PROTECTIONISM

Two memoranda were written explaining the reasons for the growth of protectionist sentiment in the modern world. The first of these by Professor Bohler, dealt with :

(1) *The Exaggeration of the Arbitrary Element
in the Movements of World Trade*

Professor Boehler's argument is as follows:

Firstly : the relations between various economic factors exhibit what he calls « a remarkable constancy » in spite of state interference, political change, « as well as cyclical fluctuations and war influences ». Thus, between 1883 and 1913, the average annual rate of growth of world trade was 3.6 %, which corresponded closely to the rate of basic production during the same period. « Even the reinforced tendency to self-sufficiency after the War could not hinder the increase of the said rate of growth to 4.85 %, average of 1925-1929, against 4.52 %, average of 1908-1913, which again seems to have equalled the rate of growth of the world's basic production ».

Secondly : Even where striking deviations from the normal development of the last century have taken place, as is the case with the domestic production and consequent decline in the importation of bread-stuffs, there is a countervailing tendency to increase the importation of other kinds of foodstuffs and of raw materials. Thirdly, there is a general tendency to neglect the extraordinarily high cost of self-sufficiency. Further, in current discussion there is an habitual tendency to neglect the importance of secondary industries, such as building, printing, and public utilities which are, to a large extent, if not entirely, immune from foreign competition. Lastly, even the neglect of the importance of the trade between industrial countries themselves does not negate the fact that, in spite of technological changes, international trade in industrial or semi-industrial products has shown surprising resilience, e.g. in spite of the growth in the use of hydro-electric power the international trade in coal has maintained its position surprisingly well.

The conclusion to which Professor Boehler arrives is as follows :

« To summarise, it may be stated that most apprehensions in regard to a possible reduction of world trade on technological grounds could not be verified in the long run. But it is probable that the attempts to increase the percentage of internal production of foodstuffs and raw materials for political reasons will increase for some time to come. Owing to the unavoidable reactions one

may expect that this tendency will find a growing objective resistance, so that in the long run the relations between inland production and imports will not be changed.

» On the contrary, the greatest theoretical possibilities of a recovery of world economics lie in the reversal of this policy, because the exchange between agricultural and industrial states has also in the post-war period contributed most to the increase of international trade. It would mean a short-sighted policy to stifle these economic possibilities for European countries by an excessive policy of self-sufficiency. Likewise, for most European countries the exports to other European countries comprise still the highest percentage of total trade. So a reciprocal loosening of restrictions on foreign trade with these countries would certainly mean one of the most efficient stimuli of recovery of the world as a whole. »

A second memorandum was furnished by Professor L. Robbins on :

(2) *The Basic Intellectual Urge towards Increased Protectionism in the Modern Age*

Professor Robbins' argument is as follows:

Though the ideal of self-sufficiency as part of a general plan of military preparation is important, and as such, has always been conceded even by free traders, the degree to which there are inherent differences of ultimate aim is capable of great exaggeration.

Secondly: exclusive gains by any one group, even if that group pursues its objective without regard to the situation of the world as a whole, are, in fact, hardly ever realisable, even in times of emergency.

The popular argument that the general extension of machine technique has fundamentally altered the terms of the problem does not dispose of the fact that trade cannot be carried on merely by exchanging one kind of raw material for another. « ... if trade in raw materials is to continue, there must be also some trade in finished products. The distribution of natural resources between the different national areas is not such as to permit trade to be carried on only by the exchange of one kind of raw material for others. If the exporters of raw materials refuse to import manu-

factured articles, then the would-be importers of raw materials will be unable to secure the means of paying for them ».

The general tendency towards increased protectionism has been greatly strengthened by a general increase in the rigidity of economic organisation, and it cannot be denied that protectionist measures which would not be justified if the general economic organisation were more flexible receive a certain degree of justification by being part of a generally rigid system. The result is that if protectionism is to be successfully fought, the struggle must be directed, not only against tariff measures in particular, but against the whole complex of devices of which it forms a part.

This conclusion may be stated in Professor Robbins' own terms:

« In the first place, since the growth of protectionism is essentially a manifestation of the progressive development of wrong ideas regarding the benefits of such policies, it follows that only by the education of public opinion to more correct views can the process be reversed. From time to time something may be achieved by tactics. Distressed governments may be manœuvred into a position in which without settled views as to policy they adopt measures conducive to greater freedom of trade. But in the long run the chronic disposition to succumb to the temptation of the seen, rather than the calculated effects of policy, can only be resisted by an educated public opinion.

» But in the second place, since the intensification of protectionism is to be ascribed to the cumulative effects of all kinds of restrictive policies, of which protectionism is only one, it follows that this process of education is likely to be much more effective, if it is part of a frontal attack on measures conducive to restrictionism and instability in general, than if it is limited to an attack on tariffs. There is much more hope of inducing the public to tolerate the absence of protection to special interests if the incidence of change on these special interests is minimized by an absence of hindrances to transfer to other lines of enterprise. The public is much more likely to tolerate the disturbances incidental to tariff reduction, if at the same time it has not to contemplate the disturbances incidental to monetary instability. Only by a general rehabilitation of the principles of sound policy can the present vicious circle be reversed. »

C. THE TECHNOLOGICAL ASPECTS OF TARIFF POLICY

(1) *The Emergence of a New Object of Protectionist Policy*

It has been made clear enough in the memoranda dealing with currency policy that one of the main preoccupations of modern states, especially those producing raw materials who are at the same time debtors of the industrial countries, is the equilibrium of their balance of payments. Thus protectionism in the modern world has two basic supports: not only is it desired to protect particular industries from external competition, but it is hoped, by protectionist device, to maintain the balance of payments in equilibrium. This is a new feature in the world economic situation to which attention is drawn, particularly in the memorandum by Dr. Pasvolsky:

« During the decades immediately preceding the World War, international trade operated mainly on the basis of price competition. Customs duties constituted the only important protectionist device, utilized, generally speaking, for the purpose of regulating the terms of competition between domestic and foreign producers in the marketing, within protected countries, of more or less closely competitive commodities. There was little, if any, preoccupation with the problem of the international balances of payments, but rather a general assumption — which was, in fact, borne out by actual practice — that accounts between countries will tend to adjust themselves through the operation of the various elements comprising them and through the functioning of an adequate international monetary and credit system. The safeguarding of individual domestic industries was the clearly recognized objective of protectionism, and, judged by post-war standards, the degree of protection was small. Moreover, again as compared with post-war conditions, the pre-war decades were singularly free from sudden disturbing factors in the operation of the highly integrated international trade, monetary, and credit systems. »

But, though the necessity of safeguarding the balance of payments plays a leading rôle in protectionist discussion to-day, it is a mistake to suppose that measures intended to produce a satisfactory result vis-à-vis of the balance of payments have no

effect upon the position of individual industries. On the contrary, it is difficult to imagine protectionist measures of any kind which do not have differential results or, as Dr. Pasvolsky puts it:

« The result is that even when the primary objective of protection is the safeguarding of the balances of payments, in effect the action involved leads to the according of an extraordinary measure of protection to individual industries. Usually, in order to reduce the requirements for foreign payments, drastic limitation is imposed upon the importation of those commodities which happen to be less indispensable or which happen to be of such a nature that with respect to them expanded domestic production may, with relatively greater ease, supplant imports. It frequently happens that the safeguarding of the country's balance of payments becomes merely an excuse for increased protection of individual industries. »

(2) *The Case for and against the Tariff Quota*

Since the tariff quota has become the most conspicuous feature of protectionism since the onset of the depression, it is only natural that much attention should have been paid to the implications of the quota system in the memoranda furnished to the Joint Committee. As already pointed out, Professor Predöhl regards the quota system as vicious only to the extent that it embodies attempts to deal with the special phenomena of the crisis : in so far as quotas are an expression of the more fundamental desire for self-sufficiency, they must be accepted as part of the normal order of things. Other writers of memoranda take up a very different attitude. It is not denied that quotas are more certain in their incidence than normal tariff rates would be, but this circumstance, so far from making quotas desirable, renders them even less desirable in normal times.

The two following passages from Dr. Pasvolsky's memorandum may be quoted in this connection:

1. « When nations find themselves in conditions in which they believe that they need quick, certain, and drastic reduction of imports, they are likely to resort to quantitative restrictions, which permit the accomplishment of this result. Hence, many creditor countries have added import licences and quotas to the arsenal of their protectionist weapons, while most of the debtor

countries have introduced exchange controls, frequently combined with the other forms of quantitative regulation. In addition, the other protectionist devices described above have come into use or have been intensified in their application. »

2. « The characteristic feature of customs duties noted above — namely, the fact that they do not allow of certain and predictable determination of their effect upon the volume of imports — which militates against their use under emergency conditions, renders them far more desirable as an instrument of protection under normal trade conditions. While customs tariffs unquestionably interfere with a full functioning of price competition in the operation of international trade, they do not, when used in reasonable moderation, destroy such competition or even seriously impair it. They leave a substantial scope both for the exercise of business initiative and enterprise and for a play of the forces of supply and demand in the formation of the prices which consumers in the protected market have to pay for the products of the safeguarded industries. »

Professor Viner points out that the present very widely extended use of tariff quotas is the second occasion upon which, since the outbreak of the War in 1914, resort has been had to this particular device. His main emphasis is upon the increase in administrative responsibility which the use of quotas causes :

« The fixing of quotas is almost invariably and of necessity an administrative responsibility, whereas legislatures have, for historical reasons, been jealous of their power over tariff rates and have been reluctant to surrender this power to administrative officials. By the substitution of quotas for import duties, administrative authorities thus obtained a greater measure of power over commercial policy, and appreciated especially the greater flexibility and speed in adjustment to rapidly changing conditions which this made possible. They escaped also in large part the necessity of disclosing and defending their policies in detail before the legislative bodies. The consuming public, moreover, were ordinarily even less conscious of the burdens resulting for them from import quotas than of the burdens resulting from formal import duties, and by the use of the import quota restrictions could be placed on imports without arousing the same degree of protest from consumers which would have followed the imposition of formal import duties sufficiently heavy to accomplish the same degree of import restriction. In tariff

bargaining, also, quotas probably had an administrative advantage over import duties in that their greater effectiveness as restraints on trade made other countries more willing to make concessions to obtain an increase of a quota than they would be to obtain the reduction of a duty. It was also probably regarded in many quarters as an « advantage » of quotas that since most-favoured-nation pledges in commercial treaties made no provision for them, and there was no satisfactory way in which the most-favoured-nation principle could be applied to them, they opened a path to almost unlimited discrimination between countries, without involving overt and unambiguous violations of at least the letter, if not the spirit, of existing most-favoured-nation obligations. »

Even from the administrative point of view, however, the advantages of the quota system can be exaggerated:

« The same absence of an obvious rule for allotting quotas among different countries in accordance with treaty obligations or equity which facilitated discrimination between countries made it also impossible for countries to acquit themselves of charges of unfair discrimination no matter how guiltless they were of the intention unfairly to discriminate, and no matter what principle of allotment they adopted. The task of allotment of the quotas among importers was also extremely difficult and burdensome, and made necessary continuous negotiation and controversy with importing interests, much more embarrassing in kind and more intensive in degree than the formalities involved in the routine administration of ordinary import duties. »

(3) *The Present Significance and the Future of the Most Favoured Nation Clause*

Throughout the nineteenth century, the concessions granted to each other by means of tariff-bargaining between states were extended to other countries through the Most Favoured Nation Clause. Even where mutual tariff concessions proved impossible, a certain degree of mitigation of the severity of a customs régime was possible through the mutual extension of concessions which had in the past been granted to others. Thus, if Country A. found it impossible to make direct concessions to Country B. and *mutatis mutandis*, Country B. found it impossible to make direct

concessions to Country A., nevertheless, the existence of the Most Favoured Nation Clause, at least in the form in which it was adopted by European countries, made it possible for both Country A. and Country B. to benefit from the reductions which each separately had made, e.g. to Countries D.E.F. and so on. Since the War, the value of so generalising concessions has been much questioned. Even before the War, the value of the Most Favoured Nation Clause was somewhat reduced by the growing technical perfection of the tariff systems of the world. As a consequence of increased specialisation, concessions made, e.g. by Country A. to Country B., although extended to Country C. by means of the Most Favoured Nation Clause, proved in practice to be of relatively restricted value to the latter because the concessions made to Country B. concerned a narrow range of commodities in which C. was in practice not particularly interested. Moreover, even in pre-War-days, the use of the Most Favoured Nation Clause in its so-called unconditional form, was not absolutely universal; the United States, in particular, refused to make use of the unconditional form, and insisted upon applying the so-called « conditional form » under which the grant of a concession to a given country was made conditional upon that country granting to the grantor concessions equivalent to those made by all other countries to which Most Favoured Nation treatment had previously been extended.

Furthermore, the question of whether the existence of the Most Favoured Nation Clause is not a barrier to the conclusion of regional pacts has been much canvassed of late. For these reasons the analysis of the problems of the Most Favoured Nation Clause contained in the memoranda submitted to the Joint Committee is of special importance. Both Professor Viner and Professor Charles Rist have analysed the problem of the Most Favoured Nation Clause in their memoranda.

They concur in stressing the relative failure, in practice, of the conditional form of the Most Favoured Nation Clause, the most striking evidence of which failure is furnished by the change in the treaty practices of the United States, which since 1922, has adopted the unconditional form of the Clause.

The opposition to the Most Favoured Nation Clause, according to Professor Rist, simply sums up the normal hostility of importers to increased international competition, for every extension of the Most Favoured Nation Clause implies an increase

in the potential area of supply. But there is a fundamental contradiction in the attitude maintained towards the Most Favoured Nation Clause by the majority of those who object to it. They are unwilling to see the area of competition widened, but, on the other hand, when they are thinking of exports, they are unwilling to submit to the differentiation which would be implied in a complete abolition of the Clause. Professor Viner in fact agrees with this analysis : « Even countries », he says, « that are reluctant to give the Most Favoured Nation pledge, are insistent... upon obtaining it, and while the unconditional pledge does, in some ways, act as a barrier to negotiation of tariff treaties, refusal to grant it would also act as such a barrier, and, if we may judge from past experience, to even a greater degree. »

But there is no reason, as Professor Viner points out, why the Most Favoured Nation Clause should be abused by high-tariff countries which refuse to make concessions and yet benefit by the concessions reciprocally made by others. His argument on this point is so important that it had best be quoted in full :

« There is a solution for this problem which is consistent with adherence to the unconditional principle. The most-favored-nation pledge should not, or need not, be granted as a routine matter, and as merely an incidental provision in stereotyped treaties of commerce and navigation. It should, instead, be made an integral part of *tariff* treaties, and accorded, reciprocally, as one of the significant items in the mutual exchange of considerations. The life of the pledge, moreover, should be made coterminous with the life of the other provisions in the tariff treaty. To countries with low-tariff and non-bargaining policies most-favored-nation treatment should be extended without a pledge, or if with a pledge the pledge should be subject to termination in case of departure from the low-tariff policy by the country receiving the pledge. High tariff countries which refuse to engage in tariff-reducing negotiations should not be given a pledge of unconditional most-favored-nation treatment, and whether in practice such treatment should be extended to any of these countries or withheld from them should be determined as expediency may dictate. Even if only a handful of countries were to adopt the policy here recommended, it would suffice to remove in large part whatever validity there is in the objection to the unconditional principle that it operates as an obstacle to tariff reduction, and would make it more unquestionably than it has

been in the past an instrument toward the reduction of tariffs as well as an instrument toward uniform treatment of all countries in good standing in tariff matters. It should be noted, however, that the policy here advocated could be followed in better grace by a country with a low tariff than by a country whose own tariff seems unreasonably high to other countries, and low tariffs are at the moment very nearly non-existent. »

(4) *A New Approach to the Problem of Tariff Relations*

is provided by the author of one memorandum who desires to remain anonymous. He starts his analysis by asking whether the best method of meeting the critical situation of the raw material and food-producing countries is not to take concerted action to increase the average level of consumption in the industrial states:

« The World Monetary and Economic Conference of 1933 proved quite ineffective to bring about any measures either of currency stabilization or of reduction of trade barriers and its only effective proposals were those for the temporary restriction of production of raw materials. The reason for restrictions was the belief that economic recovery could not come about unless prices of raw materials could be raised substantially above their then levels. Now, however, that internal recovery is showing itself in a considerable number of countries, that here has been a certain measure of price recovery in some important staples and that producers in some of the overseas exporting countries have adjusted themselves to lower prices than obtained in 1929, it may be asked whether measures to increase consumption are not the most direct way of bringing an end to the present impasse. If this contention is sound, then probably the best starting point is to be found in efforts to increase the consumption of food since it is now clear that great improvements in public health can be brought about through the greater use of what are known as the « protective foods ». It is recognised that industrial countries are not prepared to face violent disturbances to their own agricultural production. The fear of this hitherto rendered ineffective attempts at all-round tariff and quota reduction, and even at a « tariff truce ». But import restrictions in the industrial countries have had the result of keeping foodstuff prices much above the

levels at which those foodstuffs might have been available to their populations. Moreover, adjustments of costs to lower levels of prices have not been as they have in many cases in overseas agriculture. »

He makes the further point that, even in the wealthiest and best nourished countries in the world, the dietary of a very considerable fraction of the population is inadequate, « so far as the protective foods are concerned. This does not mean that there is any starvation in the United Kingdom, or even that any considerable section of the population is under-nourished in the ordinary sense; but it shows that, in the wealthiest countries, there is great scope for social policy to make improvements in public health through encouraging the adequate consumption of the health-promoting foods ». It is his point that the needs of public health and the needs of the overseas producers of staple products coincide: tariff policy in Europe designed to encourage European agriculture should lay stress upon the domestic production of those particular products which, from the standpoint of the public health of the people, are at present insufficiently consumed and yet are capable of being most efficiently produced by the European farmer. He sums up as follows:

« The change would not be rapid and Europe would, of course, continue as always to produce a large proportion of, for instance, her wheat requirements. The effects upon international trade would, however, be wholly beneficial. Increased milk and egg production in Europe would necessitate increased imports of animal feeding stuffs and a gradual revival of world markets for wheat, maize and meat might be looked for.

» Defence considerations might be expected to delay the reorientation of European agriculture but as it became realised, firstly, that animal husbandry leads to high soil fertility and would thus enable a country to produce food in an emergency with less reliance upon imported fertilizers and, secondly, that enlarged herds provide in themselves an invaluable food reserve, the present devotion to cereals and sugar would become less intense. »

(5) *The Road to Recovery : Bilateralism v. Multilateral Agreements*

Admittedly, any mitigation of the existing high level of protection can only come about as a result of international agree-

ment, both in the field of currency reform and in the field of tariff-treaty making. But the question at once arises whether such international agreements should take the form of bilateral pacts or whether, as is sometimes argued, an attempt at reform should be made through a multilateral tariff truce which might, in fact, only stabilise the status quo, or through the conclusion of a multilateral agreement envisaging the gradual reduction of tariff rates by agreed percentages all round.

The technical difficulties of measuring the burden imposed by duties of a given absolute height have been analysed by Professor Viner in one of his memoranda. He takes the view that « no clear and unambiguous meaning can be given to the concept of the « height » of tariffs, and no precise economic significance can be attached to any of the current methods of measuring the height of a tariff ». Since the burden imposed by tariffs cannot be measured directly by comparison of the absolute height of the tariffs concerned, it is clear that proposals for a uniform percentage reduction of tariff rates would in practice prove to be inequitable between State and State.

Professor Viner brings impressive arguments against the use of multilateral agreements in tariff matters:

« The recent history of multilateral negotiations is not such as to warrant optimism as to a successful outcome from further attempts in this direction. The more countries there are participating, the smaller is the pressure on any one country to make concessions, the smaller is the responsibility or credit attaching to any one country or its representatives for the failure or success of the negotiations, the greater is the probability, if the scope of the conference is limited, that for some of the participants the product of the negotiations will appear to be concessions without compensation in return, and the greater will be the opportunity to make empty but generous sounding speeches in the more public meetings while pursuing wholly obstructionist tactics in the business meetings. In any case, the failure of past conferences has, for the time being at least, put a curse on such conferences in the public mind, and bilateral negotiations, or perhaps better, negotiations between small groups of important countries, would seem to offer more prospects of success in the near future than ambitious multilateral conferences. »

Nor is he enthusiastic as to the prospects of a tariff truce; though previous failure in this respect is not to be accepted as

decisive, still, « It seems obvious... that none of the important participants at the Geneva Economic Conference participated in it with a genuine determination that something substantial should emerge from it, that what enthusiasm there was behind it was the enthusiasm of the League's Secretariat unbacked by power, and that the National representatives who had the power lacked the enthusiasm... the need now is for much more than a tariff truce, which might indeed be an evil rather than a good if it had the psychological effect of freezing the status quo and of permitting Governments to experience the warm glow of moral achievement merely because they had promised not, for a time, to make a bad situation still worse ».

While Professor Viner is thus not in favour of multilateral tariff agreements—, he thinks that something could be done by general agreement to abolish the quota system:

« Countries which would not think of abandoning the quota system unilaterally might be willing to contemplate such abandonment if it were part of an international movement in this direction. Multilateral agreement seems a much more promising avenue to mitigation of the quota nuisance than either unilateral or bilateral action, especially as in any international conference there would be important participants who were definitely hostile to the quota system, or who had adopted it only or mainly as a means of coping in trade bargaining with other countries who adhere to it. Except, however, on the ground that past experience indicates that protectionism has tended to wax in periods of depression and to wane in periods of prosperity, there is not much in the present situation to give hope of an early demise of the quota system. One can resort to wishful thinking about the irresistible influence in time of education and the spread of enlightenment, but the educational process works slowly and uncertainly, and its product is not invariably good to look upon. »

Dr. Pasvolsky is also opposed to the use of multilateral procedure in the negotiation of tariff reductions, primarily on the ground that the use of bilateral agreements can result in practice in much more significant reductions than those likely to be granted under multilateral pacts:

« In my opinion, bilateral agreements are more effective than multilateral arrangements as instruments for the reduction of trade barriers. It is difficult to imagine a multilateral agreement that would do more than provide for a horizontal cut in the

general level of customs duties in the participating countries. Such a cut, because of its general nature and because of the differences in the economic position of the countries concerned, is not likely to be extensive. Most of the recent discussions with reference to possible multilateral commercial arrangements have run in terms of cuts of the order of magnitude of 10 per cent. Bilateral agreements, on the other hand, permit much larger reductions with respect to selected commodities. Each of the signatories can concentrate its attention upon those trade barriers which hurt the most and can seek concessions with regard to those of its exports the sale of which in the market of the other signatory is especially restricted. While the bilateral method is slower and more cumbersome than the multilateral method, it is more likely to result in an increase in the volume of trade, provided, however, it is accompanied by appropriate action in the field of the application of the most-favored-nation principle. »

Finally, it has more than once been pointed out in these pages that currency instability has been a potent force making for higher tariffs. It is equally necessary to point out that tariff policies are capable of imposing such strains upon countries in a dependent position that they are forced into financial and tariff practices detrimental to the continuance of international trade. These considerations apply particularly to the relations between creditor and debtor countries. The duties of creditor countries cannot be stated more clearly than Professor Viner has done in the following sentences:

« The creditor country which during a depression imposes new restrictions on commodity imports (or on the export of capital) is therefore in effect by these measures operating to force the debtor country to default on its capital obligations, or to increase its own barriers on imports, or to do both. While debtor countries are sometimes only too ready to grasp any excuse for failure to carry out their financial obligations to the letter, the common behavior of creditor countries in the field of commercial policy during a severe depression does provide their debtors with some measure of moral, if not legal, justification for refusing to make tremendous sacrifices in the attempt to fulfil the letter of their bonds.

« Countries which deliberately assume the creditor-rôle should either feel compelled to recognize that they thereby assume also an obligation to refrain from measures which make fulfilment of

their contracts by the debtors actually or seemingly impossible or possible only at the cost of intolerable sacrifices, or else they should reconcile themselves to accepting with good grace failure by their debtors to meet their obligations on schedule during periods of stress. One of the clearest lessons to be learnt from the experience of the past few years is that before resumption of international capital movements on anything like the pre-depression scale can safely be permitted, there must occur a substantial reduction of trade barriers, even compared to their 1929 levels, and that the creditor countries in particular must recognize the inconsistency — and the futility — of demanding full payment of what is owing to them if they are simultaneously following a trade policy which makes such payment unreasonably burdensome if not impossible. »

August 1936.

(Signed): T. E. GREGORY.

Report of the Expert Committee

(Submitted June 26, 1936)

Introduction

Welcome signs of economic recovery following upon an unprecedented trade depression are manifest at the moment. But the recovery which is witnessed is only partial and, limited as it is to certain countries, it calls for a program of co-ordinated action if its benefits are to be extended to all activities and are to assure thereby lasting peace and prosperity to mankind. The crisis from which we are gradually emerging has left in its train acute political unrest, many social problems of great magnitude and a dislocation of the trading relations throughout the world which has meant poverty and suffering to millions of human beings. A solution must be found to these problems. A reconstruction of international economic relations is urgently required. The first step must be a recognition of the fact that the present situation is abnormal, both as regards the causes which have produced it, and as to the consequences which it itself has produced.

Already on one occasion after the war — in the years 1924 to 1928 — an attempt was made to reconstruct the world economically and financially. Currencies were stabilized, import and export prohibitions were abolished, even tariffs were reduced. The result was rapid progress in production and in world trade, improvement of the standard of living and a general return to prosperity. Within a few years, however, success changed to failure. A depression came, perhaps more profound than ever before experienced in times of peace. Disappointed by this failure, there are those who seem inclined to draw the conclusion that any attempt to solve the world problems of today on international lines is out of the question. They therefore fall back on

purely national remedies. In the monetary sphere they distrust general stabilization for the simple reason that the international gold standard, after its re-establishment, broke down in 1931. It is, however, not always sufficiently remembered to what extent post-war economy and finance were characterized by a number of artificial and precarious elements. It is this which, on the one hand, explains the severity of the crisis through which we have passed, and, on the other hand, holds out the hope that if these particular causes are eliminated, as they have largely been, recovery would be achieved on more secure foundation.

Firstly, the war left in its wake a tremendous superstructure of liabilities. Domestic debts had increased; and in the foreign field there were the political debts to which the economic structure had not become adapted, and which consequently proved a great strain on the balances of payments of various countries.

For a certain time, these various obstacles were submerged by a flood of international lending, but this development entailed new difficulties of its own. Long term loans were floated to a degree which, seen in retrospect, must be regarded as excessive; when the supply of long term capital declined, resort was had to short term lending and it was the instability of the latter which was responsible for one of the most characteristic aspects of the depression — the strain on the banking system and the balances of payments of many countries. Here, however, we are able to record substantial progress. Short term indebtedness in gold has been reduced by more than one-half and the volume of long term debts has also become smaller. Reparations were effectively settled in Lausanne in 1932 and the war debt question is admittedly to be re-considered. The external liabilities of the war and post-war period thus no longer represent the same serious handicap to the attainment of equilibrium.

Secondly, this superstructure of indebtedness was built up on the basis of a price-level which, in terms of gold, was about 50 % higher than the level of prices in 1914. It had been hoped for a time that such an increased price-level would be maintained notwithstanding a decline in the current gold production, as measures might be taken to economize gold and, generally, to use it more effectively as a basis for credit. But these hopes proved illusory. There came a violent fall in prices, upsetting all economic calculations. The consequence was, however, that

prices in terms of gold were suddenly reduced to below the pre-war level and, at the same time, gold production increased to record figures. A new situation has arisen and new forces are now at work. The world should be able to expect a definite rise in prices in the near future. Such an upward trend of prices, it should be noted, should greatly facilitate an adaptation of cost levels in different countries and a general reduction in trade barriers. In the past, it has been in periods of rising prices that trade barriers have been most easily lowered.

Thirdly, as a result of destruction of capital during the war, rates of interest remained on very high levels in the post-war period. While countries in Eastern Europe were able before the war to borrow at rates of 4 and 4 1/2 %, and other countries even more cheaply, the bulk of the post-war lending to the countries on the Continent of Europe was at the rate of 6, 7 or 8 %. Borrowing at such rates may have been necessary when it was a question of suddenly supplying impoverished countries with funds; but in the long run, large international capital movements on such a basis were bound to have unsettling effects. An adjustment to lower rates, both for international and domestic loans, was necessary; but such adjustment proved extremely difficult, given the large volume of Government and other indebtedness which had to be converted. In this respect, again, a marked progress has been made in recent years in a large number of countries. It is illuminating that those countries which were able substantially to reduce the general level of interest rates were the first to enjoy a considerable recovery.

The depression through which we have been passing has thus not been only an ordinary downward trend of the business cycle, but it has been aggravated by a number of factors arising out of the liquidation of the war. As has been indicated above, these special aggravations are no longer of the same weight as they were only a few years ago, and in several instances a true redress has been achieved. It cannot be too strongly stressed that this improvement in the technical position provides a hopeful basis for further efforts to bring the world back to general prosperity. There are of course many difficulties still to overcome. Adaptation must be made to structural changes, but such adaptation should be easier in a period of gradually rising prices, to which we may look forward, than it was in the period of declining prices after the war. There are further consequences

of the depression itself which still have largely to be remedied.

Once the depression had begun, a twofold sequence of changes became apparent. Increasing economic distress accentuated political unrest; political unrest in its turn aggravated the lack of confidence which the depression itself generated. Indifferent to the general world situation, each nation attempted to solve its own local unemployment problem by measures which only too often increased the pressure on other areas. Instead of creating conditions facilitating a general increase in output and employment, many nations simply attempted to reduce the import of foreign goods. The inevitable effect was a disastrous decline in the volume of international trade and a breakdown of the normal machinery by which that trade was sustained.

Any program of reform must take account, both of the facts of the present and of the necessities of the future.

Leaving on one side vague general ideals and theories, in order to devote itself entirely to what is at present feasible, the Expert Committee appointed by the Joint Committee of the Carnegie Endowment and the International Chamber of Commerce has endeavoured, on the basis of numerous reports by experts, to devise measures which can immediately be put into practice and which seem calculated to further appreciable progress in international economic relations.

Before going into the details of these recommendations, the Committee desires to emphasize what it considers as an extremely important point: it is useless for countries to conclude conventions for the concerted reduction of trade barriers so long as they are not actuated by a sincere desire for co-operation and mutual understanding. A lasting solution of the existing difficulties will be impossible so long as the nations refuse to recognize and apply the fundamental economic principle according to which goods and services must be accepted in payment for international obligations, whatever their nature.

Subject to these preliminary remarks of a general character, what is necessary in the international economic field is a concerted attempt to diminish the existing obstacles to the reconstruction of international economic relations, whether these obstacles arise in the monetary sphere or in the realm of commercial policy.

The technical situation is decidedly more hopeful, but the general situation is still fraught with great anxieties. It is a

commonplace — but a commonplace of the greatest importance — that furthering of general economic prosperity presupposes a minimum of understanding between nations.

The spirit and the ideas by which the nations are actuated remain indeed of greater significance than the perfection of purely technical devices. If it should happen that the pessimists prove right and another great war breaks out, obviously we should experience all over again the upheaval of currencies and prices which characterized the period 1914 to 1918 and of which we still feel the aftereffects.

But even though war be averted, the fear of war is in itself a powerful factor hindering economic improvement. It produces a tendency to autarchy and increase in armaments, mutual distrust leading to a stoppage of new international financing and a withdrawal of old credits — all developments which tend to make the world poorer than it need be. To the extent that re-employment depends on an extraordinary large volume of armaments expenditure, it obviously rests on a more precarious basis than if work were provided by the ordinary recurrent demand of the general public.

The conclusion is inevitable that world peace and a return to prosperity through the revival of world trade are one and indivisible.

Practical Conclusions

I. COMMERCIAL POLICY

In the later sections of this report, it will be pointed out that a pre-condition of a lasting currency stabilization is a more orderly arrangement of the international commercial policies. At this place, it is necessary to urge the converse of that proposition, i.e. that a more liberal commercial policy will only be feasible given a certain minimum stability in foreign exchange rates, as well as a general increase in production and employment, which greatly depend on a sound domestic monetary policy.

A. *Tariff Levels*

The general tariff level, which had already mounted appreciably during the post-war years, has risen considerably in most countries since the depression. To-day, more than ever, a substantial reduction of tariffs is an urgent necessity.

Tariff demobilization, indispensable though it may be, can only be effected by a series of successive *stages*. In this respect, and as regards the various proposals submitted, it is necessary to discriminate between those which, in present circumstances, stand no chance of being put into practice and those which, on the contrary, could be carried out and bear fruit in a not too distant future.

1. *What it is not possible to achieve at present.*

(a) *A general tariff truce.* — Under existing circumstances, a general tariff truce seems impossible. Those States which would be willing to adhere are probably restricted in number and their willingness to consider a truce would rapidly diminish if outside States were simultaneously to increase their tariff rates.

(b) *An all-round and simultaneous reduction of tariff rates.*

— An all-round and simultaneous reduction of tariff rates, by multilateral agreement, appears equally impossible for the moment. In the first place, *specific duties* occupy a very important place in modern tariff technique. It appears to be very difficult to find a formula by which specific duties levied on a very large number of articles can be reduced so as to arrive at an equal all-round percentage reduction. Further, the *actual levels* of the tariffs levied by different countries differ very markedly. Difficulties would at once arise as to « fairness » of the percentage reduction proposed. In all probability, nothing of any substantial consequence would result.

2. *What can immediately be done to pave the way for wider tariff demobilization.*

(a) Although the experience of the past few years seems to point to the impossibility of a multilateral policy of tariff reduction in the near future, something could already be achieved by States which propose to negotiate new tariff agreements with each other, by abandoning the practice of raising their tariff rates preparatory to bargaining. Since such mutual raising of tariffs leaves the bargaining position of the contracting parties unaltered, it is clearly useless and its net effect is simply to strengthen protectionist sentiment.

(b) Instead of endeavouring to achieve uniform reduction by an all-round and simultaneous lowering of tariff rates according to a given percentage, it would be preferable that States should undertake, by multilateral agreement, to fix *maximum rates* which should only be exceeded in individual cases specified in advance. It is not within the sphere of an international body of experts to suggest to individual Governments what the appropriate maximum level of their tariff should be. The first step in the direction of reform must consist in furnishing to the inhabitants of different countries a clearer guide than is at present available to them of the burdens which they are actually carrying through the tariffs at present levied on goods passing the various frontiers. The members of the Expert Committee are aware of the technical difficulties which have from time to time been raised when a suggestion for the creation of a comparative index of tariffs has been brought forward. Nevertheless, while they

agree that final scientific accuracy cannot be achieved in the present state of economic knowledge, they are of opinion that an international index would possess such real significance in estimating the comparative burden imposed by the duties actually levied, that they strongly recommend the creation of an international centre whose sole duty would be to construct such an index and to publish periodical surveys.

(c) The replacement of specific duties by *ad valorem* duties has frequently been recommended as being of a nature to facilitate tariff demobilization. The technical advantage of *specific duties* have led to a very considerable increase in their use. They are certain in their incidence, and they have the administrative advantage that the consumer is very often unaware of the heaviness of the burden which is imposed on him. But at the same time these so-called advantages do not outweigh the serious circumstance that specific duties, simply because the burden of their incidence is unsuspected, do in fact encourage an increasing measure of protection. It has therefore been suggested, in certain quarters, that the first step in the direction of a more sensible tariff policy should be the replacement of specific duties by *ad valorem* duties. In so far as this can be done, it is certainly desirable. But it cannot be denied that, under present conditions, such a policy would not only encounter serious difficulties, but would be attended with certain dangers. The world has arrived at the end of a period of falling prices. During that period, the burden of specific duties, levied on quantity and not on value, increased in proportion to the fall in the prices of the dutiable commodities. To replace specific duties by equivalent *ad valorem* duties at the present moment would be tantamount to renouncing the future benefits of a progressive alleviation of the incidence of the existing specific duties from the moment that prices show a tendency to rise.

The members of the Expert Committee are of opinion that the administrative advantages of specific duties are so great that it is impossible to expect any general transition from a specific to an *ad valorem* system, whether in the near future or ultimately. Nevertheless, they cannot refrain from pointing out that ignorance of the true burden imposed on the consumer when specific duties are used is frequently responsible for the levying of a grossly extortionate rate of duty, especially where manufactured articles are concerned.

B. *Import Quotas*

Import quotas, like the Exchange Regimes considered in chapter E, have a *most restrictive influence on international trade*. For the administrative authorities, they have the advantage that they fix either in quantity or in value the amount of permissible imports over a given period, but, from the point of view of the general interest, they present the serious disadvantage of opposing, more strongly than tariff rates, any automatic adjustment of international trade to changes in the economic structure of the different countries. Moreover, even if not in all cases formally inconsistent with the M.F.N.C., they result in practice in a serious diminution in the value of that clause. Under the quota system, an expansion of demand and an alteration of circumstances which would really make it desirable to increase the quantity of goods moving do not result, as would be the case under a freer tariff regime, in increasing the quantity of goods moving.

Further, experience has shown that quotas lead to a *false sense of security*. As the quantity of imports, by value or quantity, has been fixed, there is a tendency for aggravated domestic competition to arise, owing to a tendency on the part of national producers, encouraged by the more or less complete suppression of foreign competition, to develop industries hitherto considered as too costly to be profitable. The degree of protection therefore offered to each single producer is less than appears at first sight.

Moreover, experience seems to show that quotas are just as liable to be used as instruments of international bargaining as tariff rates and, once incorporated in a tariff treaty, lose that flexibility which originally appeared to be one of their principal advantages. Theoretically, it would be possible to vary quotas upwards or downwards as circumstances demand. In fact, however, particular quotas are used as bargaining instruments to obtain concessions for industries not directly concerned with the articles covered by the quota. *The quota, therefore, has become a powerful instrument restricting international trade without in practice possessing the potentialities of flexibility which are present in the case of ordinary tariff rates.*

States should therefore agree:

1. To *abolish* quotas whenever possible, and/or to envisage such a measure at a *not too distant date*.

(a) States could subscribe to a *multilateral agreement* on the necessity of abolishing the quota system as soon as currency stabilization has paved the way for a definite recovery of world trade. It is not suggested that particular States should necessarily tie themselves by any specific declaration of purpose to definite quantities. What is required is a statement of intention in this field which will weigh heavily with world public opinion and business circles.

(b) The ideal to be aimed at is that of a substitution of regimes — a replacement of the quota system by protective duties at the lowest possible level. It might be possible to envisage a period of transition during which the existing quotas would be replaced by « *tariff* » quotas, pending the definite replacement of the system by ordinary tariff rates. These « *tariff* » quotas would consist in the quantitative limitation of the goods imported at privileged rates, not, as in the case of ordinary quotas, of the quantitative limitation of imports. Imports in excess of quota would no longer be refused admission, but would merely be subject to higher duty. Such a system would pave the way for a return to ordinary tariffs, without giving rise to a criticism often formulated in respect of another system, consisting in the immediate replacement of quotas by high tariff rates, i.e., that the high initial rate of such tariffs — even if liable to subsequent reduction — would result in an appreciable increase in the cost of living.

(c) Finally, it is necessary to recognize that, in the present state of world opinion, it would probably be easier to remove *industrial quotas than quotas upon agricultural products*. Self-sufficiency in agricultural commodities is an ideal which is of more than economic significance. Moreover, the demand for agricultural products is much more inelastic than the demand for industrial products. It is therefore not easy to envisage a time in the near future when the complete abolition of agricultural quotas would be possible by international agreement. But it is suggested that serious efforts should be made to remove all industrial quotas within... (say 24 months), of the issue of a *multilateral declaration* to that effect.

2. To *improve* the general working of the import quota

system when it is impossible to envisage its immediate suppression.

The following suggestions were made by the Council of the International Chamber of Commerce at its meeting in November 1934. The Expert Committee appointed by the Joint Committee Carnegie/I.C.C. approves of these recommendations, which were along the following lines:

(a) If States do not bind themselves to increase the quantities covered by existing quota arrangements, they should at least undertake, by multilateral agreement, not to cut down the existing volumes.

(b) Notwithstanding formal agreements, efforts should be made to increase the volume of goods moving under the quota regime by a gradual increase of the minimum quantity or minimum value permissible under present quota arrangements.

(c) States should agree not to levy customs duty, licence or other dues on imports already restricted under the quota system, except in the case of an increase in the quota preparatory to a return to an ordinary tariff system. (See I. (b) above.)

(d) Finally, when applying the quota system, each State might usefully take the following general principles into account.

1. Quotas should, as far as possible, be fixed for a definite period, for example, for one year at least. Changes which may, during the course of the year, become necessary, for seasonal or other similar reasons, should be established in advance and not left to the last moment. The possibility of negotiating regular treaties covering specific periods to govern the application of the quotas during these periods, would seem to merit consideration.

2. Each country should be entitled to take full advantage of the total amount of the quotas allowed, without any other administrative limitation whatsoever. In particular, where a licence of importation under a quota system is not utilized by the holder of the licence, it should be transferable, by the competent authorities, to another importer. Under the system as at present applied, when there are excess shipments in one period, the excess is generally deducted from the quotas for the following period. The principle should work both ways: any part of a quota not used during a given period should be carried over to the next, with due regard to the diminution of consumption in the importing country.

3. Importers should receive increased guarantees of the fair

and proper application of the quotas, as well as guarantees of prompt action in the matter of issuing licences without additional charges.

4. In fixing the quotas to be assigned to the various exporting countries, importing countries should bear in mind the actual origin of the goods and not merely the exporting territory, roundabout methods being frequently resorted to in order to escape the consequences of an equitable distribution of quotas.

The application by States of the above principles would at least have the effect of reducing the inconvenience of the system for those directly concerned. But neither these principles nor the preceding recommendations can render acceptable a system which is at the best an emergency regime, fated to disappear as soon as circumstances permit.

C. Commercial Agreements

It has been suggested, in connection with quotas, that States can and should subscribe to multilateral agreements — subject to parallel measures of currency stabilization emphasizing the impropriety of the quota system *per se* and envisaging the gradual suppression of quotas, at least as far as industrial products are concerned. The desirability of the multilateral form of agreement seems evident in this case. Even bilateral agreements can contribute significantly to this end if a sufficient number of countries conclude them. Bilateral treaties, further, would, in the present circumstances, seem likely to contribute effectively to tariff reduction. The following methods are recommended:

1. The conclusion of *bilateral treaties* consciously used as an instrument for the reduction of tariff rates.

2. The conscious utilization of the M.F.N.C. as an *instrument in the reduction of tariff rates*. In the past, the M.F.N.C. has had two main forms, the « conditional » and the « unconditional ». It is not suggested that the world should revert to a more general use of the conditional form of the M.F.N.C. On the contrary, American experience seems to show that there are great advantages in the use which was common in Europe before the war, and which still persists, of the *unconditional form*.

In some cases, it might also be possible to envisage exceptions

to the grant of M.F.N. treatment in the case of countries which, even after the restoration of more orderly currency conditions, continue to practise discriminatory quota or foreign exchange regulation.

D. *Regional or Other Multilateral Pacts*

The increase in the number of separate territorial units in Europe, as the consequence of the post-war situation, makes it urgent that in certain European areas, e.g. the Baltic or Central Europe, there should be an extension of the « neighbourhood » relations of particular States in regard to the conclusion of special regional pacts. It is suggested that it is undesirable that countries not geographically interested in the conclusion of regional pacts should claim any reduction arrived at under such agreements, merely because they have contracted M.F.N. treaties with the various parties to such pacts.

Furthermore, another possible modification of the most-favoured-nation clause should be favourably considered, according to which the clause should not prevent the establishment of multilateral agreements, aiming at tariff reduction, to be applied only between the contracting States. The condition for accepting such agreements should be that they are « open » i.e. can be joined by any other State extending to the contracting parties equally favourable treatment.

E. *Exchange and Clearing Regimes*

Before entering into the question of exchange and clearing regimes, it is necessary to insist upon the fact that these emergency regimes are as much a matter of currency policy and currency difficulties as they are of international trade difficulties. In this respect, the currency problem and the exchange problem are integrally related, and it is impossible to find a definite remedy for the one without solving the other.

Subject to this preliminary observation, there can be no question that exchange and clearing regimes are inimical to the extension of international trade not merely because of their direct effect, but also because of their indirect effect in preventing « three-cornered » trade. They thus dislocate the essential

machinery of inter-State economic relations and gradually bring about the ruin of international trade.

Unfortunately, existing complications make it impossible to expect the immediate abolition of such regimes and a frontal attack on these various measures would be attended by serious dangers not only for the countries practising such measures, but also for international economic relations as a whole. In this field as in others, it is wiser to proceed by successive stages and only to envisage for the moment *preparatory measures* calculated to facilitate the abolition of exchange and clearing regimes.

The prior conditions for the *gradual* abolition of exchange and clearing regimes seem to be the following:

1. The *adjustment* of rates of exchange to local economic and financial situations. Rates of exchange should be such as to permit of the adequate transfer of interest and sinking fund payments, or the adjustment of balances of payments and of the competition of local industries in those markets to which they have been in the habit of exporting in the past.

2. In so far as exchange restrictions are the result of an impossible debt situation, it appears that the most urgent need is the *conversion* of short-term debts into long-term debts, by means of freely negotiated treaties between debtors and creditors and of a reasonable adjustment of debt charges. Fortunately, the very low level to which interest rates have fallen in the leading money markets of the world and the possibilities of improvement inherent in any recovery of world production, make the consolidation of debts and reduction of interest rates seem no longer utopian.

3. In any settlement of these questions, the necessities of current production and of increasing the volume of international trade must take first place. If exchange regimes are entirely swept away, there is the danger that foreign creditors will at once try to remove their capital from an area which they hold in disfavour. It may be necessary therefore to proceed by stages and to aim at the freeing of commercial transactions in the first instance. Capital transactions might still remain subject to control, either by legal enactments or by "standstill" agreements, arrived at voluntarily, for fixed periods between debtors

and creditors, so as to prevent the exchanges being swamped by the immediate pressure resulting from the attempt to liquidate financial transactions. In other words, it may be necessary to discriminate between commercial and non-commercial transactions.

4. Debt consolidation should, in certain countries, be combined with a resumption of *international lending*. Certain areas have, in the past, borrowed on a large scale for equipment and reconstruction purposes. Allowance must be made for the usual short-term commercial loans associated with the current movement of international trade. Moreover, in certain cases, it may be necessary to borrow abroad neither for the purpose of financing short-term import movements nor for the purpose of the long-term provision of capital equipment, but for the purpose of reconstructing currency reserves. While, in certain cases — in particular since the war — some of these loans have been excessive and unwarranted, it must be admitted that in many other cases they have been helpful and, in general, that international credits have for a century played a considerable part in the economic development of all countries. Therefore the resumption of international lending should be encouraged as soon as the solvency of the borrowing countries is such as to afford lending countries the desirable guarantees. It is necessary to emphasize the fact that it would be difficult to envisage a revival of exports in certain debtor countries, such as would enable them to arrive at a settlement of their foreign debts, unless their economic development is aided by new capital. It is not suggested that pressure should be put on the great capital markets for the purpose of making them regard such international loans with greater favour. What it is necessary to achieve is something much simpler : the revival of international lending by means of a decided relaxation of Government restrictions in the financially strong markets, and the removal of obstacles in the shape of exaggerated tariffs and other import restrictions, which prevent debtor nations from paying their debts in goods and services. At the same time, it is necessary to fix import duties in the borrowing countries at a figure which will really make it possible for the capital sums borrowed to be effectively transferred from the lending country to the borrowing country.

II. MONETARY POLICY

A. *Pre-Conditions of a Settlement*

There is a general agreement that international trade cannot flourish in an atmosphere of unsettlement as regards rates of exchange. A similar conclusion may also be drawn from the preceding chapters, namely, that it is impossible to expect a substantial reduction of trade barriers, in particular, the abolition of quotas, exchange and clearing regimes, so long as exchange rates are highly unstable. The general ideal to be looked forward to must therefore be the *stabilization of the external values of currencies*, either by linking progressively the various currencies to one or two leading monetary systems, such as the pound or the dollar, or, ultimately, by a general restoration of the gold standard in some form. It must not be overlooked, however, that domestic monetary policy also exercises a large influence on international economic relations. A monetary policy which, by bringing about a lower level of interest rates, would favour a sound increase of production and employment in financially strong countries, directly increases their purchasing capacity, and this leads to : a) an alleviation of the financial position of weaker countries ; b) an enlargement of the total volume of international commerce, and c) conditions favourable for other measures of international economic reconstruction, and therefore increases the chances of maintaining external stability.

In recent years, the technical possibilities of the gold standard have been reconsidered by financial experts and economists. Today, there is some difference of opinion on fundamental technical questions, such as :

1. The artificial widening of the gold-points with a view to avoiding too frequent movements of specie and with a view to strengthening the independence of the local money and capital markets.

2. Whether and to what extent to restore a gold exchange standard, but on lines somewhat different from the former system which, in many respects, proved highly defective.

3. The expediency of the exclusive monetary use of gold for international settlement, of reducing the minimum cover of Central Banks, of developing clearing operations between banks of issue on the basis of increased activity on the part of the Bank for International Settlements, etc. and other reforms of a similar character designed to encourage autonomy in the use of gold and to permit of the more effective use of the existing gold reserves.

4. The character of the co-operation between Central Banks, through the agency of the Bank for International Settlements, as regards both credit and currency.

These questions, which are merely quoted here as examples, are of the greatest technical significance, but are of lesser importance when it is a question of determining first principles. The question of the restoration of the gold standard cannot be decided upon in the light of these minor and technical considerations. These questions were discussed at length in the individual reports of the experts, which furnish the basis of the present document. There are still marked differences of opinion among economic authorities and detailed consideration of the various suggestions put forward has been purposely omitted from the present report, in order to approach the monetary problem from its essential and more general angle.

It would be useless to demand currency stability in any form without first paying regard to the conditions which would make it possible.

Among these pre-conditions are:

1. The *adjustment* of the exchanges of each country to a rate which would represent a fair parity in relation to other countries, taking into account the position of the balance of payments, relative costs and prices and the domestic debt structure.

It must of course be recognized that the significance of these various circumstances differs from country to country. The extent to which devaluation must be practised is a matter upon which general conclusions are impossible, since the currency of each country and the flexibility of its cost level is peculiar to itself. All that can be said is that, *without an adequate adjustment of exchange rates, the demand for permanent stabilization is purely academic.*

2. *The settlement of outstanding debt problems.* — In this

respect, the situation is probably more encouraging today than it has been during the last four or five years, owing to the gradual decline of the amounts involved by the debts themselves and the gradual improvement in the possibility of converting long-term debts on to a lower interest basis, in consequence of cheap money and the reviving interest of investors in foreign loans. As an example, we may cite the case of Australia where the burden of the external debt has, in recent years, been greatly diminished in consequence of the conversion of maturing long-term debts on to a lower interest basis.

3. *Easing of the clearing and exchange positions* (See Part I, Trade and Tariff Policy, Chapter I). — It is difficult to envisage an easing of the exchange and clearing positions without an adjustment of exchange rates and without a certain measure of monetary stability. In practice, these various operations should take place more or less simultaneously and should pave the way for a final settlement of the monetary problem.

B. *Possibility of a Joint Declaration on Monetary Policy*

Attempts to arrive at a settlement of the exchange problem have hitherto broken down owing to the unwillingness of any single State to commit itself unless others were prepared to commit themselves also, resulting in the impossibility of fixing upon the permanent rate at which to stabilize, so long as the currency situation in certain areas was still obscure.

These major considerations of policy are likely to persist for some time to come. It appears therefore that, in view of the unwillingness of statesmen to commit themselves as to permanent rates, the preliminary step towards greater stability must consist in a *declaration of ultimate objectives*, leaving the implementation of the policy to the future.

A Joint Declaration on Monetary Policy by the leading world powers would not commit any one of them to irrevocable decisions on specific rates of exchange, but it would greatly assist the process of education and the revival of confidence, provided agreement were achieved upon the major objects.

Such a Declaration should cover the following points:

(a) *The avoidance of currency depreciation as an instrument of international trade competition.*

(b) *The preservation and extension of the existing stability of rates except as necessitated by adjustment to fair parities.*

(c) *The elimination of seasonal variations in the value of currencies.*

(d) *Recognition of the desirability for a transition to a more permanent regime without undue delay.*

The practical problem is: under what conditions can the transition spoken of be realized? To this question, a twofold answer must be given:

1. It is clear that no final decisions in this sphere on monetary policy are possible *before* the future level of certain vitally important currencies (sterling, dollar, franc, mark, yen) has been decided upon. It is not the function of an international body to dictate to any individual country what the future level of its rate of exchange should be. It is equally clear that it is purely utopian to expect a definitive settlement of the international currency problem until the outlook as regards the currencies mentioned above is clearer.

2. On the other hand a much greater degree of adjustment has, *in general*, taken place than is universally recognized. Existing exchange rates show a high degree of stability; interest rates have been largely adjusted to a new level; the prices of staple commodities themselves show signs of rising rather than falling; the fall in interest rates is beginning to stimulate long term investment; the volume of indebtedness incurred in the past is being liquidated on an imposing scale; the terror of an imminent shortage of gold has been dissipated as a consequence of a revaluation of gold stocks and the increase of gold output.

(Signed): T. E. GREGORY, *Chairman of the Expert Committee* ;
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purely national remedies. In the monetary sphere they distrust general stabilization for the simple reason that the international gold standard, after its re-establishment, broke down in 1931. It is, however, not always sufficiently remembered to what extent post-war economy and finance were characterized by a number of artificial and precarious elements. It is this which, on the one hand, explains the severity of the crisis through which we have passed, and, on the other hand, holds out the hope that if these particular causes are eliminated, as they have largely been, recovery would be achieved on more secure foundation.

Firstly, the war left in its wake a tremendous superstructure of liabilities. Domestic debts had increased; and in the foreign field there were the political debts to which the economic structure had not become adapted, and which consequently proved a great strain on the balances of payments of various countries.

For a certain time, these various obstacles were submerged by a flood of international lending, but this development entailed new difficulties of its own. Long term loans were floated to a degree which, seen in retrospect, must be regarded as excessive; when the supply of long term capital declined, resort was had to short term lending and it was the instability of the latter which was responsible for one of the most characteristic aspects of the depression — the strain on the banking system and the balances of payments of many countries. Here, however, we are able to record substantial progress. Short term indebtedness in gold has been reduced by more than one-half and the volume of long term debts has also become smaller. Reparations were effectively settled in Lausanne in 1932 and the war debt question is admittedly to be re-considered. The external liabilities of the war and post-war period thus no longer represent the same serious handicap to the attainment of equilibrium.

Secondly, this superstructure of indebtedness was built up on the basis of a price-level which, in terms of gold, was about 50 % higher than the level of prices in 1914. It had been hoped for a time that such an increased price-level would be maintained notwithstanding a decline in the current gold production, as measures might be taken to economize gold and, generally, to use it more effectively as a basis for credit. But these hopes proved illusory. There came a violent fall in prices, upsetting all economic calculations. The consequence was, however, that

prices in terms of gold were suddenly reduced to below the pre-war level and, at the same time, gold production increased to record figures. A new situation has arisen and new forces are now at work. The world should be able to expect a definite rise in prices in the near future. Such an upward trend of prices, it should be noted, should greatly facilitate an adaptation of cost levels in different countries and a general reduction in trade barriers. In the past, it has been in periods of rising prices that trade barriers have been most easily lowered.

Thirdly, as a result of destruction of capital during the war, rates of interest remained on very high levels in the post-war period. While countries in Eastern Europe were able before the war to borrow at rates of 4 and 4 1/2 %, and other countries even more cheaply, the bulk of the post-war lending to the countries on the Continent of Europe was at the rate of 6, 7 or 8 %. Borrowing at such rates may have been necessary when it was a question of suddenly supplying impoverished countries with funds; but in the long run, large international capital movements on such a basis were bound to have unsettling effects. An adjustment to lower rates, both for international and domestic loans, was necessary; but such adjustment proved extremely difficult, given the large volume of Government and other indebtedness which had to be converted. In this respect, again, a marked progress has been made in recent years in a large number of countries. It is illuminating that those countries which were able substantially to reduce the general level of interest rates were the first to enjoy a considerable recovery.

The depression through which we have been passing has thus not been only an ordinary downward trend of the business cycle, but it has been aggravated by a number of factors arising out of the liquidation of the war. As has been indicated above, these special aggravations are no longer of the same weight as they were only a few years ago, and in several instances a true redress has been achieved. It cannot be too strongly stressed that this improvement in the technical position provides a hopeful basis for further efforts to bring the world back to general prosperity. There are of course many difficulties still to overcome. Adaptation must be made to structural changes, but such adaptation should be easier in a period of gradually rising prices, to which we may look forward, than it was in the period of declining prices after the war. There are further consequences

of the depression itself which still have largely to be remedied.

Once the depression had begun, a twofold sequence of changes became apparent. Increasing economic distress accentuated political unrest; political unrest in its turn aggravated the lack of confidence which the depression itself generated. Indifferent to the general world situation, each nation attempted to solve its own local unemployment problem by measures which only too often increased the pressure on other areas. Instead of creating conditions facilitating a general increase in output and employment, many nations simply attempted to reduce the import of foreign goods. The inevitable effect was a disastrous decline in the volume of international trade and a breakdown of the normal machinery by which that trade was sustained.

Any program of reform must take account, both of the facts of the present and of the necessities of the future.

Leaving on one side vague general ideals and theories, in order to devote itself entirely to what is at present feasible, the Expert Committee appointed by the Joint Committee of the Carnegie Endowment and the International Chamber of Commerce has endeavoured, on the basis of numerous reports by experts, to devise measures which can immediately be put into practise and which seem calculated to further appreciable progress in international economic relations.

Before going into the details of these recommendations, the Committee desires to emphasize what it considers as an extremely important point: it is useless for countries to conclude conventions for the concerted reduction of trade barriers so long as they are not actuated by a sincere desire for co-operation and mutual understanding. A lasting solution of the existing difficulties will be impossible so long as the nations refuse to recognize and apply the fundamental economic principle according to which goods and services must be accepted in payment for international obligations, whatever their nature.

Subject to these preliminary remarks of a general character, what is necessary in the international economic field is a concerted attempt to diminish the existing obstacles to the reconstruction of international economic relations, whether these obstacles arise in the monetary sphere or in the realm of commercial policy.

The technical situation is decidedly more hopeful, but the general situation is still fraught with great anxieties. It is a

commonplace — but a commonplace of the greatest importance — that furthering of general economic prosperity presupposes a minimum of understanding between nations.

The spirit and the ideas by which the nations are actuated remain indeed of greater significance than the perfection of purely technical devices. If it should happen that the pessimists prove right and another great war breaks out, obviously we should experience all over again the upheaval of currencies and prices which characterized the period 1914 to 1918 and of which we still feel the aftereffects.

But even though war be averted, the fear of war is in itself a powerful factor hindering economic improvement. It produces a tendency to autarchy and increase in armaments, mutual distrust leading to a stoppage of new international financing and a withdrawal of old credits — all developments which tend to make the world poorer than it need be. To the extent that re-employment depends on an extraordinary large volume of armaments expenditure, it obviously rests on a more precarious basis than if work were provided by the ordinary recurrent demand of the general public.

The conclusion is inevitable that world peace and a return to prosperity through the revival of world trade are one and indivisible.

Practical Conclusions

I. COMMERCIAL POLICY

In the later sections of this report, it will be pointed out that a pre-condition of a lasting currency stabilization is a more orderly arrangement of the international commercial policies. At this place, it is necessary to urge the converse of that proposition, i.e. that a more liberal commercial policy will only be feasible given a certain minimum stability in foreign exchange rates, as well as a general increase in production and employment, which greatly depend on a sound domestic monetary policy.

A. Tariff Levels

The general tariff level, which had already mounted appreciably during the post-war years, has risen considerably in most countries since the depression. To-day, more than ever, a substantial reduction of tariffs is an urgent necessity.

Tariff demobilization, indispensable though it may be, can only be effected by a series of successive *stages*. In this respect, and as regards the various proposals submitted, it is necessary to discriminate between those which, in present circumstances, stand no chance of being put into practice and those which, on the contrary, could be carried out and bear fruit in a not too distant future.

1. *What it is not possible to achieve at present.*

(a) *A general tariff truce.* — Under existing circumstances, a general tariff truce seems impossible. Those States which would be willing to adhere are probably restricted in number and their willingness to consider a truce would rapidly diminish if outside States were simultaneously to increase their tariff rates.

(b) *An all-round and simultaneous reduction of tariff rates.*

— An all-round and simultaneous reduction of tariff rates, by multilateral agreement, appears equally impossible for the moment. In the first place, *specific duties* occupy a very important place in modern tariff technique. It appears to be very difficult to find a formula by which specific duties levied on a very large number of articles can be reduced so as to arrive at an equal all-round percentage reduction. Further, the *actual levels* of the tariffs levied by different countries differ very markedly. Difficulties would at once arise as to « fairness » of the percentage reduction proposed. In all probability, nothing of any substantial consequence would result.

2. *What can immediately be done to pave the way for wider tariff demobilization.*

(a) Although the experience of the past few years seems to point to the impossibility of a multilateral policy of tariff reduction in the near future, something could already be achieved by States which propose to negotiate new tariff agreements with each other, by abandoning the practice of raising their tariff rates preparatory to bargaining. Since such mutual raising of tariffs leaves the bargaining position of the contracting parties unaltered, it is clearly useless and its net effect is simply to strengthen protectionist sentiment.

(b) Instead of endeavouring to achieve uniform reduction by an all-round and simultaneous lowering of tariff rates according to a given percentage, it would be preferable that States should undertake, by multilateral agreement, to fix *maximum rates* which should only be exceeded in individual cases specified in advance. It is not within the sphere of an international body of experts to suggest to individual Governments what the appropriate maximum level of their tariff should be. The first step in the direction of reform must consist in furnishing to the inhabitants of different countries a clearer guide than is at present available to them of the burdens which they are actually carrying through the tariffs at present levied on goods passing the various frontiers. The members of the Expert Committee are aware of the technical difficulties which have from time to time been raised when a suggestion for the creation of a comparative index of tariffs has been brought forward. Nevertheless, while they

agree that final scientific accuracy cannot be achieved in the present state of economic knowledge, they are of opinion that an international index would possess such real significance in estimating the comparative burden imposed by the duties actually levied, that they strongly recommend the creation of an international centre whose sole duty would be to construct such an index and to publish periodical surveys.

(c) The replacement of specific duties by *ad valorem* duties has frequently been recommended as being of a nature to facilitate tariff demobilization. The technical advantage of *specific duties* have led to a very considerable increase in their use. They are certain in their incidence, and they have the administrative advantage that the consumer is very often unaware of the heaviness of the burden which is imposed on him. But at the same time these so-called advantages do not outweigh the serious circumstance that specific duties, simply because the burden of their incidence is unsuspected, do in fact encourage an increasing measure of protection. It has therefore been suggested, in certain quarters, that the first step in the direction of a more sensible tariff policy should be the replacement of specific duties by *ad valorem* duties. In so far as this can be done, it is certainly desirable. But it cannot be denied that, under present conditions, such a policy would not only encounter serious difficulties, but would be attended with certain dangers. The world has arrived at the end of a period of falling prices. During that period, the burden of specific duties, levied on quantity and not on value, increased in proportion to the fall in the prices of the dutiable commodities. To replace specific duties by equivalent *ad valorem* duties at the present moment would be tantamount to renouncing the future benefits of a progressive alleviation of the incidence of the existing specific duties from the moment that prices show a tendency to rise.

The members of the Expert Committee are of opinion that the administrative advantages of specific duties are so great that it is impossible to expect any general transition from a specific to an *ad valorem* system, whether in the near future or ultimately. Nevertheless, they cannot refrain from pointing out that ignorance of the true burden imposed on the consumer when specific duties are used is frequently responsible for the levying of a grossly extortionate rate of duty, especially where manufactured articles are concerned.

B. *Import Quotas*

Import quotas, like the Exchange Regimes considered in chapter E, have a *most restrictive influence on international trade*. For the administrative authorities, they have the advantage that they fix either in quantity or in value the amount of permissible imports over a given period, but, from the point of view of the general interest, they present the serious disadvantage of opposing, more strongly than tariff rates, any automatic adjustment of international trade to changes in the economic structure of the different countries. Moreover, even if not in all cases formally inconsistent with the M.F.N.C., they result in practice in a serious diminution in the value of that clause. Under the quota system, an expansion of demand and an alteration of circumstances which would really make it desirable to increase the quantity of goods moving do not result, as would be the case under a freer tariff regime, in increasing the quantity of goods moving.

Further, experience has shown that quotas lead to a *false sense of security*. As the quantity of imports, by value or quantity, has been fixed, there is a tendency for aggravated domestic competition to arise, owing to a tendency on the part of national producers, encouraged by the more or less complete suppression of foreign competition, to develop industries hitherto considered as too costly to be profitable. The degree of protection therefore offered to each single producer is less than appears at first sight.

Moreover, experience seems to show that quotas are just as liable to be used as instruments of international bargaining as tariff rates and, once incorporated in a tariff treaty, lose that flexibility which originally appeared to be one of their principal advantages. Theoretically, it would be possible to vary quotas upwards or downwards as circumstances demand. In fact, however, particular quotas are used as bargaining instruments to obtain concessions for industries not directly concerned with the articles covered by the quota. *The quota, therefore, has become a powerful instrument restricting international trade without in practice possessing the potentialities of flexibility which are present in the case of ordinary tariff rates.*

States should therefore agree:

1. To *abolish* quotas whenever possible, and/or to envisage such a measure at a *not too distant date*.

(a) States could subscribe to a *multilateral agreement* on the necessity of abolishing the quota system as soon as currency stabilization has paved the way for a definite recovery of world trade. It is not suggested that particular States should necessarily tie themselves by any specific declaration of purpose to definite quantities. What is required is a statement of intention in this field which will weigh heavily with world public opinion and business circles.

(b) The ideal to be aimed at is that of a substitution of regimes — a replacement of the quota system by protective duties at the lowest possible level. It might be possible to envisage a period of transition during which the existing quotas would be replaced by « *tariff* » quotas, pending the definite replacement of the system by ordinary tariff rates. These « *tariff* » quotas would consist in the quantitative limitation of the goods imported at privileged rates, not, as in the case of ordinary quotas, of the quantitative limitation of imports. Imports in excess of quota would no longer be refused admission, but would merely be subject to higher duty. Such a system would pave the way for a return to ordinary tariffs, without giving rise to a criticism often formulated in respect of another system, consisting in the immediate replacement of quotas by high tariffs rates, i.e., that the high initial rate of such tariffs — even if liable to subsequent reduction — would result in an appreciable increase in the cost of living.

(c) Finally, it is necessary to recognize that, in the present state of world opinion, it would probably be easier to remove *industrial quotas than quotas upon agricultural products*. Self-sufficiency in agricultural commodities is an ideal which is of more than economic significance. Moreover, the demand for agricultural products is much more inelastic than the demand for industrial products. It is therefore not easy to envisage a time in the near future when the complete abolition of agricultural quotas would be possible by international agreement. But it is suggested that serious efforts should be made to remove all industrial quotas within... (say 24 months), of the issue of a *multilateral declaration* to that effect.

2. To improve the general working of the import quota

system when it is impossible to envisage its immediate suppression.

The following suggestions were made by the Council of the International Chamber of Commerce at its meeting in November 1934. The Expert Committee appointed by the Joint Committee Carnegie/I.C.C. approves of these recommendations, which were along the following lines:

(a) If States do not bind themselves to increase the quantities covered by existing quota arrangements, they should at least undertake, by multilateral agreement, not to cut down the existing volumes.

(b) Notwithstanding formal agreements, efforts should be made to increase the volume of goods moving under the quota regime by a gradual increase of the minimum quantity or minimum value permissible under present quota arrangements.

(c) States should agree not to levy customs duty, licence or other dues on imports already restricted under the quota system, except in the case of an increase in the quota preparatory to a return to an ordinary tariff system. (See I. (b) above.)

(d) Finally, when applying the quota system, each State might usefully take the following general principles into account.

1. Quotas should, as far as possible, be fixed for a definite period, for example, for one year at least. Changes which may, during the course of the year, become necessary, for seasonal or other similar reasons, should be established in advance and not left to the last moment. The possibility of negotiating regular treaties covering specific periods to govern the application of the quotas during these periods, would seem to merit consideration.

2. Each country should be entitled to take full advantage of the total amount of the quotas allowed, without any other administrative limitation whatsoever. In particular, where a licence of importation under a quota system is not utilized by the holder of the licence, it should be transferable, by the competent authorities, to another importer. Under the system as at present applied, when there are excess shipments in one period, the excess is generally deducted from the quotas for the following period. The principle should work both ways: any part of a quota not used during a given period should be carried over to the next, with due regard to the diminution of consumption in the importing country.

3. Importers should receive increased guarantees of the fair

and proper application of the quotas, as well as guarantees of prompt action in the matter of issuing licences without additional charges.

4. In fixing the quotas to be assigned to the various exporting countries, importing countries should bear in mind the actual origin of the goods and not merely the exporting territory, round-about methods being frequently resorted to in order to escape the consequences of an equitable distribution of quotas.

The application by States of the above principles would at least have the effect of reducing the inconvenience of the system for those directly concerned. But neither these principles nor the preceding recommendations can render acceptable a system which is at the best an emergency regime, fated to disappear as soon as circumstances permit.

C. Commercial Agreements

It has been suggested, in connection with quotas, that States can and should subscribe to multilateral agreements — subject to parallel measures of currency stabilization emphasizing the impropriety of the quota system *per se* and envisaging the gradual suppression of quotas, at least as far as industrial products are concerned. The desirability of the multilateral form of agreement seems evident in this case. Even bilateral agreements can contribute significantly to this end if a sufficient number of countries conclude them. Bilateral treaties, further, would, in the present circumstances, seem likely to contribute effectively to tariff reduction. The following methods are recommended:

1. The conclusion of *bilateral treaties* consciously used as an instrument for the reduction of tariff rates.

2. The conscious utilization of the M.F.N.C. as an *instrument in the reduction of tariff rates*. In the past, the M.F.N.C. has had two main forms, the « conditional » and the « unconditional ». It is not suggested that the world should revert to a more general use of the conditional form of the M.F.N.C. On the contrary, American experience seems to show that there are great advantages in the use which was common in Europe before the war, and which still persists, of the *unconditional* form.

In some cases, it might also be possible to envisage exceptions

to the grant of M.F.N. treatment in the case of countries which, even after the restoration of more orderly currency conditions, continue to practise discriminatory quota or foreign exchange regulation.

D. *Regional or Other Multilateral Pacts*

The increase in the number of separate territorial units in Europe, as the consequence of the post-war situation, makes it urgent that in certain European areas, e.g. the Baltic or Central Europe, there should be an extension of the « neighbourhood » relations of particular States in regard to the conclusion of special regional pacts. It is suggested that it is undesirable that countries not geographically interested in the conclusion of regional pacts should claim any reduction arrived at under such agreements, merely because they have contracted M.F.N. treaties with the various parties to such pacts.

Furthermore, another possible modification of the most-favoured-nation clause should be favourably considered, according to which the clause should not prevent the establishment of multilateral agreements, aiming at tariff reduction, to be applied only between the contracting States. The condition for accepting such agreements should be that they are « open » i.e. can be joined by any other State extending to the contracting parties equally favourable treatment.

E. *Exchange and Clearing Regimes*

Before entering into the question of exchange and clearing regimes, it is necessary to insist upon the fact that these emergency regimes are as much a matter of currency policy and currency difficulties as they are of international trade difficulties. In this respect, the currency problem and the exchange problem are integrally related, and it is impossible to find a definite remedy for the one without solving the other.

Subject to this preliminary observation, there can be no question that exchange and clearing regimes are inimical to the extension of international trade not merely because of their direct effect, but also because of their indirect effect in preventing « three-cornered » trade. They thus dislocate the essential

machinery of inter-State economic relations and gradually bring about the ruin of international trade.

Unfortunately, existing complications make it impossible to expect the immediate abolition of such regimes and a frontal attack on these various measures would be attended by serious dangers not only for the countries practising such measures, but also for international economic relations as a whole. In this field as in others, it is wiser to proceed by successive stages and only to envisage for the moment *preparatory measures* calculated to facilitate the abolition of exchange and clearing regimes.

The prior conditions for the *gradual* abolition of exchange and clearing regimes seem to be the following:

1. The *adjustment* of rates of exchange to local economic and financial situations. Rates of exchange should be such as to permit of the adequate transfer of interest and sinking fund payments, or the adjustment of balances of payments and of the competition of local industries in those markets to which they have been in the habit of exporting in the past.

2. In so far as exchange restrictions are the result of an impossible debt situation, it appears that the most urgent need is the *conversion* of short-term debts into long-term debts, by means of freely negotiated treaties between debtors and creditors and of a reasonable adjustment of debt charges. Fortunately, the very low level to which interest rates have fallen in the leading money markets of the world and the possibilities of improvement inherent in any recovery of world production, make the consolidation of debts and reduction of interest rates seem no longer utopian.

3. In any settlement of these questions, the necessities of current production and of increasing the volume of international trade must take first place. If exchange regimes are entirely swept away, there is the danger that foreign creditors will at once try to remove their capital from an area which they hold in disfavour. It may be necessary therefore to proceed by stages and to aim at the freeing of commercial transactions in the first instance. Capital transactions might still remain subject to control, either by legal enactments or by "standstill" agreements, arrived at voluntarily, for fixed periods between debtors

and creditors, so as to prevent the exchanges being swamped by the immediate pressure resulting from the attempt to liquidate financial transactions. In other words, it may be necessary to discriminate between commercial and non-commercial transactions.

4. Debt consolidation should, in certain countries, be combined with a resumption of *international lending*. Certain areas have, in the past, borrowed on a large scale for equipment and reconstruction purposes. Allowance must be made for the usual short-term commercial loans associated with the current movement of international trade. Moreover, in certain cases, it may be necessary to borrow abroad neither for the purpose of financing short-term import movements nor for the purpose of the long-term provision of capital equipment, but for the purpose of reconstructing currency reserves. While, in certain cases — in particular since the war — some of these loans have been excessive and unwarranted, it must be admitted that in many other cases they have been helpful and, in general, that international credits have for a century played a considerable part in the economic development of all countries. Therefore the resumption of international lending should be encouraged as soon as the solvency of the borrowing countries is such as to afford lending countries the desirable guarantees. It is necessary to emphasize the fact that it would be difficult to envisage a revival of exports in certain debtor countries, such as would enable them to arrive at a settlement of their foreign debts, unless their economic development is aided by new capital. It is not suggested that pressure should be put on the great capital markets for the purpose of making them regard such international loans with greater favour. What it is necessary to achieve is something much simpler: the revival of international lending by means of a decided relaxation of Government restrictions in the financially strong markets, and the removal of obstacles in the shape of exaggerated tariffs and other import restrictions, which prevent debtor nations from paying their debts in goods and services. At the same time, it is necessary to fix import duties in the borrowing countries at a figure which will really make it possible for the capital sums borrowed to be effectively transferred from the lending country to the borrowing country.

II. MONETARY POLICY

A. *Pre-Conditions of a Settlement*

There is a general agreement that international trade cannot flourish in an atmosphere of unsettlement as regards rates of exchange. A similar conclusion may also be drawn from the preceding chapters, namely, that it is impossible to expect a substantial reduction of trade barriers, in particular, the abolition of quotas, exchange and clearing regimes, so long as exchange rates are highly unstable. The general ideal to be looked forward to must therefore be the *stabilization of the external values of currencies*, either by linking progressively the various currencies to one or two leading monetary systems, such as the pound or the dollar, or, ultimately, by a general restoration of the gold standard in some form. It must not be overlooked, however, that domestic monetary policy also exercises a large influence on international economic relations. A monetary policy which, by bringing about a lower level of interest rates, would favour a sound increase of production and employment in financially strong countries, directly increases their purchasing capacity, and this leads to : *a*) an alleviation of the financial position of weaker countries ; *b*) an enlargement of the total volume of international commerce, and *c*) conditions favourable for other measures of international economic reconstruction, and therefore increases the chances of maintaining external stability.

In recent years, the technical possibilities of the gold standard have been reconsidered by financial experts and economists. Today, there is some difference of opinion on fundamental technical questions, such as :

1. The artificial widening of the gold-points with a view to avoiding too frequent movements of specie and with a view to strengthening the independence of the local money and capital markets.
2. Whether and to what extent to restore a gold exchange standard, but on lines somewhat different from the former system which, in many respects, proved highly defective.

3. The expediency of the exclusive monetary use of gold for international settlement, of reducing the minimum cover of Central Banks, of developing clearing operations between banks of issue on the basis of increased activity on the part of the Bank for International Settlements, etc. and other reforms of a similar character designed to encourage autonomy in the use of gold and to permit of the more effective use of the existing gold reserves.

4. The character of the co-operation between Central Banks, through the agency of the Bank for International Settlements, as regards both credit and currency.

These questions, which are merely quoted here as examples, are of the greatest technical significance, but are of lesser importance when it is a question of determining first principles. The question of the restoration of the gold standard cannot be decided upon in the light of these minor and technical considerations. These questions were discussed at length in the individual reports of the experts, which furnish the basis of the present document. There are still marked differences of opinion among economic authorities and detailed consideration of the various suggestions put forward has been purposely omitted from the present report, in order to approach the monetary problem from its essential and more general angle.

It would be useless to demand currency stability in any form without first paying regard to the conditions which would make it possible.

Among these pre-conditions are:

1. The *adjustment* of the exchanges of each country to a rate which would represent a fair parity in relation to other countries, taking into account the position of the balance of payments, relative costs and prices and the domestic debt structure.

It must of course be recognized that the significance of these various circumstances differs from country to country. The extent to which devaluation must be practised is a matter upon which general conclusions are impossible, since the currency of each country and the flexibility of its cost level is peculiar to itself. All that can be said is that, *without an adequate adjustment of exchange rates, the demand for permanent stabilization is purely academic.*

2. *The settlement of outstanding debt problems.* — In this

respect, the situation is probably more encouraging today than it has been during the last four or five years, owing to the gradual decline of the amounts involved by the debts themselves and the gradual improvement in the possibility of converting long-term debts on to a lower interest basis, in consequence of cheap money and the reviving interest of investors in foreign loans. As an example, we may cite the case of Australia where the burden of the external debt has, in recent years, been greatly diminished in consequence of the conversion of maturing long-term debts on to a lower interest basis.

3. *Easing of the clearing and exchange positions* (See Part I, Trade and Tariff Policy, Chapter I). — It is difficult to envisage an easing of the exchange and clearing positions without an adjustment of exchange rates and without a certain measure of monetary stability. In practice, these various operations should take place more or less simultaneously and should pave the way for a final settlement of the monetary problem.

B. *Possibility of a Joint Declaration on Monetary Policy*

Attempts to arrive at a settlement of the exchange problem have hitherto broken down owing to the unwillingness of any single State to commit itself unless others were prepared to commit themselves also, resulting in the impossibility of fixing upon the permanent rate at which to stabilize, so long as the currency situation in certain areas was still obscure.

These major considerations of policy are likely to persist for some time to come. It appears therefore that, in view of the unwillingness of statesmen to commit themselves as to permanent rates, the preliminary step towards greater stability must consist in a *declaration of ultimate objectives*, leaving the implementation of the policy to the future.

A Joint Declaration on Monetary Policy by the leading world powers would not commit any one of them to irrevocable decisions on specific rates of exchange, but it would greatly assist the process of education and the revival of confidence, provided agreement were achieved upon the major objects.

Such a Declaration should cover the following points:

(a) *The avoidance of currency depreciation as an instrument of international trade competition.*

(b) *The preservation and extension of the existing stability of rates except as necessitated by adjustment to fair parities.*

(c) *The elimination of seasonal variations in the value of currencies.*

(d) *Recognition of the desirability for a transition to a more permanent regime without undue delay.*

The practical problem is: under what conditions can the transition spoken of be realized? To this question, a twofold answer must be given:

1. It is clear that no final decisions in this sphere on monetary policy are possible *before* the future level of certain vitally important currencies (sterling, dollar, franc, mark, yen) has been decided upon. It is not the function of an international body to dictate to any individual country what the future level of its rate of exchange should be. It is equally clear that it is purely utopian to expect a definitive settlement of the international currency problem until the outlook as regards the currencies mentioned above is clearer.

2. On the other hand a much greater degree of adjustment has, *in general*, taken place than is universally recognized. Existing exchange rates show a high degree of stability; interest rates have been largely adjusted to a new level; the prices of staple commodities themselves show signs of rising rather than falling; the fall in interest rates is beginning to stimulate long term investment; the volume of indebtedness incurred in the past is being liquidated on an imposing scale; the terror of an imminent shortage of gold has been dissipated as a consequence of a revaluation of gold stocks and the increase of gold output.

(Signed): T. E. GREGORY, *Chairman of the Expert Committee* ;
Eugen BOEHLER, Bertil G. OHLIN, Andreas FREDÖHL, Charles
RIST, *members of the Expert Committee.*

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