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REMARKS

on the

**PRESENT PHASE OF INTERNATIONAL ECONOMIC
RELATIONS**

**Reconstruction of the Machinery of International Exchange
as a Factor in Recovery and Appeasement**

**TOGETHER WITH
OBSERVATIONS BY THE FINANCIAL COMMITTEE**

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REMARKS ON THE PRESENT PHASE OF INTERNATIONAL ECONOMIC RELATIONS : RECONSTRUCTION OF THE MACHINERY OF INTERNATIONAL EXCHANGE AS A FACTOR IN RECOVERY AND APPEASEMENT

Last year, on the eve of the Assembly, the Economic Committee submitted to the Council a report of some length, in which it put forward certain elementary facts in order to show the degree of economic error involved in a conception of national interest and international interest as opposed to one another rather than as constituting merely two aspects of the same question. The prejudicial consequences resulting from such a conception were emphasised.

The report further directed attention to the symptoms of recovery apparent in a large number of countries. At the same time, it pointed out the disturbing features of the situation in particular countries, the precarious character of activities due largely to armaments, and the contradiction between business revival in certain parts of the world and the continuance of disorganisation on a wide scale in the world as a whole.

A year later, the Economic Committee, on the basis of communications from members of the Committee and with the aid of the fairly full documentary material at its disposal,¹ finds that the situation has marked similarity to that of 1935, but with the difference that, since the latter date, its characteristic features, both good and bad, have been markedly accentuated.

The signs of improvement, which last year still appeared somewhat indefinite, are now more striking and more numerous, although unequally distributed among different countries. But the progress that is being made in a large number of countries cannot attain its full development, and is even liable to be brought to a standstill, if it is not soon accompanied by a revival in international trade. The material recovery in business and the growing confidence in the strength of the economic revival seem to pave the way, provided that political conditions are favourable, for efforts to solve the international economic problems with which it has not hitherto been possible to deal.²

Moreover, for want of the necessary adjustments, the economic world remains divided into groups where different price-levels prevail, and these groups are separated by all sorts of barriers preventing restoration of the necessary freedom of intercourse.

Lastly, in many countries, this beneficent economic reaction is hampered by political difficulties which, particularly in Europe, cause a feeling of unrest paralysing confidence and to the spirit of enterprise. The fear of international conflicts lies at the root of the rapid increase in armaments which is one of the principal causes of budgetary and financial difficulties. This fear constitutes the most serious obstacle to the normal development of undertakings of all kinds, both in international and even in national spheres. A revival in economic activity brought about by the large-scale production of new implements of war cannot, however, be anything but illusory and precarious. It imposes an ever-growing burden on the taxpayer, already sorely tried by the persistence of the crisis and the almost automatic increase in social expenditure.

¹ Three documents issued by international organisations, which give a more or less complete general view of the situation as a whole, may be specially mentioned :

(a) Note on the Economic Situation annexed to the Supplementary Report of the Secretary-General to the Assembly (document A.6(a).1936—Annex II) ;

(b) Sixth Annual Report of the Bank for International Settlements ;

(c) Report by the Director of the International Labour Office to the International Labour Conference of 1936.

² See the above-mentioned " Note by the Secretary-General on the Economic Situation ".

The Economic Committee is therefore meeting in an atmosphere which was accurately described on July 4th by M. van Zeeland, President of the Assembly of the League of Nations, when he said in his closing speech :

“ To-day as yesterday, and to-morrow as to-day, our duty, our chief concern, must be the protection of peace. We are all within the shadow of the terrifying fact that the possibilities, the probabilities, of war are nevertheless increasing as years go by. We must find a way to reverse this tendency.

“ Allow me to draw your attention once more to the dangers in this connection of relying entirely upon political methods and neglecting economic considerations. That is a truism, but one which must be periodically repeated. Though it is a fact that the political position exerts a direct and far-reaching influence on the course of business and economic activity in general, the reverse is no less true ; and we all know only too well how far political difficulties and conflicts are influenced by economic disturbances.

“ At the present moment, economic affairs are, indeed, passing through a curious phase. We feel that the worst of the depression is over. In a great many countries the revival is evident ; but it is almost entirely confined to the home markets. The improvement in international economic relations is not nearly as great as it might be, as it ought to be, and as it undoubtedly would be if certain relatively easy adjustments were made which would impose no real sacrifice on anyone.”

These words clearly sum up the feelings and the thoughts with which the Economic Committee views the grave outlook of the present moment.

Convinced as it is of the duty of an urgent search for means of an economic character both to bring about the restoration of prosperity and to contribute to the maintenance of peace, the Economic Committee has examined the adjustments necessary for the re-establishment of international trade, their prospects of realisation, under present circumstances, and the procedure to be adopted in applying them.

As is pointed out in the “ Note by the Secretary-General on the Economic Situation ”, a distinction may be made to-day between two principal groups of countries. ¹

First, countries constituting a very important group have reacted to the catastrophic fall in prices which has occurred since 1929 by an adjustment in the value of their currencies. This operation has relieved them from the necessity for taking restrictive measures by imposing quotas on numerous categories of products or by foreign-exchange control. In this group, which consists chiefly of dollar and sterling countries, and which alone represents more than half the total volume of world trade, the regular working of the machinery of trade has greatly contributed to an economic recovery that is continually broadening its scope.

To the second group—which, in fact, includes several categories—belong the principal countries of Europe which have imposed stringent restrictions on their foreign trade, such as exchange control, quotas, or a combination of the two.

In this second group we find marked differences of situation. Certain countries maintain the artificial rate of their currency only by enforcing a close network of restrictions extending to all financial or commercial relations with the outside world ; owing to the strict exchange control which they apply, their currency has ceased, at any rate in transactions with foreign countries, to exercise the function of a medium of exchange. Other countries, whose currencies have been devalued, have nevertheless established and maintained a system of exchange regulation, or a more or less general system of quotas, influenced by the precarious situation of their currency, by the fear of fresh devaluation, and by the difficulties of meeting their debts. Others, again, have resorted to these measures by way of reply to the restrictions applied by the States with which they carry on a great part of their trade.

Lastly, the “ gold countries ” make an extensive use of quotas for one or other of these reasons. For a long time, they have attempted to restore the balance of prices by means

¹ The Union of Soviet Socialist Republics cannot be classed in either of these groups. In that country, the progress of internal economic activity, already mentioned by the Committee in its report of last year, has continued.

of deflation ; but experience has shown that, in the " atmosphere " of modern social and economic life, a process of deflation extended, as would be requisite, to the whole range of economic activity is extremely difficult to apply with success.

Countries which have embarked on these different policies have sought to recoup themselves in the home market for part of the losses suffered on the external market ; for this purpose, they have resorted to an expansion of internal credit. This by itself can only constitute a temporary expedient and cannot bring about a lasting revival of economic activity.

Some of them have pushed this policy to the length of attempting to establish a state of autarchy which, as events develop, tends to become more and more accentuated. Such a policy must in the long run prove illusory. The restrictive measures adopted can only increase the difficulty of obtaining supplies of raw materials and must exercise a depressing effect on the standard of life. They make impossible the restoration of economic equilibrium by means of a wide international circulation which would bring nations into closer contact. A commercial revival of this kind would, moreover, permit countries placed at a disadvantage in the distribution of natural wealth and raw materials to acquire them easily ; and this would give the producer of these products the benefit of increased consumption and at the same time widen the outlets for the sale of manufactured goods.

The effect of all the various measures of restriction adopted has been to disturb the normal course of international circulation.

The problem is therefore to diminish and as far as possible remove the obstacles to trade created by exchange control and import prohibitions. In endeavouring to solve this problem, there is no need to embark on any theoretical discussion of the respective merits of protection and free trade, but only to ask what is the minimum of action necessary to restore international trade to normal conditions.

In its last year's report, the Economic Committee said :

" Accordingly, while the crisis tends to diminish, the machinery of international trade becomes more and more jammed. Of these two evils, the latter is now the more serious and calls accordingly the more urgently for treatment."

This statement is as true to-day as it was then. The first thing to be done is to set in motion the rudimentary machinery of international trade. At present, the two chief defects in this machinery are the impossibility, in certain parts of the world, of exchanging goods except in strictly limited quantities and the impossibility of freely exchanging one currency against another. These two anomalies exist to-day in countries on a real and in those on a nominal gold standard, which apply either the quota system or exchange control, or both ; but they also apply even in certain countries which have devalued their currencies. They are not found it is true, in the vast territories of the dollar and sterling areas, but by their impact they also affect the interests even of this latter group.

Accordingly, the first objective must be to restore a situation in which, irrespective of frontiers, the purchaser can buy what he wants, the debtor can pay what he owes, the tourist can go where he wishes—without encountering, owing to Government intervention, impassable obstacles such as quotas and currency control. It is essential that each country should make its own contribution to remedying this situation.

The Committee has no wish to pronounce dogmatically for or against monetary devaluation or to give any country advice on the best monetary policy to be followed. But everyone realises to-day that, in order to restore international trade, it is necessary to fill in the gap which separates the price-levels of the majority of the countries with a gold standard (whether real or nominal) from those of the majority of the countries with a depreciated currency. The former must be left free to choose whatever method they may prefer to achieve this end ; but it must not be forgotten that, in order to maintain the value of a currency or an excessive price-level in the face of opposing international tendencies, a whole series of restrictive measures must inevitably be applied. Experience shows that such measures aggravate the disparity in prices against which action is directed, increasingly weakening the national economy and preventing it from regaining the impetus which is essential to a sound recovery.

In the opinion of the Economic Committee, which does not claim to have any specialised knowledge of currency questions, the only sound policy is one which ensures freedom of action, enabling active economic influences to operate with the maximum facility both within the country and outside it, and making it possible for normal relations to be resumed with other countries—a particularly important consideration. Consequently, the Economic Committee does not consider that an attempt at currency adjustment can bring about any lasting improvement in the economic situation unless it is accompanied by a relaxation of direct and indirect import restrictions (quotas and exchange control), an important secondary effect of which would be to check any tendency towards a too rapid rise in prices following on devaluation.

The operation which consists in bringing—by means of either deflation or devaluation—internal prices into line with external prices is one which each country must carry out of its own accord and by its own efforts. Nevertheless, it is clear that the co-operation of other countries can create conditions under which this operation may be carried out with a minimum of risk and a maximum of gain.

In particular, this co-operation might lessen the misgivings of countries which, even if they consider the possibility of an adjustment of their currency—accompanied by the abolition of quotas and exchange control with their usual train of clearing and compensation agreements—hesitate to take such a step so long as they fear the further deliberate devaluation of the principal currencies, more particularly sterling and the dollar.

Lastly, countries which have based their whole economic system on the existence of a close network of quotas and measures for currency control would probably hesitate to do away with these measures unless they are assured that other countries will reduce their restrictions in their turn, thus enabling the former to export a reasonable proportion of their products. As regards the latter, their contribution towards a restoration of normal trading conditions should consist in abolishing all quantitative limitations on imports and in removing exchange control, thus enabling their currencies once again to play their full part as an instrument of trade.

The countries in question, however, are anxious to avert the serious disturbances which might result from the psychological influence of the memory of the havoc caused in past years by inflation. Before doing away with exchange control and the artificial value of their currencies, they may consider it essential to make provision for adjustment or consolidation of their debts and for the support of their currencies, even if only for a short period.

At the same time, efforts to restore budgetary equilibrium would in any case be required, especially because, although the abolition of exchange control may suffice to revive short-term credit, only the confidence resulting from a complete restoration of normal conditions would place long-term capital once again at the disposal of those countries which have need of it.

As regards exchange stability, it should also be noted that the two principal currencies, the dollar and sterling, have in fact been stable for a long time past and that neither in the United Kingdom nor in the United States is there any desire to embark upon a further deliberate devaluation. Moreover, the application of the normalisation programme outlined above, which would revive the international movement of trade, would go far to provide the conditions hitherto regarded as prerequisite for the *de facto* stability of currencies.¹

It is obvious, however, that, if the currencies of several large countries were readjusted, the sudden return of capital might, in the absence of measures designed to guard against this pressure, affect the value of sterling and possibly also of the dollar, at all events for a time. But those effects would be reduced to a minimum if, in accordance with the foregoing views expressed by the Economic Committee, currency adjustment was accompanied by an increase in imports in the countries concerned.

The Economic Committee does not wish to examine in detail the programme for restoring normal trade conditions outlined above, as this would exceed the scope of its report. But it

¹ See, in this connection, the statements of the Chancellor of the Exchequer and of Mr. Morgenthau and Mr. Cordell Hull, mentioned in the Economic Committee's report of September 13th, 1935 (document C.344.M.174.1935.II.B).

desires once again to stress the importance—and this is the primary consideration—of re-establishing the basic conditions for the working of the international machinery of trade.

The Committee is well aware that this programme of normalisation calls for great determination on the part of those responsible for its application. But, at the same time, it notes that all those countries which have had the courage to embark upon it have reaped their reward, and it is convinced that this normalisation would also ensure the success of the efforts to bring about national recovery already undertaken by a large number of countries, though hitherto with less success than courage owing to the falling-off of their foreign trade.

Those who maintain that in present circumstances a normalisation programme is much too ambitious a project to envisage should reflect that, while its application calls for decision and courage, it might, on the other hand, help effectively to ward off dangers and complications which are far more formidable. Nevertheless, it must not be undertaken with any ideas of petty bargaining, since in that case the programme would probably break down owing to the clash of conflicting interests.

Such a programme, on the contrary, should be devised and submitted with a twofold aim—material and moral—economic restoration and political restoration, recovery and relief of tension. Considered from this dual aspect, as a work of peace and as a constructive effort to bring about the economic restoration of Europe and the success of national programmes of social progress, it would probably obtain the necessary support in all countries where the gravity of the present situation is realised.

M. van Zeeland concluded his speech by stating that :

“ Such being the case, does not wisdom demand that the next Assembly should extend the scope of its deliberations and that, without neglecting in any way that which must be done in the political sphere, it should again make a comprehensive and strenuous effort to set in motion an economic revival—the revival which is here close at hand and which appears to be awaiting nothing more than that men should make a gesture of good-will ? ”

But, before making an attempt of this kind, we should ask ourselves whether it is reasonable to believe that the countries concerned are better able to-day than they were in 1933, at the time of the London Conference, to play their part and to make the necessary concessions.

The Committee considers that there is a whole series of reasons why an affirmative reply should be given to this question, provided, however, that this action is not simply left in the hands of technicians and interested parties, but is detached from purely economic interests and is raised from the outset to the level of a work on behalf of peace and conciliation, in their turn the most powerful influences on economic life.

There exist, at all events in a large part of the world, factors¹ which point to the possibility of a re-establishment of international economic co-operation. The first of these is economic recovery itself, which is now making its influence strongly felt. The relative increase in prices, for raw materials in particular, and the new methods introduced, even by countries which are applying quotas and exchange control most strictly, in order to facilitate (by partial readjustments of the values of their currencies) the marketing of their goods, are helping to lessen the gap between the various price-levels. Nearly all countries have embarked upon a policy of internal credit expansion entailing the development of production, which is an important factor of national recovery. Even in countries with depreciated currencies, a sincere desire for stability is apparent and, moreover, those countries which have defended the former gold parity most strenuously by means of restrictions are beginning to feel the serious drawbacks of this system.

Lastly, all countries feel the necessity for making some effort, both in the national and the international sphere, to change the present atmosphere of tension and unrest. But, assuming that an attempt at normalisation is possible, what form should it take ?

¹ It should be noted that the agenda for the Inter-American Conference for the Maintenance of Peace which is to meet very shortly at Buenos Aires also includes a study of current economic problems.

The Committee considers that the idea of a world conference should be ruled out, since from the outset the diversity of the interests of different countries would constitute an obstacle to its success.

Moreover, no conference is competent to deal with the first problem which arises—namely, the readjustment of price-levels and the currency measures which may be necessary for that purpose. As stated above, this question must be settled unilaterally by each of the countries concerned, and it is for those countries individually to decide whether and in what form they wish to consult with other States, with a view to obtaining their support or assurances calculated to facilitate the carrying-out of their policy. But, in the case of countries practising exchange control and restricting payments, certain consultations of this kind appear to be essential. In any event, the measures taken in any country in the monetary sphere must affect other countries, so that consultation, when practicable, will be expedient in order to preclude as far as possible the pursuit of divergent policies. The exchange of views which has taken place has convinced the Committee that co-operation on these lines can easily be obtained if desired. Needless to say, in this connection, the action taken by the principal countries is of the greatest importance.

It should be repeated, however, that, to be effectively maintained, the readjustment of price-levels must be supplemented by the lowering of trade barriers and the abolition of currency restrictions. The readjustment of prices will automatically afford ample protection for the national economy and will enable various quantitative trade restrictions which may be regarded as essential so long as internal prices and world prices are maladjusted to be relaxed immediately or altogether abolished. In this sphere also, it is in the first place for the Governments concerned to act on their own initiative in the interests of the economic development of their respective countries, so as to encourage the upward trend of business and the restoration of the currents of international trade.

Nevertheless, experience has shown that even those countries which have readjusted their price-levels hesitate to remove their protective barriers as rapidly as could be desired. It is therefore necessary that national efforts to liberate trade should be supported by vigorous action with a view to restoring international co-operation. To give it the greatest chance of success, any attempt at international economic collaboration should, however, be confined in the first place to a limited number of countries—namely, those which have a decisive influence on the course of events, both in the political and in the economic sphere.

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In conclusion, the Economic Committee wishes to inform the Council that the economic situation has now come to a parting of the ways, whence there will follow either a further contraction of trade or a restoration of normal conditions which may bring untold benefit to all countries.

The Economic Committee is accordingly convinced that no pains should be spared in the international field to make sure that the decisions taken lead in the right direction. In view of its limited powers, it would merely express to the Council the view that, however difficult the situation may be, it nevertheless presents a whole series of features favourable to action on the lines suggested. The Council is alone in a position to consider, having regard to other than economic considerations, whether the time has come to propose consultations and, if so, within what limits and in what form.

REMARKS BY THE FINANCIAL COMMITTEE

The Economic Committee has rendered a great service by presenting its Report on the Present Phase of International Economic Relations, which has been submitted to the Financial Committee for comments.

The Financial Committee has no hesitation in recording that it is in general agreement with the conclusions reached by the Economic Committee. It endorses in particular its view that it is indispensable for the restoration of normal international economic intercourse to close the abnormal gap which separates the price-levels of different countries. It also fully shares the view that it is for each country to deal with its own monetary problems and that a world conference would not at this stage prove helpful and that any attempt at international economic collaboration should be confined in the first instance to a limited number of countries likely to have a decisive influence on the course of events. It wishes finally to emphasise its agreement with the view that no currency adjustment can bring about any improvement in the economic situation unless it is accompanied by a relaxation—leading we should hope to ultimate abolition—of exceptional import restrictions (quotas and exchange control, etc.).

The task of adjusting the level of prices ruling in various countries so that such adjustment may be as stable and lasting as possible calls for special comment.

In all countries, the fall of prices had profoundly disturbed the relations between the cost of production and the prices of the goods produced and between the burden of debt and the reduced incomes which the fall of prices had occasioned. Certain countries, by allowing their currencies to depreciate, were able first to stop a further fall of the price-level and then to induce a moderate rise. The general effect of this and the earlier measures of deflation was to restore to a greater or less extent equilibrium between costs and prices and between the burden of debt and incomes—that is, to achieve internal economic equilibrium.

The extent to which this equilibrium has been attained in many countries is demonstrated by the steady and substantial progress of their internal production and trade, by the achievement of budgetary equilibrium, by the funding of short-term debt and the conversion of long-term loans to a lower rate of interest and by the setting free of hoarded savings. In a number of these countries, the volume of production has indeed exceeded that achieved in the years immediately preceding the depression (see the Secretary-General's Report to the Assembly ¹).

The experience of recent years has clearly demonstrated that there are limits to the extent to which a stable internal equilibrium is attainable by a process of deflation (reduction of costs).

It may well be thought that the dollar and sterling countries, which have attained so great a progress in their economic activity, would hardly wish deliberately to embark upon a policy of further devaluation, provided of course that the measures chosen by other countries to adjust their price-level do not exceed what is required for their internal equilibrium.

¹ Document A.6(a). 1936. Annex II.

If international stability is established on sound and enduring foundations, it should ultimately also help to promote resumption of international lending—a potent factor in the development of international exchange of goods and services.

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The Financial Committee endorses wholeheartedly the opinion expressed by the Economic Committee that to restore international stability and to liberate international trade from the stranglehold of the restrictions which are suffocating it would greatly contribute, not only to the economic prosperity of a large part of the world, but also to the maintenance of peace.
