

**International Economic
Reconstruction**

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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

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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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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.

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

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

THE JOINT COMMITTEE IS COMPOSED AS FOLLOWS

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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. 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), 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. OHLIN (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 Bankvereniging ;
- Professor Jacob VINNER** (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. PRÄDÖHL 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.

CONTENTS

FOREWORD	7
INTRODUCTION	13
Introductory Report on the Problem of International Economic Reconstruction, by Professor Bertil OHLIN	17
General Report on the Problems of Monetary Stabilization and the Improvement of Commercial Relations between Nations, by Pro- fessor T. E. GREGORY	157
Practical Conclusions of the Committee of Experts	207
Practical Recommendations of the Joint Committee	227

International Economic Reconstruction

by

Professor Bertil G. OHLIN,
Professor of Economics, College of Commerce, Stockholm

Contents

INTRODUCTION

The goal of economic activity. — Defence and economic policy. — Peace and international economic organisation. — The national and social, not the individualist or socialist view-point. — Impossibility of « back to 1914 ». — Possibility of rapid progress.

CHAPTER I. — ECONOMIC PROGRESS BEFORE THE WAR

A. International trade, Capital movements and Migration

Migration as a condition of economic growth. — The export of capital. — The changing character of trade. — Trade and productive factor movements as substitutes.

B. The Functioning of the Pre-War Gold Standard

Why did the gold standard function well? — Short-term credit transactions. — Credit policy and the adjustment of trade balances. — The rôle of London. — Foreign exchange stability, capital movements and trade. — Liberty of action in domestic economic policy. — Failure to keep the wholesale price-level stable.

CHAPTER II. — BREAKDOWN OF THE INTERNATIONAL ECONOMIC SYSTEM IN 1930-1935

A. The instability of the Economic Situation in the Years before the depression

The restoration of international commerce in the 1920-ies. — The causes of instability. — Price relations and indebtedness. — The changing character of international indebtedness.

B. The international Relations during the Depression

Difficulties of countries producing primary commodities. — Growth of

international short-term indebtedness. — Increasing obstacles to foreign trade. — Causes and consequences of the fall in prices. — The international liquidity panic. — The internal liquidity crisis. — The vicious circle of deflation, depreciation and trade restrictions. — The causes and effects of the new commercial policy. — The different development in the gold and sterling blocks. — The different policies of the gold and sterling blocks. — The financial policy in gold and sterling countries. — Foreign trade. — The main lessons of the course of events since 1930. — Revival before readjustment.

CHAPTER III. — THE ECONOMIC AND PSYCHOLOGICAL BASIS OF THE RE-ORGANIZATION OF INTERNATIONAL ECONOMIC RELATIONS

Re-organization is not the same as restoration. — Comparison with the pre-war system. — Economic nationalism and the spread of a new technique. — Less need of certain trade. — Losses caused by foreign trade restrictions. — Can manufacturing nations pay for the necessary import of raw materials? — The Japanese competition. — Social legislation and international competition. — The immediate difficulties resulting from continued policy of restriction. — State intervention and foreign trade. — Anti-dumping measures. — Conclusion concerning the rôle of international trade. — The advantages of a free export of capital before the war. — Less favourable effects in the future. — Capital export and unemployment. — The claim for control of capital exports. — International migration and unemployment. — Reconstruction presupposes expansion.

CHAPTER IV. — THE MONETARY SYSTEM AND THE INTERNATIONAL CAPITAL MOVEMENTS

Can the gold standard function under present conditions? — The contradiction of internal and external stability. — Rigid parities and foreign trade. — Short-term capital movements and rigid parities. The primary aim : internal economic stability. — Necessity to avoid deflation and inflation. — A two-blocks monetary system. — Pre-requisites of any international monetary reconstruction. — Adaptation of cost levels and external currency values. — The liquidity problem and the distribution of gold. — The foreign debt problem. — Foreign exchange restrictions. — New foreign investments.

CHAPTER V. — COMMERCIAL POLICY AND WORLD TRADE

A. *The Effect of the Present Commercial Policy*

The fall in world trade. — The industrialization of « young » countries. — Growth of regional trade. — The bilateral equalization of trade balances. — The productive character of multilateral trade. — Bilateral equalization reduces trade. — Effects of foreign exchange regulation. — General characteristic of commercial policy. — Bearing upon political relations.

B. *Re-organization of International Commerce*

The goal. — The need of domestic expansion. — Less discrimination. — Influence on the State revenue. — Erroneous opinions an obstacle.

A beginning should be made by financially strong countries. Autonomous action. — Non-discriminatory bilateral agreements. — Lead of the Great Powers. — Quotas and Equality of Treatment. — Discriminatory bilateral methods. — The direct connection between imports and exports. — The reduction of three-cornered trade. — A general conclusion. — A new discriminatory policy. — Multilateral agreements. — International cartels.

CHAPTER VI. — THE AGRICULTURAL CRISIS

Introduction. — Origin of the crisis. — Development of agriculture in the absence of an industrial depression. — Coincidence of industrial and agricultural depression. — Policy of restriction and price-raising. — The output of cereals. — The output of animal foods. — Policy has counteracted tendencies to adjustment. — Better conditions in 1934-1936. — Animal Foods. — The present position of vegetable foodstuffs. — Sugar. — Mitigation of the agricultural crisis. — The future outlook. — Autarchical tendencies as regards food supplies. — Conditions of solution. — A higher standard of consumption. — Cheaper food. — Reduction of the area under wheat. — Industrial expansion essential. — Military considerations.

CHAPTER VII. — THE PROBLEM OF « OVERPOPULATION », COLONIES, MARKETS AND RAW MATERIALS

THE TWO PROBLEMS

A. Raw Materials, Markets and Colonies

High raw material prices. — A non discrimination agreement. — Most raw materials are produced in non-colonial areas : a political transfer of colonies would not provide a solution. — Importance of colonial markets. — The real source of gain. — Preferential policy of today. — Conclusions. — An alternative solution. — Where lies the interest of the « have-nots » (states poor or altogether lacking in colonial territories) ? — Interests of the colonial powers. — Access to the world market all-important. — Importance of freer trade and balanced currency conditions. — Colonies and the standard of living. — Raw materials in wartime.

B. Over-population, Employment and Territorial Expansion.

Density of population and « over-population ». — Growth of population. — Emigration. — Net reproduction rate. — The « over-population » problem in Germany, Italy and Japan. — Employment without territorial expansion. — Terms of exchange. — Importance of reasonably free trade. — Influence of new colonies. — Emigration to colonial districts. — Growth of the native population. — Investments in colonies. — Not colonies, but industrialization a necessity. — Industrialization depends on international trade. — Different problems can be solved on the same lines. — Importance of international understanding. — Dangers of discrimination. — Respect of contracts.

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-

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

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

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 reverse 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 1930-1935

A. THE INSTABILITY OF THE ECONOMIC SITUATION IN THE YEARS BEFORE THE DEPRESSION

The Restauration 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

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 began 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.

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

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 « laissez-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 $\frac{3}{4}$ 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 $\frac{1}{2}$ % 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 to "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 offer 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	29,800	210.3	6,900	65.5	510,0	36.3	702,00	783.5

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.

Empoyment 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

INTERNATIONAL ECONOMIC RECONSTRUCTION

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.

Contents

I. MONETARY PROBLEMS

A) Problems of Causation

- (1) Underlying changes in the world situation, making for dislocation and lack of stability ;
- (2) Abnormal technical features in the working of the monetary system ;

B) Problems of Current Policy

- (1) The influence of fluctuating exchanges as a means of helping the revival of foreign trade ;
- (2) The significance of the position in different countries :
 - a) Gold Bloc ;
 - b) Czechoslovakia ;
 - c) United States ;
 - d) The sterling Area ;
- (3) The neutralisation of the defects of currency instability ;
- (4) Exchange control.

C) Problems of the Immediate Future

- (1) Flexible parities ;
- (2) Provisional currency groupings ;
- (3) The future of long-term international investment ;
- (4) Can a repetition of the situation of 1931 be prevented in the case of Great Britain ?
- (5) The menace of short-term capital movements ;
- (6) The significance of a return to the « status quo ante » as regards prices.

D) Long Term Problems

II. COMMERCIAL POLICY

*A) Current Policy and Commercial Policy**B) The Background of Increased Protectionism*

- (1) The exaggeration of the arbitrary element in the movements of world trade ;
- (2) The basic intellectual urge towards increased protectionism in the modern age.

C) The Technological Aspects of Tariff Policy

- (1) The emergency of a new object of protectionist policy ;
- (2) The case for and against the tariff quota ;
- (3) The present significance and future of the most favoured nation clause ;
- (4) A new approach to the problem of tariff relations ;
- (5) The road to recovery : bilateralism v. multilateral agreements.

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

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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.

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 Mlymarski'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 overrated. 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 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 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 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. »

(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 supposed ¹.

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
	<u>40</u>	<u>25</u>	<u>17</u>	<u>14½</u>	<u>14</u>
TOTAL	40	25	17	14½	14
All other	30	20	22	17½	15
	<u>70</u>	<u>45</u>	<u>39</u>	<u>32</u>	<u>29</u>
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 as~~ be taken to represent ~~very~~ ^{roughly} 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 Boehler, 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 negative 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 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 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 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 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, 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 PREDÖEL, Charles
RIST, *members of the Expert Committee.*

CHECKED
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