

THE TRANSITION
FROM WAR TO PEACE
ECONOMY

LEAGUE OF NATIONS

1943

[Communicated to the Council
and the Members of the League.]

Official No.: C.6. M.6. 1943.II.A

May, 1943

THE TRANSITION FROM WAR TO PEACE ECONOMY

Report of the Delegation on Economic Depressions
Part I

LEAGUE OF NATIONS
GENEVA
1943

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**II. ECONOMIC AND FINANCIAL
1943.II.A.3**

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PREFACE

In October 1937 the Assembly of the League of Nations instructed the Economic and Financial Organization of the League to report on the measures that might be employed "for preventing or mitigating economic depressions." A special Delegation was appointed by the Council of the League of Nations in January 1938 for this purpose.

The Delegation consisted of Sir Frederick Phillips (Chairman) and Mr. W. W. Riefler representing the Financial Committee of the League; Dr. R. Ryti and Mr. F. L. McDougall representing the Economic Committee; Professor Carter Goodrich representing the International Public Works Committee of the International Labour Organization; Professor Oskar Morgenstern, M. Jacques Rueff and Professor Bertil Ohlin.

The decision of the Assembly and the Council was a natural development of the work of the Economic and Financial Organization, which had been concerned with the major problems of economic and financial policy since 1920 and had for a number of years been carrying out a programme of research into the nature and causes of economic fluctuations.¹ The task of the Delegation has, from the outset, been greatly facilitated both by the experience of the Organization and by the studies referred to above. One result of those studies was to bring about between economists and officials concerned with economic policy in many countries a greater measure of agreement in this field than previously existed.

The work of the Delegation was interrupted by the outbreak of war and it has since been impossible to convene all the original members in one place. But the special problems created by the war have naturally been engaging the members' attention. These problems, which concern the transition from war to peace economy, are of vital importance for the future. They are, moreover, problems for which a solution is becoming increasingly urgent, and the Economic and Financial Committees of the League of Nations, reporting last summer,² expressed the hope that the Delegation

¹ League of Nations publications directly relating to the problem of economic fluctuations include: *The Course and Phases of the World Economic Depression* (1931); *Prosperity and Depression; An Analysis of Business Cycle Theories* (1937); *The Statistical Testing of Business Cycle Theories*; Vol. I, *A Method and its Application to Investment Activity* (1938); Vol. II, *Business Cycles in the United States of America, 1919-1932* (1939); *Economic Fluctuations in the United States and the United Kingdom, 1918-1932* (1942).

² League of Nations: Economic and Financial Committees. Report to the Council on the Work of the Joint Session; London, April-May; Princeton, N.J., August 1942.

might meet and issue its recommendations without too great delay.

It has accordingly been considered desirable to issue a report now under the authority of those members or their representatives that are available and new members appointed with the authorization of the President of the Council, Dr. Costa du Rels. The Chairman and certain other members of the Delegation, while accepting the report as a whole as being a valuable contribution to the understanding of the problems with which it deals, must, in view of the official positions which they hold, put themselves on record as not being identified with any specific measures proposed or discussed therein.

The final text was drawn up at a session held in April 1943. The composition of the Delegation was as follows:

Sir Frederick Phillips, G.C.M.G., C.B. (Chairman),
Mr. J. B. Brigden (replacing Mr. F. L. McDougall, C.M.G.),
Prof. Carter Goodrich,
Hon. Henry F. Grady, Chairman of the Economic Committee
(replacing Mr. W. W. Riefler),
Dr. G. H. C. Hart,
Dr. Zygmunt Karpinski,
Prof. O. Morgenstern,
Mr. G. F. Towers.

We were fortunate enough to be able to associate Dr. Fernando Lobo with our work and to arrange for the attendance of Prof. G. Haberler, the author of the League of Nations study on *Prosperity and Depression*, who had attended most of the previous meetings in Geneva. In addition we had the advantage of comments on the draft report from two members of the Delegation at present in the United Kingdom, Mr. W. W. Riefler and Mr. F. L. McDougall, and a number of outside experts.

We desire to express our appreciation of the very valuable preparatory work performed for the Delegation by Mr. Alexander Loveday and the officials of the Economic, Financial and Transit Department of the League of Nations. Their work covers not only the basis for the text of the present report, but a large number of special studies which have been published in recent years.

For the convenience of the general reader, we have asked the Department to prepare a brief summary of the report which appears as Annex III.

We have been influenced in our decision to issue a report at this stage by the following considerations:

a) The war is creating economic changes and upheavals that will greatly intensify the forces leading to instability in the postwar world and it is necessary to devise policies in advance if the risk of depression and unemployment is to be mitigated. In particular, it is necessary that every effort should be made to think out in advance the methods by which as smooth a transition as possible from war to peace economy can be effected.

b) A major postwar depression, the factors making for which are already very apparent, could scarcely fail to lead to a resumption of policies of intense economic nationalism all over the world and thus render the whole problem with which we are concerned incalculably more difficult.

c) If the economic and social objectives of the United Nations are to be fulfilled, means must be devised for maintaining in time of peace—so far as possible—the high levels of production and employment achieved in wartime.

d) Independent action by each country for the achievement of full employment and economic stability would inevitably be self-defeating, and it is of the utmost importance that national policies should be co-ordinated on the basis of an agreed international plan, each being supported and furthered by the others.

But economic co-operation between countries for such purposes will be feasible only if political security is firmly established and if economic policies are no longer conditioned by the fear of war. Moreover, such co-operation cannot be achieved unless the peoples of the world understand realities and are willing to face them. We have no doubt that a spurious "realism," which ignores the effects of national policies on the interests of other countries, will be prevalent after the war as it has been in the past and that the pressure of special interests in favour of self-regarding policies will again be strongly felt. The triumph of these forces would, we believe, have the most disastrous consequences. To resist them, a high degree of statesmanship and courage on the part of those responsible for postwar policy is required and, on the part of the rank and file of the people, an understanding of how much is at stake. One of the objects of our report is to contribute to that understanding.

The conditions which may obtain at the termination of hostilities, no one can foresee. But that fact no more constitutes a sound reason for failing to plan for peace than ignorance of the way in which peace may be broken constitutes an excuse for being unpre-

pared for war. We can only win the fruits of peace if we are prepared for it and have our plans ready. Moreover, the war has already given rise to great changes in the economic situation and the economic structure of the world which are known and require consideration. Whatever happens, the problems of the transition from war to peace economy, of relief, of reconstruction must arise for settlement and concerted action; and these problems will be affected by such known changes and developments as the growth of the engineering and machine tool industries in various parts of the world, the acceleration of the industrialization of certain agricultural areas, shifts in population, the new distribution of the holdings of foreign assets, the universal or quasi-universal imposition of exchange control, the freezing of foreign assets by certain governments, etc.

All these are known facts affecting the future of society, demanding consideration now and reconsideration as time passes. It is the broad lines of policy that require immediate attention. The details may with advantage be left till later.

We have decided, therefore, to divide our report into two parts. The first, which we submit now, deals with the transition problem, though it necessarily touches on the longer-term problem of fluctuations in economic activity in peacetime. The second part, to be published later, will deal more fully and directly with that longer-term problem.

The present war has given rise to far-reaching changes not only in economic structure, but also in ideas concerning the objectives of economic policy and the means by which these objectives should be reached. We can, therefore, no longer assume, as we might legitimately enough have done some years ago, that our recommendations should be confined within the limits set by the existing mechanisms for the execution of policy; nor can we assume that the general principles and objectives of policy will be those which obtained in most countries of the world before the war. We begin our report, therefore, by a statement of principles and objectives, basing ourselves on our interpretation of the general trend of social-economic thought in the United Nations today. Throughout the report we make recommendations based on those principles; our recommendations are naturally much more far-reaching than they would have been, had we reported in 1939.

April 12th, 1943

INTRODUCTION

1. OBJECTIVES OF ECONOMIC POLICY

The war is having a profound effect on the attitude of all classes of society towards the problem of economic security and cyclical unemployment. Why, it is asked, has society been so organized that all can find work to do when the object of that work is destruction, but men and women are unable to find employment when they desire to work to satisfy their own wants? Why can society be so elaborately and so efficiently organized to lower but not to raise the standard of living? We for our part do not believe that men and women, when this war is over, will tolerate an organization of society under which those who are willing and anxious to work, for no obvious or conscious fault of their own—indeed for no obvious cause—are deprived of the opportunity of doing so. They will demand the right to work and to create, because creative work is the very essence of existence, and one of the first objects of policy must be to satisfy that claim in so far as it is humanly possible to do so. To afford unemployment allowances, though essential, is not enough. No self-respecting persons want to live as a charge on their community when capable of useful activity and of contributing to the general welfare. Work is as essential to human well-being as is leisure, and this fact has been learnt during the bitter years of unemployment before the war.

Apart from the tragedy of forced unemployment itself, the conscience of the world was profoundly shocked by two facts that, though not new, came vividly before the public mind during the course of the decade preceding the outbreak of war. The first of these facts was the coexistence of large unsaleable stocks of food-stuffs and raw materials (part of which from time to time was deliberately destroyed) and of the want and deprivation suffered by the unemployed and the partially employed. The second was a fuller realization, which resulted from careful and extensive inquiries into standards of living, that even in the richest countries a large proportion of the population was inadequately fed, inadequately housed and inadequately clothed, and always had been. This change in the orientation of thought was clearly shown

in the discussions that took place and the resolutions that were adopted in the Assemblies of the League of Nations during the three or four years preceding the outbreak of war. In these discussions and resolutions emphasis shifted year by year away from more abstract issues to the practical problems of the individual, to his standard of living, of housing, of nutrition and health, to the conditions of rural life in all its aspects and above all to the problems of unemployment and depressions.

These facts suggested that something was so radically wrong with the functioning of the economic system that, not the wisdom of this or that policy, but the fundamental assumptions of economic thought came to be questioned. The economics of consumption began to replace the economics of production.

Let us begin, it was urged, by reviewing what are the basic needs of the people, at the bottom end of the scale the minimum physiological needs, and pass from that to a consideration of our land and mechanical equipment, our labour force and scientific discoveries, with the aid of which those needs may be met. Let us organize our economic system in such a way as to satisfy these needs and satisfy these needs first. If this is done and these minima rendered secure, much of the danger of depressions and much of the suffering incidental to depressions will be obviated.

To some extent this attitude towards economic problems was already influencing government policies before the war; the movement for improving nutritional standards was gaining in impetus; governments and local authorities were undertaking extensive plans for slum clearance; meals were being provided to school children and other methods adopted to aid the needy in obtaining a more adequate diet; unemployment insurance, where it existed, had proved itself a powerful breakwater against the tide of depression and was being more and more generally adopted.

But insurance at best may mitigate, it cannot prevent a depression; and the war has done much to stimulate and strengthen constructive rather than defensive policies and beliefs by proving how greatly production can be increased when governments and public opinion are resolved that it shall be. It has awakened the public to a consciousness of the enormous capacity of a modern society to produce when the latent powers of production are

organized and directed to a definite objective. In the United States of America in 1942, while that organization was still in process, although some five million men were drawn off into the armed services, the real income produced (after eliminating price changes) was 16% higher than in 1941 and 48% higher than in 1939. The machine industry which lies at the basis of our whole industrial system has been expanded in all the highly industrialized belligerent states to a point far in excess of anything known before in history. Why, it is asked, cannot this whole apparatus of production be utilized in peacetime to satisfy the needs of the consumer?

This change in thought is, of course, not more than a change in emphasis. Production on which most emphasis was placed in the past was production to satisfy consumers' needs. But the change in emphasis is, we believe, both important and likely to prove beneficial. If governments and the public are resolved to secure and maintain a minimum standard of living for all, we see no reason why, at any rate in the countries possessing modern mechanical equipment, they should fail to do so. But to do so will demand courage and determination and the road to success may prove a stony one. It is very much more difficult to maintain full employment of all the resources of production when demand itself depends on the aggregate tastes and desires of the mass of the people and is subject to changes in taste and in fashion, than when it is determined by the pre-planned requirements of war. Again it is more difficult to maintain when each individual can exercise his right to work or not to work, to choose one occupation rather than another, to spend or to save. That in most countries men will insist on such freedom we do not doubt. It is indeed one of the essential freedoms for which the Allies are fighting. We are necessarily concerned in this report with the problem of achieving the objectives we are now discussing within the framework of a social system designed to preserve individual liberty. As we shall endeavour to show later, liberty can only be maintained if the state uses its authority to suppress monopolistic practices, whether of producing firms or labour organizations, and thus assures the necessary mobility of all factors of production.

The belief that we should think in terms of the consumers' needs

first and then in terms of our mechanical, scientific and human power to satisfy those needs is no nationalistic doctrine, and the war has deepened the belief that the difference in the standards of living of different peoples is a menace to social order and international understanding, and moreover a menace that can and should be greatly reduced after the war is over. The mechanical industries of the leading industrial states and, above all, the machine tool industry which have been so vastly expanded are not likely to find sufficient scope for their output at home and should, it is felt, constitute the instrumentality by which a better society may be built up throughout the world, by which the benefits of mechanized production may be spread to all.

We believe that a sense of world unity is developing owing to the very fact that this is literally a world war, owing to the worldwide distribution of the allied forces, and owing to the extraordinary acceleration of means of communication that the war has caused. Within this conception of world unity lies the still more definite conception of unity amongst the United Nations out of which has developed the principle of equality of sacrifice and a pooling and sharing of the resources available for war and of the risks of war.

Statesmen of the United Nations have already made known their intention to undertake the task of relief and reconstruction as part of the general war effort. In accordance with this policy it was stated in the "VIIth Report to Congress on Lend-Lease Operations" that "relief and rehabilitation of the reoccupied areas will be the common responsibility of all the United Nations, and must be a combined operation in the same sense as the military operations themselves. Success in restoring the countries we free will be a powerful factor in shortening the war, giving the liberated peoples their chance to share in the victory."

If the spirit that has inspired these declarations continues to permeate subsequent policies designed not simply to make good the damage wrought by the war, but to develop both advanced and backward areas, the objectives of full employment of resources and of higher standards of living will without doubt be easier to attain. As we shall show in the second part of our report the capital goods industries are peculiarly susceptible to wide fluctua-

tions in demand, and their recovery from depression constitutes one of the most obstinate problems of economic policy. But the potential demand for capital goods is inexhaustible, and a courageous policy of foreign investment by the great industrial states when domestic demand falls off might perhaps do more than any other single means to maintain economic activity both at home and abroad. It would do much more than this; for by such exports—by the provision of plant and equipment—the less advanced countries would be able to produce more economically and to raise their national incomes and standards of living. As their national incomes increased, their power to purchase abroad would increase too. The initial export of machinery would create a constant demand later for machine parts, for tools and for further machinery; trade would breed trade. An expanding foreign trade lies at the very root of the economic philosophy of today as we interpret it, not for the sake of that trade itself, but because trade is the indispensable handmaiden of material prosperity, full employment, human welfare.

Many writers, when considering the economic organization of the future; have insisted that one of the main obstructions to prosperity in the past has been the growth of an exaggerated economic nationalism and that a surrender of certain sovereign rights, recognized in the past as such, is a prerequisite of greater success in the future. This may be true. But we believe it is more useful to formulate first the objectives of policy and then a plan for attaining them. If the execution of such a plan is obstructed by lack of co-operation or the danger of lack of co-operation, it may be necessary to demand that national governments accept certain limitations on their rights to take unilateral action affecting the interests of other nations. But the fact should not be overlooked that both in the early 'twenties and in the depression years in the following decade exaggerated nationalism was partly due to fear and that fear in its turn due in part to political insecurity and in part to the absence both of objectives of policy and of a plan. That fear will revive and breed the same offspring if political security is not attained and if objectives and plan are lacking again. In 1918 statesmen looked back forlornly and hoped more than they strove to restore the economy of 1913. No one could desire to revive the

international economic system of 1939, for there was none—only the ruins of a system. We must look forward. Let us try then to formulate first the objectives of economic policy as we see them.

We believe that the objectives of economic policy should be to assure:

1) that the fullest possible use is made of the resources of production, human and material, of the skill and enterprise of the individual, of available scientific discoveries and inventions so as to attain and maintain in all countries a stable economy and rising standards of living;

2) that, in so far as possible, no man or woman able and willing to work should be unable to obtain employment for periods of time longer than is needed to transfer from one occupation to another or, when necessary, to acquire a new skill;

3) that in the use of these productive resources, the provision of goods and service to meet the essential physiological needs of all classes of the population in food, clothing, house room and medical care, is a prime consideration;

4) that society distribute, as far as possible, the risk to the individual resulting from interruption or reduction of earning power;

5) that the liberty of each individual to choose his own occupation is respected and is promoted by equal educational opportunities;

6) that the liberty of each country to share in the markets of the world and thus to obtain access to the raw materials and manufactured goods bought and sold on those markets is promoted by the progressive removal of obstructions to trade;

7) that the benefits of modern methods of production are made available to all peoples both by the progressive removal of obstructions to trade and by courageous international measures of reconstruction and development.

We should be under no illusion about the difficulty of attaining these objectives. Indeed, the full realization of one at any time may prove incompatible with the full realization of another, and as time passes, greater emphasis will no doubt be laid on one or another of the aspects of the whole body of doctrine. They reflect, however, a general orientation of thought of very real significance

which is likely to have profound social and economic effects. The objectives which condition progress can never be immutable or easy of immediate attainment.

If these objectives continue to be accepted as we believe they are accepted today, it should prove far easier to avoid and mitigate economic depressions in the future than it has been in the past. The acceptance of the first and second objectives implies that governments will in their turn accept responsibility for assuring that the fullest possible employment of resources, both human and other, is maintained. This alone will represent a great advance from the situation in, for instance, 1930 and 1931, when governments generally started with the belief that, if by unemployment insurance or direct financial aid the acutest forms of physical distress were obviated, they had done all that was necessary. These two, as does the third objective, postulate indeed that production is at once a social enterprise and a social responsibility, and that as and when private initiative proves inadequate, the state must take measures to right the situation. They postulate, that is, that when the profit motive ceases to exercise enough force to maintain employment, employment must still be maintained for paramount social considerations. For reasons we shall explain in Part II of our report, such a change in attitude will, we believe, benefit and not endanger private enterprise.

As we have already indicated, any determined endeavour to realize the third objective and render a minimum standard of living secure for all will promote the establishment of a solid volume of demand which will prevent economic activity falling below a certain point and thus act as a breakwater against the tide of depression. Above all it will aid agriculture and help to prevent depression becoming generalized owing to a falling off in farmers' money income.

The fourth objective, by assuring social security, by affording a minimum income to those who suffer from temporary or permanent misfortune or have become too old to work, will have an exactly similar influence in consolidating demand. The fifth, the liberty of the individual, requires no comment.

The last two objectives, if persistently pursued, will prevent that accentuation of depressions which we have seen in the past to

result from the efforts of governments to isolate themselves from their onslaughts. They will do much more, for they will, as we have shown, afford a means by which the most unstable part of the capitalist structure, the mechanical and allied industries, may find an outlet for their products when home demand slackens.

The emphasis we have laid in our objectives on maintaining employment may perhaps seem to reflect a tendency to attribute too great a significance to those phenomena of depressions that are peculiar to highly industrialized and highly capitalized countries. We are, in fact, fully conscious of the disastrous effects of depressions on agricultural states. But it is our duty to put forward proposals for the prevention and mitigation of depressions, and it must, we believe, lie with the great industrial markets of the world to adopt the constructive measures of major importance required to secure greater economic stability and to accelerate economic development. If they can maintain the employment of their resources, the producers of crude products will be able to rely on a steady market for their exports and an expanding supply of the machinery and machine-made goods they require.

2. THE "RIGHT TO WORK"

As we have just stated, the public is likely, we believe, to require governments to assume greater and more definite obligations with reference to unemployment than before the present war and to demand a recognition of what is somewhat loosely but not inappropriately called "the right to work." Our report is based on that assumption, and in Part II we deal with the long-term problems that the risk of depression on the one hand and the assertion of this right on the other present. But we think it may be well here to define rather more precisely what we understand by this term, "right to work," and to set out as simply and as plainly as possible a certain number of its many implications.

Let us begin with a negation. The term does not, we take it, imply that no man or woman shall ever be in search of a job. Some persons will inevitably be unemployed from time to time when they are changing from one occupation to another, either of their own free will or as a result of declining activity or demand for labour in one branch of industry and expansion in another. Such

changes in the relative size or labour requirements of different industries are inevitable in any economy in which production is directed by the tasks and desires of the public. In exactly the same way some changes in relative prices, a drop in some prices, is necessary in order to permit of such changes in any economy in which production is directed by the tastes and desires of the public. Nor does the term imply that the state should assume responsibility towards each individual severally to secure him employment when he is temporarily disengaged.

But it does mean that governments are responsible for avoiding large-scale or protracted unemployment and, furthermore, that no head of family at any rate or single person should be kept for long periods of time in enforced idleness when he is able and willing to work.

Prior to 1929 the most advanced governments held that they had fulfilled their obligations if they assured to all workers (or all insured workers) a minimum income in good times and bad, in youth and old age. Now more is demanded: the right to function, to contribute something to the national income, to create, not simply to subsist or avoid dying of starvation.

If governments are to assume this increased responsibility, they must have the necessary powers and the support of public opinion in the exercise of their powers. If the profit motive does not suffice, or does not suffice at all times to obviate serious unemployment, then this new motive of policy, namely, the provision of work, will have to be recognized as overriding. Both labour and capital must accept the fact that industry has ceased to be the private concern of certain shareholders or certain trade unions and is a social function carried out in the interests of all. Governments, when taking measures to promote employment, must be able to count on the support of the business world; if, on the contrary, the entrepreneur habitually tends to abstain from enterprise whenever the government has to intervene and has, for instance, to supplement a waning private demand for goods and services by a public demand, then either large-scale unemployment will occur or the government will be forced to take over the whole conduct of business itself. We believe that governments will best be able to secure the full backing of both entrepreneurs and workers if they give

their representatives as full a share as possible in both the elaboration and execution of anti-depression policies. What is necessary is that all three parties should face up to the difficulties together and feel a joint responsibility. This is all the more necessary, as, for success in carrying out this responsibility, radical changes will have to be made in certain practices and attitudes which have been prevalent in both groups.

It is clearly impossible for a government to assure maximum opportunity for employment if those in control of a business, which but for monopoly control would expand, make use of their privileged position to prevent such expansion. Such monopolistic restrictions on trade, whether exercised by business management or by labour, should be removed. Thus, if building activity is being checked by a combination of lumber interests keeping the price of timber unduly high, the government must break the price ring and should be able to look for public support in so doing. But building activity may also be checked by the refusal of a union to admit new members and the consequent labour shortage and disproportionately high wages. Such limitation of membership, which in fact is practised by a small minority of unions, and other restrictive practices which are more widely prevalent have been largely motivated by the fear of unemployment and have been particularly conspicuous in fields in which extreme irregularity of employment has in fact existed. If the fear of unemployment can to a large measure be lifted by a programme of stabilization, it should be possible for the trade unions to co-operate by the modification or the removal of the restrictive practices which impede its success. If the measures for assuring regularity of employment proposed in this report are vigorously put into effect, such changes in union practice can reasonably be required. Without such modifications of practice on the part of both business and labour, it is quite certain that governments cannot fully succeed in assuring employment.

Men should be encouraged to work in those occupations for which there is a growing demand. Not all workers can expect to find work year by year in the occupations to which they have become accustomed. The very essence of life and progress is

change. It follows, therefore, that the right to work must not be interpreted as a right in all cases to find similar employment at the same rate of wage as heretofore. New inventions will render certain occupations redundant; certain skills laboriously acquired in the past will cease to be wanted. In these circumstances the government should (a) try to create conditions in which there is a maximum chance that other jobs will become available; (b) failing this, when unemployment threatens to continue for a long period, be prepared to offer work itself or to offer training in new skills. The unemployed will then be in a position to choose between unemployment benefit without work, work of probably quite a different character to that to which he was used and possibly at a substantially lower wage, and learning a new skill.

We attach the greatest importance to the educational functions of the state in this connection. If the primary objectives of economic and social security together with rising standards of living are to be attained, then the maximum use must be made of the inventive and scientific skills of each nation. But new inventions are liable to render old skills redundant. The state can do much at once to overcome this difficulty and to accelerate progress, if it affords adequate opportunity and adequate incentive to all to learn new skills and has the power to assure that all occupational markets are open to all.

Granted these conditions, we believe that the menace of long, dreary years of unemployment may be overcome and at the same time the freedom of the individual preserved. But if sectional interests obstruct the government in its endeavours to live up to its new responsibilities, then either it will fail, or in an effort to succeed will sacrifice individual freedom. For the right to work it will tend to substitute the command to work. Governments can, of course, assure employment if they assume themselves the right to decide what every person will do and at what remuneration. But our purpose is to assure at once liberty and opportunity.

8. NO RETURN TO THE PAST

The objectives set out in the previous sections stand in sharp relief against the history of the period between the two wars.

The Unstable Recovery of the 'Twenties.

The attempt to reconstruct the world economy after 1918 looked back to the first decade of the century. Slowly, very slowly, an international monetary system was built up which bore at any rate an outward resemblance to the monetary system which had functioned before the war. Movements of capital, to a greater extent than before motivated by social rather than investment considerations, helped to restore the position in Europe. But progress was distorted by new features which were a legacy of the war, reparations, war debts, heavy unemployment in particular countries.

As we show below, the improvised system looking back to the past broke down from 1929 onwards. Commodity prices came tumbling down in sensational fashion. Producers and even whole countries which had specialized in the production of particular products found their markets disappearing and their returns inadequate. The breakdown spread. Side by side with the agricultural depression industrial unemployment soared by leaps and bounds. Nationally and internationally, financial systems ceased to work. In an endeavour to protect markets, tariffs, quotas and other trade controls were introduced in one country after another. International obligations ceased to be met.

The Great Depression.

The collapse that came at the end of 1929 developed into the great depression of the early 'thirties, affecting all countries and almost all occupations. The following table shows the contraction which took place in the national income of 24 of these countries.

A number of these figures are no doubt rough approximations, and different methods have been employed in their calculation; but they give an adequate picture of the magnitude and the generality of the depression. In the United States of America, Roumania and Yugoslavia, national income was down by more than half within three years. In Canada, Germany, Poland and Czechoslovakia, the loss was over 40%. Some of these countries are highly industrialized, others essentially agricultural, others again of a mixed economy. In the case of the United Kingdom the decline was smaller than elsewhere; but this was largely a reflection of the

fact that the United Kingdom was suffering from severe unemployment in 1929.

National Incomes of 24 Countries, 1929, 1932 and 1933
Millions of U.S. Dollars¹

Country	National Income			Depression Year ² as % of 1929
	1929	1932	1933	
Australia	3,737	2,570	2,677	69
Austria	1,044	895	799	77
Belgium	1,905 ^a	1,390	1,382 ^d	73
Bulgaria	406	284	257	63
Canada	5,867	3,377	3,221	55
Czechoslovakia	2,667	1,722	1,588	59
Denmark	992	911	951	92
Estonia	92	60	67	65
Finland	461	350	333	76
France	9,599	8,071	7,797	81
Germany	18,092	10,761	11,030	59
Hungary	1,032	700	647	63
Ireland	737	708	682	87
Japan	5,941	5,099	5,717	86
Netherlands	2,319	1,736	1,722	74
New Zealand	860	659	633	74
Norway	690	518	510	86
Poland	3,175	1,739 ^c	1,739	55
Roumania	1,202	619	594	49
Sweden	2,045 ^a	1,715	1,730	84
Switzerland	2,058	1,445	1,329	65
United Kingdom	21,335	13,707	19,231	88
United States	82,691	40,089	42,504	49
Yugoslavia	1,215	564	564 ^b	46

¹ Conversion effected throughout at the exchange rates ruling in 1929.

² 1932 or 1933, whichever is lower.

^a 1930; ^b 1932; ^c 1933; ^d 1934.

Source: League of Nations, *World Economic Survey 1933/9*, page 84.

The total loss of money income in all the twenty-four countries given above may be roughly estimated at over \$60 billion in the single year 1932 or a sum approximately equal to the total income of all these countries, exclusive of the United States and the United Kingdom, in 1929. The loss of real income produced was, of course, less, but much of the agricultural produce was never sold and rotted on the farms. The income actually enjoyed, therefore, was substantially less than what was produced.

At the depth of the depression in 1932, over 25 million industrial workers throughout the world were unemployed. Through no

fault of their own, more than 100 million people suddenly found that society no longer had any use for the services which produced for them their daily sustenance. Serious though as was the material privation and want that unemployment frequently entailed—the undernourishment and malnutrition, the sacrifice of small comforts, the loss of homes representing the accumulated savings of years—this was perhaps not so important as the moral and psychological cost: the helpless feeling of insecurity, the anxiety regarding the future of dependents, the frustration of idleness, the sense of counting for nothing in the community.

To these 25 million industrial workers, with their dependents, moreover, must be added an unknown army of land workers underemployed on the farms or employed in producing what was never enjoyed. How great was the aggregate loss in wealth and welfare throughout the world we can never guess; but a single illustration taken from a single country may give some indication of the nature of that loss.

It has been calculated by the National Resources Committee¹ that if unemployment had not exceeded two million workers, which is taken as a residual figure, between 1929 and 1937, the income produced in the United States at 1929 prices during the course of that period would have been approximately \$200,000 million higher than it actually was. We can only grasp the meaning of a figure so great as this by comparing it with other magnitudes. Two hundred thousand million dollars is two-and-a-half times the total national output of the United States in the boom year 1929; it is equal to four times the total estimated national income of the United Kingdom, the four British Dominions given in the above table and Germany in 1929.

But the loss incurred by the last depression was far greater than even this calculation might suggest for the whole structure of international economic life was disintegrated by it. Suddenly, after the autumn of 1929, one country after another found itself in the slough of the deepest depression in its history. For this arrest to progress, no government was prepared. No government had elaborated plans for restarting the machinery of production should occasion arise. Hurriedly, without thought for others, without in-

¹ The Structure of the American Economy, Part I.

ternational consultation, without any common leadership, each government improvised measures at first of self-defence, then of salvage. Investment ceased. The capital flow was reversed; short-term commercial loans to foreign countries were called in. Gradually the gold reserves of the debtors were sucked away in the backwash. In 1928 the United States had exported \$899 million of capital; in 1929 these exports dropped to \$185 million. During the ten years between 1919 and 1929 her long-term foreign investments had risen by some \$9 thousand million. Europe alone had absorbed over \$2.5 thousand million in this period and her total long-term indebtedness to the United States amounted to over \$4.5 thousand million. Eastern and Central Europe had borrowed also large sums in the Western European capital markets. When the tap was turned on the flow of credit in 1930, these borrowers were faced with a short-term indebtedness which has been estimated at over \$5 thousand million and the annual service due on the long-term debts can scarcely have amounted to less than \$500 million. Only a very small fraction of the total foreign capital absorbed by Central and Eastern Europe was directly invested in business in the form of share capital, the earnings on which might have been expected to decline as prosperity waned. On the rest, debt service was due, and in the two years 1930 and 1931 the prices of goods entering into international trade, of the goods by which that service had to be met, falling gold, fell by well over a third. By 1932, the annual service of debt required between 40% and 50% more goods in payment.

The Instability of Prices in the Interwar Period.

During the last twenty years, the price of wheat and of jute has been halved three times within about twelve months, the price of cotton three times in periods of under eighteen months. The price of copper and of lead was halved four times within periods of two years and doubled three times even more rapidly. The price of zinc was halved twice in eighteen months, of tin twice in twenty-four months; zinc and lead doubled in price three times in two years or less; copper three times in eighteen months. On one occasion the price of coffee was halved in eight months, on another the price of sugar trebled in four months. Between 1920 and 1933, the price of

crude rubber fluctuated between four cents a pound and twenty-five times that amount, and was on several occasions doubled or halved in the space of a few months.

These tremendous price variations were not the result simply of currency fluctuations in the early 'twenties. The severest falls took place in 1929 and 1930 at the beginning of the depression. Interpreted in terms of human suffering, they meant that farmers in many areas were unable to purchase clothes or boots, were unable to send their children to school for lack of them, were unable to obtain food other than that produced on the farm; that debts were unpaid and banks forced to close their doors on their depositors; that savings large and small were lost; and the plight of the paid labourer on the farm or in the mine was often such as to make the incomeless farmer seem fortunate.

The Breakdown of the World Trading System.

The World Economic Conference in 1927 had insisted that a return to the effective liberty of international trading was a primary condition of prosperity. Now in adversity all tariffs were raised. The movement began with the adoption of the Hawley-Smoot Tariff in the United States, at the very moment when, with the cessation of capital exports, goods should have flowed to that country in repayment of debt and in payment of interest. "Our people are not likely to forget," said the Secretary of State in 1940, "the contribution which the enactment of the 1930 Tariff made to the intensification of economic warfare among nations, to the growth of trade barriers, to the vicious spirals of resentment, ill-will and retaliation."¹ In the following year the United Kingdom broke with the tradition of the nineteenth century and abandoned free trade. By one means or another almost² every country of the world restricted its foreign purchases. Prohibitions on imports were imposed, currencies abandoned to their fate or prevented from performing the normal functions of money. The whole mechanism of international intercourse was jammed and fractured. At the outbreak of the present war there was no general

¹ Statement by the Hon. Cordell Hull, Secretary of State, before the Finance Committee of the Senate, February 26, 1940.

² Panama was an exception.

system of conducting trade; there was no general willingness to devise one. The Government of the United States, reversing its former policy, was conducting an active campaign in favour of lower tariffs and the extension to all countries of advantages granted to any one. Certain other countries with strong commercial traditions were still struggling to uphold the commercial principles that had brought them prosperity in the past. But over the greater part of Europe, in Japan, to a lesser degree, also, in most of Latin America, trade had ceased or was ceasing to be the business of the merchant operating under simple and stable laws and concerned with providing the consumer he served with goods at the lowest available prices. Governments were assuming daily control of all trading operations by means of import prohibitions, varying quotas, exchange control, export subsidies, and by means of trade agreements from which none but the two signatory powers might benefit.

By these treaties, concluded for a few months at a time, the State replaced the merchant in international bargaining. The seller, when in a position to do so, used its power to try to obtain for itself an assured place in the markets of certain countries. The intention behind this was to try to secure an assured market for the sale of a relatively stable volume of goods and be freed from the full force of the competition which might come from new competitors. It was urged in favour of those treaties that greater certainty of markets and greater stability of prices could be secured than under multilateral trading. But it also followed that these advantages were often obtained by the maintenance of prices which otherwise might have been lower and also by the prevention of the growth of new competitors elsewhere. Under the most-favoured-nation clause, which had previously been incorporated in almost all commercial treaties, any concession granted by one country in a trade agreement with another was automatically extended to all countries enjoying treaty rights. The very object of these bilateral treaties, on the contrary, was frequently to obtain exclusive advantages. In consequence, other countries, finding their markets threatened or their debtors unable to meet the service of their loans, were forced to make similar bilateral agreements, and the whole system of restriction and control spread and impeded the

expansion of trade. But more important than the brake on trade was the fact that commercial treaties had been converted into instruments for damaging the trade of other countries. In place of a commercial system, there existed a mechanism for commercial warfare.

The Breakdown of the World Currency System.

Just as there was no world-wide system of trade, so there was no general currency system. The fragmentation into which the trading system was broken was reflected roughly in the fragments of the currency system. But it was not reflected exactly. In 1929 nearly all the countries of the world maintained exchangeable currency based on gold. In 1939 the largest group of countries whose currencies were maintained stable *inter se* and really exchangeable was the sterling bloc; only the United States and Belgium were *de facto* or *de jure* on a standard based on gold; and over wide areas, the use of money for effecting purchases abroad was only permitted under license.

Before the end of this disastrous decade, although the world economic system had disintegrated into a system of groups, some measure of recovery had been achieved. In the United Kingdom, in several northern European countries and in certain of the British Dominions, not only had the depression that started nine years before run its course by 1938, but national income, after making allowance for changes in the value of money, was quite substantially greater than it had been in the past. All these countries had attached their currencies directly or indirectly to sterling and formed a group which constituted, as it were, a remnant of the old world system. Russia, rather a continent than a country, had in almost complete isolation more than trebled her money income. But in Germany, which had about restored her income in terms of money, recovery was based on rearmament, on the preparation for war; and in many other countries afraid of Germany's rearmament, the growing economic activity had the same cause. The real income per head in the United States of America still remained some 15% below what it had been in 1929. World industrial production (excluding the U.S.S.R.) had only just about reached the level of that year and world trade was still about 10% smaller.

4. THE TASK BEFORE US

The statesmen of the world will therefore have before them at the termination of hostilities a triple task of unprecedented magnitude.

a. They will have to construct a world economic system in place of that which was wrecked in the storm of the early 'thirties.

b. They will have to direct the transition from war to peace economy; to take measures to assure that the whole machinery of production may be converted back to the manufacture of goods to meet civilian needs with as little friction as possible.

c. They will have to assure that in the execution of both these tasks forces likely to give rise to renewed depression are held in check or counteracted.

We are primarily concerned with the last of these great issues. But probably the most important single factor which has tended to intensify the depth of depressions in the past has been war. The depth of the depression of 1929 was, we believe, due to the combination of an ordinary cyclical set-back with deep-seated structural maladjustments. These maladjustments were in large measure a legacy of the last war. They were reflected in the over-extension of agricultural capacity and the growth of economic nationalism; in the destruction of savings and currencies in the postwar inflation; in the rapid growth of industry in neutral and non-European States and the subsequent difficulty of some of the older countries in adapting themselves to the new competitive situation; in the disturbances in international balances of payments caused by the existence of large political debts, the irregularities in the flow of capital from nation to nation and the failure of certain countries—in particular the United States of America—to adapt their tariff policy to the change in their international creditor status resulting from the war.

5. THE NATURE OF THE REPORT

Illustrations from the past could be multiplied. But in the situation in which this Report is being written, the point needs no labouring. We shall accordingly begin our Report with the consideration of policies to meet the cyclical effects of the present war.

In formulating our views on this as on all other questions, the

breakdown of the international economic mechanism before the outbreak of the present war and the impossibility of forecasting what will take its place, even though we postulate certain objectives of policy, are a cause of difficulty and perplexity. That difficulty and perplexity must be felt by all who are responsible for the formulation of policies; but the need to decide upon a course of action and to pursue it courageously remains unaffected. We shall necessarily have to make certain arbitrary assumptions as to the probable course of events—assumptions that may prove false—and we shall not hesitate to make recommendations relating to the structure of production and trade itself when such recommendations prove necessary for the fulfillment of the mandate with which we have been charged.

One tacit assumption on which we need not elaborate underlies almost every recommendation we make, namely, that peace is restored in such a manner as to revive confidence. In the absence of effective machinery for collective security, in the absence of a resolve to maintain peace profoundly imbedded in the will of those who have power to do so, there will be no economic stability, no hope of avoiding depressions and unemployment in a free economic system.

For reasons we explained at the end of the first section of this introduction, our report deals more directly with the problems of industrial states than with the great areas of food and raw material production in Asia, America, Africa and elsewhere. It is the great industrial markets of the world which will mainly determine the degree of economic stability enjoyed by the world as a whole and therefore by the producers of crude products and it is with the problem of stability in the transitional period that we are primarily concerned. But the suggestions we make in Chapter III concerning the re-establishment of a world economic system apply directly to almost all regions.

While it is, we believe, clear from what we have already said that postwar plans and policies must be laid in advance, conditions change too rapidly and too radically in wartime and the future is too uncertain to allow of any policy being more than tentative and provisional. The two main uncertainties, in our opinion, relate to (a) the type of social-economic system that peoples will desire to

set up (b) the manner in which peace comes about. The economic objectives which we have set out might be attained under very different economic systems. In particular it is impossible for us to foresee what degree of participation or supervision by the state in the conduct of business will be desired and in fact different countries are likely to hold very different views on this point. In Chapter II, therefore, we have considered the maintenance or release of controls primarily in connection with the problem of securing economic stability and full employment in states in which individual enterprise is encouraged. In confining ourselves to these aspects of the problem of control, we do not wish to imply any judgment concerning the value of other criteria.

If countries are gradually liberated, the nature of the international problems that will present themselves will obviously be widely different from those that would be caused by an abrupt termination of hostilities. We have not felt that it would be useful for us to make detailed recommendations on the basis of one or another of these possible alternatives and have confined ourselves to trying to define certain principles of policy which we believe will be applicable in either set of circumstances.

CHAPTER I

THE EFFECTS OF WAR ECONOMY

1. GENERAL CHARACTERISTICS OF WAR ECONOMY

Before proceeding to a consideration of the measures required to effect as smooth a transition as possible from war to peace economy, it is necessary first to indicate briefly what are the characteristics of war economy which imply a problem of transition and secondly what are the factors of postwar instability that are likely to make their influence felt. In this chapter we shall confine ourselves to the first of these tasks.

In all countries the ultimate object of war economy is to direct available resources to the production of the goods and services necessary for the successful conduct of war. During the present war the object of most of the belligerent states has been to achieve a maximum output of war goods and services. This has involved drastic changes not only in economic activity but also in economic structure and organization as well as in the availability and ownership of resources.

To achieve maximum production of the desired type, governments have made use of all unutilized productive resources, have directed to their own needs existing resources which were actively employed in producing other goods and services, have expended part of the national capital reserves either by not making good the wear and tear of machinery, buildings, etc., or by selling their foreign investments, and finally some have added to the nation's debt by borrowing abroad.

The employment of unutilized resources has naturally created during the war conditions of full employment, not necessarily of all equipment, but in nearly all cases of all labour available after the claims of the fighting services have been met and of all the equipment suitable for war purposes. A considerable amount of equipment not suitable for war purposes is left idle.

The diversion to the war effort of actively employed resources has been effected by restricting civilian consumption and investment to meet civilian needs. The necessary curtailment of civilian

demand has been achieved by taxation and restrictions on income increases and on consumers' credit, which together have limited the amount of funds available for private expenditure, and by measures designed to check the expenditure of the funds left available. Amongst such measures are the rationing of the consumer, stopping the production or import of certain classes of goods and schemes to promote voluntary or enforce compulsory savings.

2. STRUCTURAL CHANGES IN PRODUCTION

The longer the war lasts the greater will be the capital consumption both in belligerent and non-belligerent states. Communities live on their capital by not making good the wear and tear of their machinery and equipment, their buildings and their means of communication, by allowing their farm land to get out of good heart, by reducing inventories, by not replacing the clothes and furniture and other durable or semi-durable goods owned by private individuals and by the deliberate destruction of various classes of goods to furnish scrap material for munitions or other war purposes. If a country sells its foreign investments or borrows abroad, its capital resources will be equivalently reduced or mortgaged but not necessarily capital resources in general. The whole balance of world economy may, however, be affected. Before elaborating this point further, let us consider the implications for the future of the changes produced by war economy that we have thus very briefly summarized.

The apparent full employment of resources during hostilities is something profoundly different from the full employment which we believe will be a prime object of social policy after the war. In the first place a very large proportion of the working population is engaged not in economic pursuits, but in the armed forces the major part of which will have to be reabsorbed into civilian pursuits. While in all countries a considerable amount of equipment which cannot be converted to war use stands idle, there has been an enormous extension of plant for the manufacture of munitions and instruments of war; mines have been opened up, some of which cannot be operated at a profit in peacetime, others of which will compete with former sources of supply; land has been brought into cultivation that may no longer be required; townships have grown

up around munitions plants that meet no obvious peacetime need; substitute materials are being produced on a vast scale that will have to meet the competition of the natural products once the normal channels of trade are reopened. Some of the industries engaged on the production of these materials, especially those producing new materials likely to find a place in peacetime economy and those of strategic importance, will no doubt be maintained. But others may no longer be required after the war.

It is, indeed, inevitable that much plant and equipment and many skills acquired during the war will prove redundant, that many centres of industry will decline. The peace pattern cannot be superimposed on the war pattern. How great the distortion has been may perhaps be most easily shown by means of a single illustration. In the last prewar year the United States manufactured somewhat under 6,000 aeroplanes of all types and employed about 49,000 workers in this industry. According to plans formulated at the end of 1942, production is to be raised by the end of 1943 to an annual rate of 125,000 planes which it is estimated will require 1,200,000 employees. In 1939 the iron and steel industry employed under 1,000,000 persons and the whole automobile industry under 400,000. The aeroplane industry is, of course, an extreme case, but throughout the whole globe similar, if less violent, distortions are taking place. Excess plant, whether due to expansion to meet military needs or to expansion to meet civilian needs in areas cut off from their former sources of supply, constituted one of the gravest causes of economic instability after the last war; it will without doubt constitute a grave difficulty after this war.

But the expansion of the metal, the engineering and above all the machine tool industries during the war should in general prove an asset and not a liability, an asset the value of which will be determined by the policies pursued. These industries form the foundation of the whole industrial system and the strengthening of that basis should greatly facilitate the development of industry throughout the world, just as the acquisition of new skills by labour should facilitate the growth of new industries and the development of old. The war has enormously increased the number of persons in all parts of the world who have acquired a mechanical sense. For this new basic plant, as for these new skills to render the

services of which they are capable, however, a high rate of investment will have to be maintained. There will lie the crucial problem.

As against the excess capacity we have mentioned, there will be an increased demand arising on account of the curtailment that has been imposed on consumption by the restrictions on spending, on account of the depletion of stocks of raw materials and of goods in the hands of consumers, and on account of worn-out plant, dilapidated houses, lack of houses, etc. These deficiencies are all the natural result of the diversion of resources from civilian to war needs. They will be enormously increased in certain areas—and, as regards certain goods, in all areas—by the destruction wrought in war. Houses are not being built and are being destroyed; machinery and means of transportation are not being renewed and are being destroyed. An official estimate issued last autumn gave the number of houses damaged by air raids in Great Britain as one in five.

We shall find a physical condition therefore of simultaneous excess and want and one of the first problems to present itself will be the manner in which and the extent to which the excess may be adapted to satisfy the need. This chapter is concerned with the presentation of certain of the problems of transition and not with their solution; but we wish to emphasize here at the outset that a solution to these problems cannot be found at the last moment. Both governments and business firms must have their plans laid in advance; plans that will require, no doubt, constant adaptation and modification during the course of the war and constant consultation between the representatives of governments and the representatives of the business world.

Postwar demand will differ from war demand not only as regards the physical objects it causes to be produced, but in that it will be exercised mainly not by the state but by the whole mass of the population. In wartime the state at once purchases itself a major portion of the total national production, and as regards the rest determines to a very large extent what shall be produced and what prohibited. It substitutes its own preference schedule for the aggregate preference schedule of the various income groups of the population. The economics of war are relatively simple, for under

modern conditions the appetite of the war machine for goods is almost insatiable. It is simple in these conditions and with so large a proportion of each country's manhood under arms to assure full employment. It is incomparably more difficult to assure it when production has to be geared to meet not almost unlimited repeat orders by the state, but the infinitely miscellaneous demands of the individual. We shall show in the next chapter that this individual demand will inevitably be jerky and uneven and consider the means by which it may be smoothed out.

3. SHIFTS IN DEMAND

Within varying limits, demand will shift after the war from the state to the individual and the restraints imposed on individual demand during the war must be gradually released in order to render that shift possible. We have seen that these measures of restraint operate either through the monetary mechanism or directly on the goods that the individual consumer may wish to buy. They should become the levers by which the shift may be accomplished. Their effectiveness as levers will depend largely on their effectiveness in achieving their initial object of exercising restraint. Recovery will be aided and not impeded by the enforcement of restrictions during the war, and world recovery by the application of the principle of equality of sacrifice. Thus if instalment credit has been adequately reduced and consumers' debts paid off, the re-opening of this form of credit will facilitate the purchase of durable goods. If defence loans and war saving certificates or compulsory savings funds, part of which is likely to be converted later into cash, have been widely distributed over all sections of the community, the revival of the public's monetary demand will be helped. The existence of rationing schemes in all countries will render it easier when restoring market freedom to thwart violent price changes.

The conditions for achieving full employment after the war will indeed be largely influenced by measures taken during the war and it is important that the influence of present measures on future prospects and possibilities should be borne constantly in mind. The governments that have the instruments we have mentioned at their

disposal will be much better able than others to achieve a smooth transition, delicate as the task of making the best possible use of these instruments may be. In addition to these restraints on the capacity to spend and incentive to invest, the war has of course given rise to another class of control affecting not the demand of the consumer but the administration of production and trade. We have in mind, for instance, the monopoly of food import instituted by certain governments, the inter-allied shipping control, the long-term contracts for the purchase of raw materials effected by the American and British governments, the whole mutual aid procedure, the almost universal institution of exchange control, the bilateral trade agreements negotiated as a result of these controls during the war, and finally the whole gamut of direct controls over domestic production and the growth of government owned and operated plants.

All these changes constitute factors which will prove of prime importance in the structural situation that will present itself at the end of the war. It is within the framework of that structure, gradually adapted to peace conditions, that the transition from war to peace economy will have to be effected.

4. THE RESERVES OF SAVINGS

We do not propose to discuss wartime fiscal policy in any detail in this report, but these monetary instruments are likely to prove so important for the control of postwar demand that we think it desirable to elaborate somewhat on two points.

The postwar problems created by the construction of war plants will be particularly serious if provision is not made to allow producers to amortize their plants adequately during the war. If, in the interests of national revenue, amortization rates are kept low, so that at the end of the war the unamortized capital value of the plant greatly exceeds its capital value as determined by the income it can earn in the production of peacetime goods, a powerful factor of dislocation will have been created. The existence of such false capital values will give rise to vested interests which may prevent the appropriate adjustments to peacetime conditions from taking place and seek to maintain the excessive capital values at

the expense of the whole community by heavy tariff protection, subsidies, etc.

At the same time care must be taken to avoid any abuse of facilities afforded for accelerated amortization. If, for instance, assets are sold to third parties after the war at prices which exceed book values after such amortization has been deducted, the excess might be employed to reduce the accelerated depreciation previously allowed to the seller.

In addition, governments have themselves financed and own many plants, the ultimate retention, disposal or scrapping of which is likely to have important economic consequences. In their final decisions concerning these plants, governments will have to consider not simply the immediate fiscal effects of alternative policies, but the effect of such policies upon the whole economic structure of the country and upon the chances of maintaining the fullest possible measure of employment.

The second point relates to the savings certificates, savings accounts, etc., of the individual citizens which will be regarded by them to some extent at any rate as their amortization reserves against their personal capital (clothes, furnishings, houses, etc.) that has been allowed to run down during the war. These reserves may prove of great importance, and in the interest both of equity and postwar stability it is desirable that they should be as widely distributed as possible. But at the same time there is a danger that their conversion into cash after the war may have serious inflationary effects.

They will of course tend to lose their value if prices are allowed to rise owing to inflationary methods of war finance. If only for this reason, therefore, it is important that every effort should be made during the war to check inflationary tendencies. In particular a disproportionate rise in agricultural prices is likely to cause hardship and injustice because the smaller a person's or a family's income, the greater the proportion of that income that will be spent on food. The chances of full employment after the war will be seriously jeopardized in industrial countries if the distribution of income is rendered more unequal owing to a rise in the price level or a large rise in the relative cost of food.

5. THE INCREASE IN DOMESTIC DEBT

A part of the claims on the state that have been acquired by business firms and individuals will, as we have said, be treated by them after the war as cash and will help to revive demand if properly controlled. But the increase in the public debt will bring with it a double danger. In the short run, it may lead to inflation if too many people, consumers and producers, wish to cash their claims immediately after the war. In the long run, the risks are different but may also prove serious. A domestic debt, it is true, does not reduce the wealth of the community in the same sense as a foreign debt. It affects merely the distribution of the national income in the future; it involves a transfer of income from the taxpayers to the owners of the debt. The resulting tax problem is, of course, much less serious than in the case of an external debt, but it is still formidable if the debt is very large. The crucial factors are the distribution of the debt compared with the distribution of taxes in the existing tax structure. It should be possible by careful management and selection of taxes to effect the transfer from tax payers to debt holders without in the process impeding enterprise. But political forces may well make it well nigh impossible to use the appropriate tax methods and difficult to avoid heavy taxation on risk capital on which enterprise depends. The taxation of risk capital tends to check investment and economic progress and a high level of taxation may reduce other desirable public expenditure which has to compete with interest payments on the debt for the limited tax receipts. These dangers will be aggravated whenever prices fall; for each price fall must bring about a further shift in distribution of the national income in favour of the owners of these fixed claims.

6. CHANGES IN THE INTERNATIONAL DISTRIBUTION OF CAPITAL AND EQUIPMENT

More important still as a cause of instability may prove to be the changes in international indebtedness that are taking place today. The trade of the world had assumed a pattern before the war which was largely determined by the international distribution of foreign investments. The mechanism of production, industrial and agricultural, throughout the world had adapted itself to

this pattern. That distribution is being profoundly modified and the whole pattern not only of trade but of productive capacity will as a result be violently distorted. In addition, therefore, to the distortion of the economic structure resulting from the growth of war industries, there will be a distortion due to these changes in international claims. The changes will necessarily render it more difficult to set the delicate machinery of multilateral trade in motion again, and the greater they prove to be, the more serious will be that difficulty. The problem is not one affecting the balance of payments of one or two countries only but of the whole network of trade and production throughout the world. We deal later with the mechanism by which these transfers were effected.¹

The international network of production will in any case have been substantially modified by the growth of new industries during the war and perhaps especially by the growth of mechanical industries in areas which previously relied mainly on foreign countries for their machinery and machine parts. The industrial development that has taken place during the present war is in striking contrast to the development during the last and will give rise to different problems. Between 1914 and 1928 there was a rapid expansion of consumers' goods industries in countries which could no longer depend upon external supplies. In the last three years countries in this position, though they have expanded these industries, have found it difficult to obtain the necessary machinery; but almost all belligerent states outside the continent of Europe have developed or are developing their engineering industries. This in the end will accelerate all round industrial development, and though industrialization of undeveloped areas tends to increase trade by increasing wealth, it at the same time necessitates constant adaptation in the industrially more advanced areas. It will compel these latter areas, therefore, to render their factors of production as mobile as possible so as to meet and absorb the constant series of small shocks that changes in external demand will cause.

7. DESTRUCTION WROUGHT BY WAR

Up to this point we have been considering the effects of war economy and war finance on the general economic structure and

¹ See Chapter III, pages 85-86.

organization in order to indicate certain of the conditions from which the transition to peacetime economy will have to start. But in many countries, not war economy but the war itself will have caused the profoundest changes; in many countries, especially in those under German and Japanese domination, not the extension but the loss or destruction of industrial equipment, not rations but the lack of rations and consequent starvation, will give rise to the most serious problems.

We shall be faced by a world in fact with no functioning international system to which to revert, moving rudderless into an unforeseeable future from a present in which the whole structure of production and trade, national and international, will be distorted, and in large areas of which many will have been killed or crippled, civilian populations will have been uprooted from their homes, plant will have been destroyed, and the means of transport, the docks and railway terminals will have been battered and blasted. There may prove to be surplus stocks of some foodstuffs or raw materials in certain localities; there will certainly prove to be desperate need of these in others accompanied by penury. There will be on more than one continent serious currency inflation or the stage so set for inflation that it can scarcely be avoided. Against this we may set an unprecedented increase in the capacity of the capital goods industries in certain industrial states and industrial areas which should imply an unprecedented increase also in their capacity to reconstruct.

It does not fall to us to submit detailed proposals regarding the whole formidable task of relief and reconstruction that lies before statesmen, but only to make suggestions regarding the broad lines of policy by which we believe that certain of the influences making for instability may be restrained and tempered. We shall begin with the simplest case, namely that of countries whose chances of attaining full employment after the war are not limited mainly by lack of raw materials or inability to buy them, and then proceed to a consideration of some of the problems likely to face countries suffering from a penury at once of raw materials and of means of effecting purchases abroad. In this way we shall move from the more national to the more international problems. But, as we shall

endeavour to show in the next chapter, many of the apparently national problems require international action for their solution.

8. WARTIME INTERNATIONAL AGENCIES

In this connection we should draw attention to another effect of the war, namely the creation of a number of international agencies—most of them Anglo-American at this stage—which today exercise important administrative functions. Certain of these agencies, and others the creation of which is contemplated, may have later a wider representative basis and become instruments for the execution of agreed policies after the war. We give a list of those at present in operation in Annex I.

CHAPTER II

THE TRANSITION FROM WAR TO PEACE: DOMESTIC ISSUES

1. THE NEED FOR PREPARATION

All great wars tend to accentuate the depth of depressions and to cause both structural and psychological changes which for many years after the restoration of peace accentuate economic instability and the risk of depressions with their consequent unemployment. The measures adopted during the course of the war for the better conduct of war do not suddenly cease to make their influence felt once the need for them is past. Forethought during the war may do much to lessen subsequent risks; and plans for the transition to peace conditions must be made in advance. In this and the following chapter we deal with the problems that are likely to present themselves during this period of transition. But, though we are dealing with peacetime conditions, we do not wish to imply that action should be postponed till peace is won. On the contrary, we believe it to be of vital importance that governments should prepare in advance; that many of the decisions especially regarding joint international action should have been taken before the termination of hostilities.

It is equally important that the business world should think out its policies for this transition period in advance. We are concerned here primarily with government policies and it seems certain that, at any rate during the first years of peace, governments will have to continue to exercise many of the economic functions which they have assumed during the war. The rapidity with which and the extent to which various controls may be abandoned will depend on the one hand on the general social philosophies of individual countries and on the other on the rapidity with which confidence can be restored, scarcity overcome, and those conditions re-established under which private enterprise may flourish. There will, we feel convinced, be a strong desire in all countries to be liberated from many of the restrictions to which all have been subjected during the war, so long as this is compatible with the avoidance of eco-

conomic disaster. We consider, therefore, in this and the following chapter the forces that may lead to such disaster and the collective measures that may be required to prevent them from rendering the daily conduct of normal economic activity impossible.

2. CHARACTERISTICS OF THE POSTWAR TRANSITION PERIOD

Although the relative importance of the various factors that are likely to influence the postwar economic situation cannot be foreseen with any sort of certainty, the nature of the factors themselves may perhaps be guessed with a fair degree of probability. All these factors will not present themselves in all countries; but it will, we believe, help to clarity in the discussion which follows, if we attempt to sketch in deliberately rough outline the major issues as we see them, without attempting to shade in the details of possible local variations.

We may expect to find then, at the end of the war, an economic system functioning in most countries which has been designed to maintain a maximum supply of goods and services required rather for the conduct of war than for the satisfaction of normal civilian needs. Under this system and in these conditions, governments substitute their scale of preferences for that of the public and enforce that scale by direct control over production, by direct or indirect control over consumption, by the allocation of contracts, raw materials and even labour and plant, by rationing in various forms, by taxation designed to limit private consumption, etc. Under the conditions then obtaining, both the mechanism of production and the nature of consumption will be largely determined by the State and foreign trade will either be in the hands of the State or conducted only under State license. Prices will be subject to controls of varying scope and degrees of rigidity and the State will determine what external purchasing power domestic currency may enjoy.

When the war ends, the main object of this whole system, the diversion of the resources of production to the war effort, will largely disappear with it. The first question that will present itself to statesmen then, is whether and to what extent and with what rapidity the government should allow the scales of preferences of the public to express themselves again through the price system

and replace the government's scale. That is likewise one of the crucial questions for the formulation of postwar economic policy.

Before attempting to answer it, let us consider the other probable factors in the postwar situation. We shall find, on the one hand, vast armies of men ready to be demobilized from the forces and from munition factories for whom employment must be found, and, on the other hand, a vast pent-up civilian demand for all the goods and services of which they have, to a greater or less extent, been deprived during the war. There will, indeed, be much more than this civilian demand for consumers' goods. The total postwar pressure on productive resources may be conveniently classified in the following groups:

a. The demand for non-durable or semi-durable consumers' goods such as food, clothing and furnishings which is likely to prove the most urgent.

b. The demand of factories all over the world for raw materials required to meet both these and other civilian requirements. In many cases factories will require supplies to reconstruct working stocks in addition to the amounts consumed in the process of manufacture.

c. The demand, private or state as the case may be, for the repair and reconstruction of essential services such as harbours, warehouses, shipping, railway communications, the destruction of most of which is already far greater than in the last war.

d. The demand by industrial enterprise for new machinery and plant to replace or repair what was destroyed or worn out during the war and possibly to meet new or changed needs.

e. The demand for the construction or repair of other classes of capital goods, especially dwellings, schools and other buildings, both to replace what has been destroyed and to make good the lack of building during the war years.

f. The demand which we may anticipate will develop, slowly in the more sorely stricken countries as income increases, but much more rapidly in those which have not suffered the direct ravages of war, for durable consumers' goods, the supply of which in the hands of the public will have been progressively depleted during the war.

This whole chain of unsatisfied demand reflects the destruction

and impairment wrought by the war. In the war areas, the machinery of production will have suffered direct and very serious loss and in all areas general wear and tear. Some part at any rate of the machinery set up during the war will prove useless in times of peace, and some of the old industries will find their plant redundant owing to the competition of new "substitute" materials or new and better processes. Agriculture will have deteriorated in certain war areas; seed will be short; herds and flocks will have been reduced; the land will have got out of good heart. In other areas productive capacity will have been greatly extended. There will be a parallel loss in human beings and in human productive capacity. To the direct casualties will be added the impairment of health, the strain of the war on nervous reserves, the strain of long years of inadequate diet on human energy and power of resistance, and finally the redundancy of certain skills acquired during the war and no longer needed.

On the other hand the war will have enormously accelerated inventive processes; many new materials will have reached the stage of large-scale manufacture; the machine tool industry will have been very greatly expanded; the machinery in certain industries will have been modernized and greatly improved; the organization of many concerns and of whole industries will have been remodelled and costs reduced; new skills will have been learnt and a much larger proportion of the total labour force will have mastered more than one skill.

The world we have to face, therefore, will be much poorer and ill organized to satisfy its needs promptly; but its ultimate technical productive competence will probably have been increased.

The needs to be satisfied can only be satisfied to the extent to which they can be expressed in terms of purchasing power. In fact, in many countries both private individuals and business firms will be in possession of purchasing power or potential purchasing power in the forms either of bank balances or of government bonds and certificates—the obverse of part of their unspent income and unsatisfied wants. On the other hand, many countries will be faced by a serious lack of means for effecting purchases abroad and the fiscal capacity of almost all states will have been stretched almost to breaking point. Taxes will be very high, the burden of debt in

many countries greater probably than ever before in history. Both the domestic and the foreign credit of governments will have been seriously indented upon and changes will have taken place in the distribution of foreign assets throughout the world so profound that, if war had had no other economic effect, the international equilibrium would be seriously threatened.

At the end of the hostilities it will be necessary to marry the productive powers liberated from the armed forces and from armament production to the potential demand that has been dammed back and to render that potential demand effective. As the experience of the last postwar period proved, there is a possibility that governments, under the pressure of public opinion, will be so anxious to satisfy demand and to absorb those waiting to be demobilized into industry again as quickly as possible that they will overlook the risk of too hasty action leading to a violent setback after some brief period of booming conditions and a more serious catastrophe later. Let us attempt, therefore, before turning to these questions, to summarize the risks that present themselves.

3. POSTWAR FACTORS OF DISEQUILIBRIUM

These postwar factors of disequilibrium, though they are likely to take different forms at different dates, all arise from two distinguishable types of cause; namely, the profound structural changes that have taken place during the war, and the catalytic character of postwar demand.

a. Among structural changes, we include not only the enormous growth of metallic and engineering industries, or the growth of new industries in countries previously relying on foreign-produced industrial goods, the development of certain types of labour skills, the concentration of labour and industry for strategic reasons in certain areas, but also the abnormal price relationships that have established themselves in each country during the war, the growth of independent national price and cost levels, the changes—temporary or permanent as they may prove to be—of the economic functions of government, the effects of war financing on the banking structures, etc.

Many of these changes will necessarily prove to have a temporary and wartime value only and the reversion to requirements

of peace conditions will necessarily involve friction, loss of time and loss of income. Others, such, for instance, as the rapid industrialization of certain countries during the war, are likely to prove to be nothing more than the quickening of pre-existing tendencies, but a quickening so exceptional as to cause serious dislocation and loss elsewhere.

All these changes—whether they continue or necessitate a shift back again to a *status quo ante*—will set up strains and stresses in the national economic structures and on the whole international economic system, the cumulative effect of which may give rise to one setback after another.

b. The postwar consumers' demand is likely to give rise to violent fluctuations in economic activity both on account of its physical character and on account of its influence on prices. We divided consumers' demand above into two categories: the demand for non-durable or semi-durable consumers' goods on the one hand, and for durable consumers' goods on the other. When consumers' goods are strictly non-durable, a sudden increase in demand due to the fact that the supply was previously below physical requirements or normal standards will have no direct cyclical effects. Thus, if the consumption of food is suddenly increased after the war as rations are abolished or raised, that increase is likely to prove permanent and to have a stabilizing effect on world economy. The reverse is true of semi-durable or durable goods. In normal times, the demand for such goods expresses itself day by day, month by month or season by season as existing supplies on the market are worn out or have become obsolescent and, if there are no extraneous forces leading to depression or boom, is likely to prove relatively smooth. But, if the great mass of the stock of such goods in the consumers' hands has been worn out with no opportunity of replacement and that opportunity suddenly presents itself, then there will be a sudden scramble for these goods, followed later by a scarcely less sudden collapse of demand, and again later there is likely to be a revival of demand less intense than the first and a subsequent falling off. The reason for this is obvious. The age distribution of the goods in the hands of the public is abnormal and, until slowly over a series of years it smooths out to a normal age curve for each commodity, irregularities of demand

and production will continue to occur. We wish to emphasize this risk, for it must prove serious and, though it may be reduced if foresight is shown, it can never be wholly eliminated. The jerky nature of postwar civilian demand for certain classes of goods will therefore have to be offset by other measures.

c. This jerkiness of demand is likely to affect also the capital goods industries. There will be a sudden outburst of demand for machine parts for the readaptation of plant and for new machines to replace those that have been worn out—coming perhaps a little later than the recrudescence of civilian demand for immediate necessities. The age distribution of the mechanical equipment of industry will be abnormal and the concentration of necessary replacements round certain dates in the future will prove a factor of disturbance.

d. The release of pent-up demand for all classes of goods, unless carefully controlled, may also have serious indirect effects through prices. If the physical needs that are felt are allowed to express themselves in money terms, the prices of the raw materials required for the satisfaction of those needs may be forced up and a price boom be caused. Once a rapid rise in prices has started, it may be reinforced by the desire of merchants, manufacturers or speculators to cover themselves as quickly as possible in anticipation of a further rise. This is what happened at the end of the last war and contributed largely to the boom of the latter half of 1919 and of 1920 and subsequent collapse.¹

The gravity of this danger will depend not only on the rapidity with which quantitative controls over consumption (for instance, food rationing) are lifted, but also on the control of credit. We shall consider this aspect of the problem below.

e. But lack of means of payment may prove as unsettling as excess. If, for instance, countries requiring raw materials of foreign origin cannot obtain foreign credits with which to purchase them and are forced to sacrifice such foreign assets as they may possess or are driven to sell their currency through the operations of the exchange market, monetary chaos and violent exchange depreciations are likely to follow. Again, this occurred after the

¹ See *Economic Fluctuations in the United States and the United Kingdom, 1918-1922*. League of Nations, 1942.

last war and the exchange depreciation led in its turn to other countries imposing anti-exchange-dumping duties or to a general raising of their tariff levels without reference to their long-term balance of payments situation. The whole structure of world trade was thus distorted in the early postwar years and this distortion seriously aggravated the depression of 1929. The risk of a repetition of these events will be all the greater if serious inflation has taken place during the war as it is already taking place in certain countries.

f. At the same time, any attempt to meet the needs of impoverished countries (whether for raw materials or other goods) by means of loans at fixed interest at so high a rate as to involve a service likely to exceed their capacity to pay in bad times, may well only diminish immediate postwar difficulties at the cost of causing still more serious difficulties later. We have drawn attention in the Introduction to the tragic effects of uncontrolled capital movements during the interwar period.

Governments, in framing their postwar policies, will have to keep constantly in mind these various factors likely to cause or contribute to serious changes in economic activity. The first group of factors, those that we have mentioned under the general heading of structural changes, will present themselves in very different forms in different countries and, except for those resulting from government controls which show a certain uniformity, we shall deal with them incidentally. We wish, however, to insist at once on the need to view realistically the question of the writing off of plant that is really surplus to peace requirements. Much of it may no doubt be required for the maintenance of security in the world, and some international agreement for its maintenance may well prove necessary. But plant which is not required for this purpose and cannot be adapted to another, either because it is clearly redundant or because it is designed for needs that no longer arise, should be accepted as having a scrap value only and the difference between that scrap value and original costs courageously accepted as an unavoidable part of the total war outlay.

4. THE PROBLEM OF CONTROLLING DEMAND

The first concern of governments at the end of hostilities will naturally be to get the demobilized men back into employment again and on the other hand to satisfy civilian wants to a greater extent than was possible during the war. These two objects are complementary; the one will be attained to the extent that the other is realized. The rapidity with which either objective is in fact attained will be largely dependent on the availability of the raw materials required for consumers' goods and on the financial means to acquire them. We think it may help to clarify our exposition if we begin with the case of a country which is in a relatively advantageous position to obtain these raw materials and we shall confine the rest of this chapter to a consideration of such a case. In such a country, the immediate demobilization problem may prove not to present serious difficulties. After the last war, the period of demobilization unemployment, in for instance the United States and the United Kingdom, only lasted for a few months. There was practically full employment in the former country by the summer and in the latter by the autumn of 1919. The real difficulty in both cases was to avoid a price boom and subsequent collapse and to avoid the inevitable jerkiness of postwar demand from accentuating this collapse. Let us consider these risks in that order.

We may anticipate that, however advantageously any particular country may be placed, there will be a world shortage of most raw materials, of many foodstuffs and of manufactured goods after the war which will tend to raise the prices at which they can be acquired anywhere. In other words, there will be a seller's market. The strength of this market will depend upon the purchasing power available and, if a runaway price boom and subsequent collapse are to be avoided, measures are likely to be required, especially in the financially stronger countries, to control purchasing power. At the same time, if physical needs are to be satisfied and men re-employed in industry to satisfy them, it is clearly imperative that individual purchasing power, rigorously restricted during the war, should be unhobbled if not unleashed. That may prove to be a delicate operation and a government's power to per-

form it successfully will depend in part on the principles upon which it has conducted its war finance.

5. FINANCIAL CONTROL OF DEMAND

The expenditure will come from two main sources:

1. Soldiers will tend to spend part of their demobilization bonuses and final pay before they get back into industry, and the civilian population as a whole will tend to spend part of the savings it has effected during the war.

2. Industrial firms will tend to disburse the abnormal amortization reserves built up during the war while entrepreneurs will tend to embark on capital projects of which a substantial backlog must have been created as a result of war restrictions and prohibitions.

In the period following the last war events were allowed to take their course. The rate of interest rose and the process of rapid expenditure was checked, if at all, by the fall in the value of the bonds and other securities in which the latent purchasing power had been held.

Apart from other objections, it is obvious that a rise in interest rates and a fall in the value of securities imposes no check or only a very trifling check on the expenditure of bonuses or individual savings. It has been the policy and the wise policy of most governments to attract small savings into securities such as savings certificates and savings bonds where capital depreciation is impossible. The remedy for too lavish spending by returned soldiers or by the general public must be found in wise publicity. Many millions of individuals will find themselves for the first time in their lives in control of moderate capital sums, and the task will be to persuade them to retain these sums as a safeguard against unemployment and the other financial risks of life. We think a large measure of success is possible and that the well-being of the community can be greatly strengthened if the public is persuaded.

As regards an abnormal rate of expenditure due to the disposal of amortization funds or an over-rapid process of capital investment, we are of the opinion that no purely monetary remedy can be devised which is not open to serious objection. Accordingly, reliance must be placed on other measures of control; for example,

if licenses are required for the use of certain varieties of steel, it would be impossible for many forms of capital expenditure to be undertaken without the approval of the government. Some slight assistance might also be found in a policy of making market issues for new capital subject to control although this, under modern conditions, covers only a small part of the problem.

In addition to the measures we have already discussed, governments will, of course, be able to exercise some influence over inflationary tendencies by means of their fiscal policies. So long as these tendencies exist, great caution should be exercised in reducing rates of taxation, though the reduction of the rates of some taxes will, we believe, prove to be generally necessary to restart business on a peacetime footing. We have in particular two classes of taxes in mind, first those consumption taxes which are likely to curtail the classes of demand that should be revived at once, and secondly, such corporation taxes as are likely to check enterprise and obstruct the switchover from war to civilian production. The rapidity with which and the extent to which taxes on necessities and conventional necessities can be removed or reduced will, of course, vary from country to country. As a general rule, such taxes should be reduced first; but if in any country certain industries producing durable goods not of first necessity are unable to restart operations rapidly enough owing to lack of demand, governments may be compelled to extend their tax abatements to their products.

High rates of direct taxation are liable in any case to have some restrictive effect on initiative and enterprise; but this effect will be much less serious if the taxation falls rather on individual income than on corporate savings. In certain countries a modification of existing fiscal legislation may be required so as to lessen the incidence of taxation on productive enterprise and on risk-bearing capital. At the same time, government deficit expenditure may require to be kept down to a minimum. The timing of such deficit expenditure will in fact prove one of the most difficult tasks with which governments will be faced. The too hasty cancellation of orders in the first postwar weeks, assuming a general cessation of hostilities, may prove more expensive to the community than their completion. But on the other hand, governments may have to hold back certain essential public works until the first upsurge of

individual civilian demand has exhausted itself. We attach all the greater importance to this point as there is a real danger of governments accentuating a possible postwar price boom and subsequent collapse by incautious action in sanctioning public works at the wrong moment. A brief period of confusion and unemployment is inevitable in any case while demand is expressing itself, firms are converting or restarting their machinery, men are moving from one occupation to another. This is not the moment for the government to absorb labour on postponable undertakings which may take months or even years to complete. A time will inevitably come when this public expenditure is sorely needed to make up for a waning civilian demand. At the same time, the destruction of fixed property during the war has already been so vast that in many states much government expenditure on reconstruction will have to be undertaken urgently. We may conveniently consider at this stage, therefore, the direct control of demand.

6. PHYSICAL CONTROL OF DEMAND

(a) *Consumers' Goods.*

We have to face the fact that the destruction in some countries will be so great that governments may have to consider controlling consumer demand not simply to prevent an early postwar inflation but in order to assure that the community is saving enough to restore at least that part of the damaged fixed capital that is urgently required to put the whole apparatus of production into working order again. In other words, it may have to direct and control the productive processes and consumption in the same manner, though not necessarily to the same extent nor, of course, for the same purposes, as it did during the war.

We will begin with the simpler problem of the controls that may be necessary to prevent the consumers' demand alone—irrespective of such urgent governmental undertakings—from having an inflationary effect. It is, we believe, safe to assume that in most countries the controls of consumers' monetary outlay that we have just discussed will not of themselves prove adequate to prevent a sudden and dangerous rise in prices if all other controls are abolished. In such circumstances governments will have to consider whether they should maintain their price controls or their quan-

titative controls (or both) and furthermore how, if the latter are continued, they may be rendered compatible with that expansion in demand required to absorb the demobilized in productive enterprise again.

Direct control of consumption during the war takes various forms but four are of major importance: first, direct rationing of the final consumer; secondly, special permits granted to individual consumers on proof of need; thirdly, what is known as point rationing of the consumer; fourthly, rationing or some other form of direct control over the producer and distributor.

The first of these three forms is confined to relatively easily specified goods, such as foodstuffs, petrol, etc. Food constitutes by far the major part of such rationing schemes in most countries. Now food is at once a prime necessity and, in the consumers' hands at any rate, mainly a non-durable commodity. There is therefore no economic reason against increasing consumption as quickly as possible and little risk of such increase having later cyclical effects except through the price mechanism. The risk of runaway prices may, however, prove to be serious and may even adversely affect supplies, especially if there is a failure to reach some international understanding regarding rations, as we suggest in Chapter III. We recall that in 1920 price control of meat had to be re-introduced in England because decontrol was leading to excessive slaughter. If price control is continued and rationing abolished, distribution will become haphazard, and queues at shops will be caused with all their waste of time and energy.

We feel, therefore, that there can be but little doubt that the right procedure in the case of straight rationing is, gradually and as rapidly as possible, to increase the rations as the supplies coming forward increase. If the government purchases the crude product and fixes prices at all stages up to the final retailers' price, there should be comparatively little difficulty in arranging for the gradual and smooth expansion of demand and decontrol of price, so long as the prices fixed are not kept artificially low by means of government subsidies. Granted that rations are not raised more rapidly than the supplies, there should be no underlying tendency towards higher prices, but on the contrary, as the needs of one income group after another are satisfied, a tendency for prices to

fall. As soon as prices have fallen below the fixed maxima, those maxima may be abolished.

Probably some goods will continue to sell at maximum prices for a considerable time after others have been decontrolled. This is a sign that the fixed prices fail to reflect real market preferences under the changed market conditions; and at some stage in this process of transition to normal conditions the maxima fixed for these goods will have to be raised or abolished. By this process both a slump in the general food price index and a sudden rise could, we believe, be avoided.

If the government has subsidized retail prices, however, more difficult problems arise. An increase in the amount of the rations will involve an increase in the amount of the subsidy if prices are not allowed to rise (unless agricultural costs can be reduced) and this may tend to have inflationary effects in other sections of the whole price system. If the government decides to keep the subsidy constant in amount for some time or gradually to reduce it, a rise in retail prices with consequential rises in wages and production costs may prove unavoidable. This in its turn may affect the foreign exchange rates. No one can foresee exactly the form which these difficulties will take nor their gravity. The increase in supplies of food coming forward, the drop in freight rates after the abolition of the blockades, the absence of war risks, etc., may be sufficient to allow the government to drop its purchase price by the amount of the subsidy and so gradually to restore the price mechanism in the manner we have described above. But when a subsidy exists, it is probable that the restoration of the normal price mechanism will have to be begun at the wholesale end and not at the retail. That is to say, retail prices will not be affected by a fall in freight rates and other costs so long as these reductions in cost are offset by a reduction in the subsidy granted. When there is no subsidy, there may be a simultaneous lowering of prices from top to bottom of the scale.

The permit system, which is generally enforced when supplies are too short to go round, or alternatively when only a part of the population requires the goods in question, presents no special difficulties. Permits will require to be more liberally granted as supplies increase and, in the case of goods bought by all, may,

when supplies suffice to justify such a step, be replaced by coupon rationing.

Point rationing, as we have said, is normally applied to semi-durable goods such as clothes, though it is being increasingly applied also to certain foodstuffs. An uncontrolled outburst of demand for semi-durable goods at the end of the war may well involve the twin risks of a price boom and of a subsequent collapse in demand because wants are satisfied in an abnormally short space of time. Here again, therefore, we suggest that the right procedure is not to abolish the system suddenly but to increase the number or the purchasing power of coupons. This is equitable because it will enable the lower income groups to replenish their stocks so long as they are able to purchase.

The problem of price decontrol under a point rationing system is somewhat complex. Even if (to take the most favourable case) the relative value of coupons has been fixed so as to be in fair accordance with the relative prices of the rationed goods, it by no means follows that this coincidence will continue if the total supply of coupons is increased. Relative prices, that is, are dependent upon total outlay. They are also dependent upon the stock of the goods in question in the hands of the public. Consequently, they will tend to vary both with the total number of coupons issued and with the period of rationing. It is quite probable, therefore, even in this most favourable case, that when the coupons are increased, there will be an excess demand (and shop queues) for certain rationed goods and an excess supply of others. In the face of this situation, the government can adopt four courses:

- (a) It can change the coupon values in the manner widely adopted during the war.
- (b) It can change the fixed prices or abolish the price maxima.
- (c) It can exclude the goods in plentiful supply from rationing which would automatically raise the value of the points in terms of the remaining rationed goods.
- (d) It can attempt to increase the supply of the goods in great demand by, for instance, its allocation of raw materials or tonnage.

In many cases, recourse will no doubt be had to this fourth possibility. Whether it will prove preferable to change the coupon

values or prices must depend on the particular circumstances that arise; both courses may in certain circumstances be adopted simultaneously. Obviously, the nearer the total coupons issued are to satisfying real minimum needs, the stronger is the case for allowing the price mechanism free play again. The point on which we desire to lay stress is that consumption should be allowed to expand gradually and smoothly. It may indeed prove advantageous, if a subsequent collapse is to be avoided, to increase exports of certain rationed goods, for instance clothes, before domestic needs have been fully met and thus facilitate the imports of, for instance, foodstuffs; or it might prove desirable to create a situation under which the population has more money to spend at an early stage on durable goods and less on semi-durable goods. In this way, the demand for durable goods also would be spread and smoothed out. The transition to peace economy will be unavoidably uneven if public demand shifts in sudden jerks from one class of commodities to another.

In all countries in which severe and general rationing has been imposed, the demand is likely to be directed first to non-durable and then successively to semi-durable and durable goods. For this reason, unless there is a large government demand for durable goods for reconstruction purposes, it may prove to be wise policy to keep a closer control on the first two classes than on the third. It may even be necessary to stimulate the demand for durable goods by removing consumers' taxes and abolishing all wartime checks on consumers' credit. Conditions are, however, likely to vary very widely from country to country. When the standard of living is relatively low or has been greatly reduced owing to the war, an early stimulation of the demand for durable goods may, as we suggest, prove desirable. But in other countries in which, for instance, the number of motor cars per head of population is normally very large, the risk of too rapid and jerky a replacement may have to be met by controlling instalment credit and purchasing power in general.

To avoid all risk of misunderstanding, we should perhaps add at this point that none of the proposals we have made are in any respect incompatible with policies which governments may wish to pursue not only to permit but also to assure adequate supplies

of the necessities of life to all classes of the population. As we remarked in the Introduction, such policies would lessen the risk of depressions becoming overwhelming in their effects by rooting into the social system an immutable minimum demand. This might be achieved by a variety of means—by the establishment of sufficiently high unemployment and other insurance benefits as has recently been proposed in England in Sir William Beveridge's report,¹ or by the adaptation of the system of wartime food administration in order to assure the provision to all of minimum supplies of certain of the basic necessities. We are not concerned here with these problems of long-term policy, which will be considered in the second part of our report, but only with the ways and means by which the postwar expansion of demand may be so regulated as to avoid violent ups and downs in economic activity.

(b) *Investment Goods.*

As we remarked in the preceding section, to fix the price of all the goods offered for sale in peacetime is scarcely possible. The variety of manufactured goods is so great that the administration of any such control presents almost insuperable difficulties. A similar difficulty presents itself with regard to the narrower range of products required for productive processes. In spite of this difficulty, we anticipate that during a brief period when plant is being transformed from war to peace purposes and re-tooling is being carried out, it may be necessary to continue wartime supervision over the distribution not only of raw materials but of machine parts, tools, etc. The increase of the machine tool industries in many countries has been so great that this period of shortage should not, we anticipate, generally last more than a few months.

But a somewhat different problem with reference to capital goods and the raw materials composing them is likely to present itself in countries which have suffered serious damage during the war. In these areas the total demand for capital construction may for a time exceed both the supply of real savings and the supply of essential materials and certain other productive resources. In these circumstances governments may have to have recourse for a longer period to either or both of the two methods of preventing a rapid rise in prices that we have mentioned above—physical or financial.

¹ Social Insurance and Allied Services. 1942.

They may find themselves compelled to continue control over the distribution of certain essential raw materials, such as steel, for longer than is necessary when this pressure of demand does not arise; or they may, as we have suggested above, be in a position to keep demand down by the control of new capital issues; or they may adopt both methods.

(c) *Raw Materials.*

The quantitative raw material controls instituted during the war have taken four interlocking forms: (a) government purchase, (b) tonnage control, (c) control of international trade and (d) some system of allocation to consuming firms, through direct quota, priorities, licenses to purchase, etc. These quantitative controls are normally accompanied by price control.

So long as the supply of tonnage or of raw materials is seriously short—so long, that is, as decontrol would be likely to result in a runaway price rise—these controls must, we consider, be maintained in some measure. This implies the maintenance of the government's preference schedule in place of the public's. But we have to recognize that the determination of that schedule in peacetime will become increasingly difficult. So long as the government is itself the final consumer of a very large proportion of the raw materials it controls or so long as the public is directly rationed, it is relatively easy to estimate the total amount of raw materials that each industry and finally each firm will require. But when the future demand for the final product will be determined by an as yet unexpressed consumers' choice, the risk of error is obviously enormously magnified. In order to attain the dual objectives of rapid re-employment and smooth price changes, governments will no doubt draw up in the first instance rough categories of preference determined for instance by the absolute shortage of some raw material, the government's own requirements in order to reconstruct key services, the demands of the export trade, the amount of labour that the manufacture of a raw material may absorb, the essential character of the final product to the home public.

These are the types of consideration which will no doubt influence decisions about tonnage and import priorities. But their extension to quotas or priorities as between different firms will involve inevitable difficulties. On the other hand, so long as raw

material prices are controlled, some quantitative control of distribution as between firms may be indispensable, if both injustice and waste are to be avoided. There is indeed much to be said in favour of removing price controls from raw materials not mainly entering into rationed consumers' goods at the earliest possible moment. To fix the prices of all the infinite range of commodities offered to the public for sale in peacetime is, we believe, likely to prove impossible except conceivably in a few countries with an exceptionally efficient administration, and then only if the administration enjoys the wholehearted support of public opinion. To fix the prices of the raw materials alone, at once involves this extremely difficult problem of the distribution of the raw materials and gives to the manufacturer fortunate enough to secure them a windfall profit without necessarily having any great effect on the price of the consumers' goods. That price will be determined in the short run by the demand for and the supply of the final product.

In spite of these difficulties we do not believe that the immediate decontrol of the prices of this class of raw materials would be practicable. Such a course would imply decontrolling, for instance, all metal prices. But the engineering and heavy industries are likely to be suffering from their great overextension during the war in any case and should not be subjected to the shock of rapidly rising raw material prices. Moreover, there will probably be very large quantities of scrap metal on the market so that the period during which there is a risk of a price boom will probably be short. Another fact which weighs in the balance in favour of some continuation of price, and therefore quantitative, control is that raw material prices tend to fluctuate more than do those of the finished product.

In view of all these considerations, we conclude:

(a) That the rationing of raw materials not made into rationed goods may have to be maintained for some time after the cessation of hostilities and maximum prices on these goods retained.

(b) That governments may frequently find it advisable to leave each trade to carry out the rationing of individual firms under government supervision, in order both to obtain the active co-operation of the business world in government planning and to

make the maximum use of each industry's knowledge of its own peacetime problems. No monopoly is created by such co-operation; but a maximum chance of equitable distribution of these supplies amongst the individual producing units may be assured.

(c) That as soon as there are grounds for believing that the risk of runaway prices is past, such controls should be abolished, commodity by commodity. In this connection we would remark that it will probably happen that, after most of the controls have been abolished, a limited number of goods still continue to sell at maximum prices with every indication that these prices would jump were the control removed. In such circumstances it may well be wise to remove the control and allow the changed price ratios to express themselves.

(d) That to prevent private traders from purchasing for stock, it may be wise, as other controls are being liberated, to demand, before granting an import license, a declaration of stocks held and of the purpose for which the imported goods are required.

(e) That for the same reason, governments should continue to collect statistics of stocks of foodstuffs and raw materials held in all hands and should publish the results.

Indeed, in the early transition period these statistics of stocks will be every whit as important as they were during the war. They will constitute the government's main basis for determining rations, allocations and prices. If with a given ration and price, stocks are diminishing, that is a sign that either the ration is too large or the price too low; if stocks are increasing, there is reason to increase the ration or drop the price or possibly to make both these changes simultaneously. The need for adequate statistics of stocks will continue to exist even after the abolition of rations.

However efficient a national administration may be, no government acting alone can hope to prevent wide fluctuations in raw material prices. Joint action, as we show in Chapter III, is indispensable. But before turning to the international aspects of the problem, we wish to consider the probable effect of government demand on the smooth transition from war to peace economy.

7. PUBLIC WORKS

In a number of countries, especially in Asia and in Europe, the damage wrought during the war is so great that it can only be repaired with government aid and a situation is likely to present itself similar in many ways to that which obtained during the war. In a war economy, there is an abnormal demand for the products of the heavy industries, and that demand is concentrated, together with a very large demand for certain consumers' goods for the army, in the government's hands. This involves a curtailment of ordinary civilian demand and the diversion of the resources of production to meet the government's needs. Whenever destruction has been very extensive, the same need for an abnormal rate of saving, for diverting productive resources from consumption to capital goods will arise—the same concentration of demand in government hands. But there is this important difference—that part of the government's demands in peacetime can be postponed.

Indeed the need to reconstruct may prove to give the government a powerful instrument for countering the automatic oscillations in consumers' demands. We have seen that those oscillations are likely to be caused by the abnormal age composition of the semi-durable and durable goods that the public gradually accumulates after the war.

It should be the object of the government to dovetail its demand—in fact its public works—into the zig-zag of consumers' demand. In order to do this, it will require to have a general plan carefully elaborated in advance. It should know what it wants to do not next year or the year after only, but over a period of five or ten years. It should have the individual projects that fit into the general plan worked out in considerable detail; those that are likely to prove the most urgent, for instance the reconstruction of means of communication or of workmen's dwellings, in as complete detail as the demands of war on personnel permit; it should attempt to classify these projects according to degree of urgency, to the period required for their execution, according to locality, to the type of labour skills required, etc. It should be ready to start on one or another of these projects with the greatest possible promptitude as circumstances demand, and at the same time it should be prepared to postpone putting projects into execution. To achieve

this state of preparedness, the closest co-operation between central and local authorities, and, in countries with a federal constitution, between federal and state or provincial authorities, is clearly required. No country can hope to keep business active if central control and singleness of purpose are lacking.

We foresee two major dangers in connection with public works after the war. The first is that projects that are indispensable for getting the whole national or international economic mechanism functioning again will not be ready; the second that governments, afraid of unemployment or desirous of maintaining their own administrative organization unimpaired, will hamper normal business recovery by launching too many schemes or launching them at the wrong moment. Normal public works should be delayed in so far as is possible without too serious capital depreciation until the more pressing work of reconstruction is completed. They may be urgently required some years after the termination of hostilities to check the onset of a major depression.

We believe that these general principles will meet with common consent; in substance, indeed, they are similar to those approved by the representatives of governments, employers and workers who adopted the Public Works (National Planning) Recommendation at the International Labour Conference of 1937. There is likely, however, to be greater division of opinion concerning the rate at which the government should undertake the work of reconstruction and concerning the financial implication of that work.

Clearly the general standard of living may be seriously depressed if, at a moment when privately owned machinery and plant is largely worn out, the government diverts resources on a large scale for other reconstruction purposes. In such circumstances, the consumption industries may be unable to recover rapidly and it may prove necessary to continue rationing for a considerable period of time. On the other hand, the government must get the key services, shipping, harbour facilities, railways, etc., into working order as rapidly as possible. In determining its time schedule the government should, we consider, be guided by the overruling necessity to maintain full employment not simply in the first year or two after the war but, in so far as that is possible, permanently.

Too great haste may necessitate such restrictions on consumption as to cause a depression in living standards at the outset and then again later, on account of unemployment. Moreover, the burden of debt and taxation will in any case be so heavy after the war that some relief on the latter will probably prove a psychological necessity.

The government, in determining its time schedule, will require to distinguish also between the reconstruction of the mechanism of production and other capital goods. It may be essential for instance to restore shipping facilities as quickly as is physically possible in order to assure the transport of essential food and raw materials, and to curtail consumption until this is done. But to curtail consumption in order to rebuild houses involves a choice between two types of consumers' goods. When the destruction to workmen's dwellings is extensive, rebuilding will have to be begun on a large scale at once. But then it should be realized that, granted full employment of resources, consumption may well have to be curtailed.

The extent of this necessary reconstruction work will help to determine the rapidity with which quantity and price controls and other government intervention can be released.

As we have stated above, when the government is in the position of the final purchaser of the products of any industry such controls are relatively easy to administer and should, in our opinion, be maintained. They should be maintained because the fact that the government has to arrange for the work to be done, is likely to be due to an abnormally large demand or abnormal urgency. Its intervention is likely, therefore, to have inflationary effects unless it adopts or retains special measures of control. These measures should relate not only to priorities for raw materials and for contracts or price maxima but also to skill monopolies. The postwar demand for different types of skill will certainly be abnormal, and the government should enforce its power to control monopolistic positions, to train additional workers to meet its requirements, in exactly the same way as it enforces its power to prevent monopolistic prices for goods.

The same is true of labour skills in general; it is just as essential that they should be adapted to peace conditions of demand as that

plant should be. The redundant skill ceases to be an asset; the new demand for skills must be met by training and the trained must be given the fullest opportunity to get work. In the first few months after the cessation of hostilities there is likely in any case to be considerable voluntary or enforced unemployment while men are resting after the strain of the war years, or seeking new occupations, and while plant is being adapted to meet civilian demands. Even with the great expansion of the machine tool industry, re-tooling must take a number of months, and during this period the demand for labour is necessarily restricted. It is exactly at this stage that critical importance will attach to government policies governing the rate of demobilization, the release of funds for expenditure by the civilian population, the tapering off of war contracts, the initiation of public works.

The policy of each government will necessarily be determined mainly by local conditions; but it will in every case have to be borne in mind that for some time a continuation of large government deficits due to the necessity of completing contracts, the costs of demobilization, the financing of reconstruction at home or abroad is likely to be accompanied by more liberal private spending while industry is ill equipped to meet the new demands. Great care will be required to obviate an inflation of prices at this moment, and if public works other than those necessary for the restoration of the essential public services are undertaken, preference should be given to schemes which can be quickly completed as the private demand for labour expands.

While the unavoidable though diminishing government deficits will constitute a major factor on the demand side in the early transition period, the extent to which stability and full employment over a series of years can be secured will, we believe, be largely determined by the extent to which postponable government projects can be employed to fill gaps rather than to compete with an active market demand. The first essential, therefore, which the government can only supplement, is that business firms themselves should work out their plans in advance and be ready to put them into execution as rapidly as possible. Firms will naturally look to the various ministries and committees of reconstruction for information and guidance in preparing their plans.

8. EMPLOYMENT AND TRAINING SERVICES

They may be helped when the time comes for the execution of their plans, and labour helped in finding rapid re-employment, if the services which the governments have provided during the war are maintained and adapted to the needs of the transitional period. This is especially true in the case of the agencies developed for placement and training. In order to promote the most effective utilization of manpower for the imperative needs of war, governments have greatly expanded and strengthened their employment services, have in many cases provided facilities for transfer of workers to a distance from their homes, and have undertaken extensive programmes of training both within industry and outside. In the shift of manpower from war to peacetime employment, the corresponding problems will be scarcely less urgent and perhaps even more difficult and complex. Workers discharged by the war industries and men demobilized from the armed forces will need skilled guidance in the search for jobs, and will, as we have just said, need in many cases training or retraining to prepare them for new employment. Of particular interest and urgency will be measures for the vocational rehabilitation of men injured in the war. These problems must be met if the unavoidable dislocations of transition are to be held to a minimum and if full employment is to be speedily re-attained. They cannot be met if the manpower machinery developed during the war is scrapped abruptly at its close; it should instead be readapted for use as an important instrument in the postwar period.

CHAPTER III

THE INTERNATIONAL PROBLEMS OF TRANSITION

Up to this point we have dealt with problems relating to domestic demand without reference to the capacity of countries which lack raw materials to find the means of paying for them. We pass now to a consideration of the situation that is likely to arise in areas in which lack of raw materials and the whole international balance of payments position is likely to prove of major importance and to constitute the major factor rendering the full employment of other resources difficult after the war. The problem with which these areas will be faced is obviously an international one. They lack adequate means for effecting payments abroad. We pass therefore from the national to the international aspect of the transition from war to peace economy. But we make this division between national and international aspects for the sake of logical clarity only. There will in fact be no parallel grouping of countries. No country will be able to overcome its transition difficulties by national action alone or in spite of unwise international policies, and much of what we have said in the preceding chapter will apply also to those countries whose chief preoccupation will be the acquisition of adequate supplies of raw materials or of foodstuffs from abroad.

1. THE NEED FOR GOVERNMENT ACTION

Before considering the questions that are likely to arise in countries which for one reason or another may not be able to restart civilian production rapidly and effectively after the war, it may be well to recall very briefly what happened after the last war. Then, apart from the provision of food to Europe, there was little or no concerted endeavour by governments to tackle the problems that presented themselves. It was expected that business would revive through its own inherent strength.

The two countries in the strongest financial position almost immediately abolished the greater part of the machinery of control over prices and distribution that they had built up during the war.

A rapid and violent price boom resulted, in the course of which demobilized men were in fact rapidly re-absorbed into industry only to be thrown out on the streets shortly after when the boom burst.

This price boom naturally rendered it more difficult and more expensive to furnish Europe, considerable areas of which had been reduced to a state of starvation or semi-starvation, either with the food required to maintain existence or with the raw materials and other goods required to restart business.

International action was confined to the provision of foodstuffs, the major part against credit (relief loans), part in exchange for such gold and foreign assets as the countries might possess and about one-fifth by way of gift. In the period of most urgent need up to the summer of 1919 gifts amounted to a very small fraction of the deliveries. Enemy countries, with the exception of Austria, paid in gold or its equivalent for all they obtained.

The provision of foodstuffs, itself a vast administrative undertaking, was effected with remarkable vigour and imagination. But the major problems of reconstruction, of effecting a smooth transition from war to peace, were left untouched. From such information as is available, it would appear that Continental Europe's imports from overseas during the first two years of peace 1919/20 amounted, in billions¹ of dollars, approximately to

Foodstuffs	6.3
Raw materials	7.2
Finished goods	3.9
	<hr/>
Total	17.4

while exports amounted to about \$5 billions. Of the difference of just under \$12½ billions, over \$5½ seem to have been covered by invisible exports of which the most important were receipts from her mercantile marine (circa \$1¾ billions), emigrants' remittances (circa \$1½ billions), expenditures of foreign armies (\$1 billion).

There remained, therefore, an adverse balance of over \$6½ billions to be covered by borrowings. Relief accounted for less than \$1 billion, intergovernmental loans (apart from relief) and other

¹ Used in the sense of thousand millions. All the figures are rough estimates. The comparable figures in 1937 were 1.8, 2.9, 0.8, Total 5.0.

long-term borrowings to not quite \$3 billions, leaving over \$2½ billions to be found as best it could from short-term borrowings or, under the pressure of the imperative need to obtain goods in order to get men re-employed and business restarted, by the sale of domestic currencies to speculators.

These are the approximate magnitudes of the situation as it presented itself in these years, so far as can be ascertained today. But they necessarily fail to present the complete picture. European currencies collapsed under the two-fold pressure of budget deficits and the need to obtain goods from abroad. But this need was far from being fully met and the consequent failure to restart business deprived governments of the means with which to restore either social order or budgetary equilibrium. How great was the unfilled need cannot be determined, but the following figures of raw materials imports in three years by three groups of countries are significant.

Continental Europe:
Overseas Imports of Raw Materials and Semi-manufactured Products
\$(000,000,000's)

	Continental Europe	Western Allies ¹	Neutrals ²	Other Countries ³
1919	8.6	2.5	1.0	.1
1920	8.6	2.0	1.0	.6
1927	3.2	1.4	.5	1.3

¹ France, Belgium, Italy, Portugal.

² Denmark, Netherlands, Norway, Spain, Sweden, Switzerland.

³ Germany, Austria, Czechoslovakia, Hungary, Yugoslavia, Bulgaria, Roumania, Greece, Finland, Estonia, Latvia, Lithuania, Poland.

It will be observed that the western Allies and neutrals required and were able to obtain from overseas in 1919 and 1920 considerably greater quantities of raw materials and semi-manufactured products than in 1927, by which year relatively active economic conditions had been generally re-established. Exactly the reverse was true of the other countries of Europe whose imports in 1919 were indeed negligible.

Under the pressure of these difficulties and of the inflation resulting from budgetary deficits, currencies collapsed and owing to this collapse the greater part of the savings of the industrial workers and of the middle income groups evaporated. These latter,

normally an industrious and stable element of society, became a major source of political instability and unrest.

The problem of postwar reconstruction, ignored at the time of the armistice, did not solve itself. It was adjourned for four years and during these four years the whole economic and social organization of many countries rotted. When it was finally faced, it had ceased to be a general problem of transition and reconstruction and had become a problem of cutting the gangrene out of the most affected areas one by one. This was done, as it could probably only have been done, by the issue of loans, essentially to restore confidence to populations who were riddled with fear. Once stabilization was effected, borrowing proceeded on so large a scale that when prices fell in 1930 and business became inactive, the burden proved too great to be supported and the collapse we have referred to in the Introduction took place.

In judging this record, we must recall that governments abandoned control of the situation in 1918 or 1919 on the insistent demand of the public which was weary of long years of restriction and regulation and that there was then no recent experience from which to judge the economic effects of a major war.

It is difficult to assess with assurance the importance of the various factors both political and economic that contributed to the breakdown in many European countries in the 'twenties. But it is at least certain that if a plan had been elaborated for the provision of stricken areas, not simply with what they required to eat but with what they required in order to be able to feed and clothe themselves, it would have contributed greatly to economic and social stability. If currencies weakened by internal inflation had been supported at once, rather than after the collapse was under way, it is certain that trade would have revived more rapidly and probable that many obstacles to trade from which the world suffered throughout the interwar period might have been avoided. Moreover, it is obvious today that if the price boom of 1919-20 had been curbed, the cost of the provision of the goods to Europe would have been greatly reduced.

To leave the task of reconstruction to be shouldered by the mechanism of private business to the extent to which it was left showed a misconception of the very principles on which the success

of private enterprise depends. In fact, great courage and initiative was shown by private firms and when the risks seemed reasonably good business revived rapidly. But what was required to avert the disaster that took place was to restart the wheels of production also where the immediate risks were bad and the hope of profit remote. No business firm, however great, could or should have assumed these risks, and because governments failed to face the real issues, business in all countries suffered, and suffered almost throughout the twenty-year interwar period.

As we shall show immediately, the difficulties after this war are likely to be more and not less serious. The areas overrun by armies are much more vast, including as they do much of the Far East; in 1918, France, though war scarred, was not famishing; the Netherlands, Norway, Denmark were but little affected; the destruction to buildings, to industrial plant, to docks and means of communication is already much greater than it was in 1918; not troops only but vast armies of workers have to be repatriated to their homes; Europe's capacity to pay for imports from the earnings of her mercantile marine or from emigrants' remittances will be very greatly reduced—and, finally, confidence has been wasting away not only during the war but during the whole period since 1930. The need for government action to restart peacetime economic activity and to create the conditions under which normal business, public or private, can function must, we believe, be apparent to all. There must be a period of transition. The more effectively governments act, the shorter that period will be.

2. THE NEED FOR INTERNATIONAL ACTION

It is obvious, moreover, that, except in a completely and unimaginably autarkic world, the great majority, if not all, of the questions we discussed in Chapter II will present themselves in an international setting and cannot be solved by independent national action alone. But when we recall the disastrous efforts of governments to pursue such independent and autarkic policies in the 'thirties, some brief exposition even of the obvious would seem to be required. The immediate postwar period will be one of all-round shortage; one of the most serious postwar risks will be price inflation. If governments endeavour to keep their national price levels

stable but allow unlimited competition for raw materials and food-stuffs on the world market, their policy will inevitably break down. Concerted action and restraint from action on the international markets is clearly required. If governments adopt wholly diverse credit policies, if one inflates credit and another depresses wages, the chances of establishing an international price equilibrium under which business can be done may be indefinitely postponed. In the absence of such equilibrium full employment can scarcely be secured or, if secured, maintained. If, on the other hand, full employment is sought by competitive devaluation, disequilibrium is deliberately caused. If one government abolishes its control of prices while others maintain theirs, it will threaten at once its chances of export and its exchanges. If its exports fall off or fail to revive, full employment will not be secured; if its exchanges are deliberately devalued owing to the pressure caused by such autarkic price policies, other countries are likely to refuse once more to accept its goods as they did in like circumstances in the 'twenties. The transition from war to peace economy is in fact an exceedingly delicate operation in which all must co-operate. Together we may stand; divided we shall quite certainly fall.

Just as private individuals will find their stocks of durable and semi-durable goods depleted at the end of the war and will require cash or credit to reconstitute them, so most nations dependent on foreign raw materials—and all nations are dependent to some extent—will find their stocks depleted and will require cash or credit to reconstruct them. They will require international credit.

Similarly, the national demand will tend to be jerky like the individual demand. There will be a sudden demand for the replenishment of working stocks in addition to the normal demand to cover the outflow of manufactured goods from the factories. Once that demand is satisfied, it will not recur. In the absence of control there is likely to arise, as in 1920, a speculative demand from those who have available means of payment in anticipation of the rise in prices that the lack of control permits to take place.

We find, therefore, that there are three distinct problems:

(a) the provision of the amounts of raw materials required to reconstitute essential working stocks;

(b) the damping down during the period of general scarcity of any tendency for countries to acquire more materials than are really essential for the smooth working of their productive processes;

(c) the provision of credit to those countries that cannot restart their economic machine for lack of raw materials without credit.

As we shall show below, however, we believe that in certain cases it may be necessary to provide raw materials without either demanding cash or providing credit.

Let us begin by a brief inspection of the international scene as it is likely to present itself. We shall find wide areas in the world in which the population has been reduced to a minimum of subsistence or actual starvation, as it has in occupied Russia, parts of China, Poland, Greece, Yugoslavia, etc.; in which agricultural production has declined and the immediate productive capacity of agriculture has been impaired; in which the whole transport network has been torn and worn, rolling stock is inadequate, roadbeds and bridges are unsafe and harbours damaged; in which much machinery has been destroyed, other machinery displaced, and much of the rest is inefficient; in which workmen's dwellings round the industrial plants have been bombed; in which great numbers of the industrial population have been taken away from their homes to work elsewhere and many of the younger men have been killed or wounded in the war; in which, therefore, the whole productive capacity has been greatly reduced and with it the potential as well as the real demand for raw materials. But to what remains of the normal demand for raw materials must be added the abnormal demand for reconstituting stocks, the abnormal and in some countries the normal demand for foodstuffs, and an abnormal demand for shoes and clothing, new industrial machinery, machine parts, harbour equipment, as well as a greatly reduced normal demand for certain classes of manufactured goods. It is impossible to estimate even roughly what the magnitude of the problem is likely to be. But some sense of its possible magnitude may perhaps be derived from the figures given earlier in this chapter of Europe's trade balance in 1919/1920.

Import prices in Europe in these two years ruled high, perhaps

130% higher than in 1935. In 1935 Europe's trade figures were as follows:—

	\$(000,000,000's)			Total
	United Kingdom	9 other Industrial Countries	Rest of Europe	Continental Europe
<i>Imports:</i>				
Foodstuffs and live animals	1.6	1.4	.3	1.7
Materials, raw or partly manufactured	1.3	3.2	.7	3.9
Manufactured articles .....	.6	1.6	1.0	2.6
All goods	3.5	6.2	2.0	8.2
<i>Exports:</i>				
Foodstuffs and live animals .....	.1	.6	.9	1.5
Materials, raw or partly manufactured .....	.4	1.3	.6	1.9
Manufactured articles	1.5	3.4	.3	3.7
All goods	2.0	5.3	1.8	7.1

To the European demand, whatever it may prove to be, will be added the requirements of the U.S.S.R., China and other war areas. In normal times the imports of raw materials into the U.S.S.R. and China do not exceed \$300 million. What the requirements of famine-stricken populations may be it is impossible to foresee.

The total demand of the war areas that are likely to be faced with a temporarily difficult balance of payments situation will probably not arise in its full force at once. Even the 1918 armistice, which caused an immediate cessation of hostilities amongst most of the belligerents, was far from world wide. We may anticipate a gradual evolution from war methods and administrations to those of peace. It may well be, for instance, that as one area after another is liberated in the course of military operations, its immediate needs for foodstuffs or raw materials may be met by some extension of the mutual aid principle and administration and that the more extensive and automatic means for reviving economic activity will develop only gradually. On such questions it is clearly impossible to formulate definitive intentions far in advance of the actual events. What is important at this stage is to formulate general principles of policy and in certain cases to set up appropriate international mechanisms by means of which a transition to peace economy may be effected.

3. RELIEF

What is essential in a peace economy is that individuals and nations should be able to produce, and exchange what they produce. Some nations may be unable to start owing to lack of food or raw materials; they may be unable to pay. Unless they can produce and exchange, other countries will scarcely be able to maintain full employment. The revival of economic activity in all areas will naturally depend primarily on the efforts made by the peoples of those areas themselves; but in some cases help from those able to render help will be required.

The tendency after the last war was to regard relief as relating to physiological needs only. We believe that that view was unfortunately narrow. Relief, to be effective, must not simply fill the human belly for a short period of time, but must enable the individuals who require it to continue that process themselves in the future. The distinction between relief and reconstruction should not be determined by classes of commodities. The real line of distinction, if there is one, is financial.

Relief is the provision of goods without immediate or postponed payment. But relief is the first step in reconstruction, and if it fails to reconstruct, it is ineffective charity. It is obviously wiser, and more humane, for instance, to provide some relief in the form of food and some in the form of fertilizers which will enable a country to grow its own food next year than to provide food two years in succession. But what is true of fertilizers is true of any raw materials that will enable a country to acquire later what is indispensable to its economy. It is wiser to provide food plus cotton or wool or any other raw material which can be worked up into export goods than food for two years in succession. What is necessary is to ascertain the minimum amounts of goods of all sorts essential to get the economic mechanism of countries functioning again and to compare these minima with (a) the assets of these countries that can be immediately mobilized without leading to a subsequent breakdown and (b) the extent to which the borrowing capacity of these countries can be employed without leading to a subsequent breakdown. The difference between needs and these two resources is the amount on account of which there is a claim for relief. Failure

to meet that claim may result in starvation, social disorder and inflation. It may, however, well prove impossible to meet it in full.

The extent to which it can be met will clearly depend, *inter alia*, on the willingness of states large and small to participate in a common effort to restore economic activity as rapidly and efficaciously as possible. The need to do this constitutes a challenge to all, a challenge to which it is to be hoped all will respond.

In 1919, relief was not thought of in these practical economic terms. It was looked upon rather as a form of charity which should be extended to some countries and not to others. Political considerations and not capacity to pay determined whether payment in cash should be demanded. The probable effect of such cash payments or of the issue of relief loans on the countries' capacity to acquire raw materials had little influence on policy.

We have described above the effects of this failure to make provision for reconstruction in the first years after the Armistice and need not insist further on their unfortunate nature here. But we would venture to insist that relief and reconstruction should be considered as a single problem; that relief should not be looked upon as a form of charity confined to foodstuffs; that initial mistakes and lack of vision are likely to cause irreparable damage and involve subsequent costs that the world will be ill equipped to bear. Above all, they will involve the risk of a serious depression similar to that of the 'thirties occurring, not at once, but some years after the termination of hostilities. As we have remarked already, no estimate of the probable value of the relief that may be required can be made at this stage. The Inter-Allied Committee on Postwar Requirements is obtaining estimates of the kinds and amounts of foodstuffs, raw materials and articles of prime necessity required in Europe, and presumably similar inquiries will be made as regards other parts of the world. This is perhaps the most that can be done at present. It will constitute the first item in the balance sheet we drew up above. In considering the other items in this balance sheet, the fact will require to be borne in mind that certain European countries have large frozen funds abroad. It would be a mistake to assume that because all these countries may be in need of raw materials, they will all be without means with which to purchase them. On the contrary, there is a

danger that in the absence of concerted measures of control, these funds may give rise both to an inflationary movement of prices on the world markets and to an inequitable distribution of scarce materials. Such control may take various forms. Let us consider first the co-ordination of domestic demand.

4. THE INTERNATIONAL ASPECTS OF RATIONING

In Chapter II we suggested that, in order to prevent runaway prices and a subsequent slump, governments would be well advised to maintain and gradually increase rations and maintain price control until prices fall below fixed maxima or these maxima were proved to be out of gear with the market. But, if such policies are to be effective, they will require during the period of scarcity to be internationally co-ordinated. If one country increases its rations much more rapidly than others, it may cause a rise in world prices and render the maintenance of rations elsewhere impossible. Moreover relief may take two forms, the abstention of the richer states from absorbing a disproportionate share of the supplies which are scant, and the direct provision of supplies to others. If both forms are employed, the monetary cost of the second will, of course, be reduced. On the other hand, if relief is to be afforded at all, it is natural to demand that the recipient country should continue and properly enforce its rationing system and give every assurance that both what is received and what is produced at home is equitably distributed.

We suggest therefore that both in order to prevent a rise in world prices of essential goods that would render impossible a smooth transition to peace conditions anywhere and in order to keep down the costs of relief and reconstruction, rationing policies after hostilities should for a period be co-ordinated. We should advocate such co-ordination at least as regards the following points:

- (1) The size of the direct rations and the rates of increase;
- (2) The coupon (point) rationing purchasing power allowed and the rate of increase;
- (3) The maximum prices fixed for consumers' goods.

Such co-ordination would not of course imply identity of rations or prices in the various countries. We are not concerned with theoretical and unattainable equity, but with the eminently prac-

tical problem of preventing booms, slumps and unemployment. To fix rations so low as to be within the purchasing power of the poorest in all lands would be intolerable in the states with a relatively high standard of living; to fix for the poor states rations which could never be bought by the majority of the population would involve at once waste and miscalculation. More important than the absolute amounts are the rates of change. What we propose is that varying initial amounts once agreed should not be changed except by common consent until the period of scarcity is past. Exception would of course have to be made for perishable goods and certain strictly local produce, but on the other hand the policy should not be confined to food but should cover clothes and possibly other rationed commodities of international significance.

This co-ordinated control of consumers' demand will, we believe, go far to assuring the stability or relative stability of prices that is desired. But it will not, we foresee, be sufficient by itself. Many important raw materials are not used to any great extent for consumers' goods or at any rate for the class of consumers' goods to which rations apply. Moreover, if the prices of those that are used for rationed goods were left uncontrolled, the manufacturer might be so squeezed by a rise in their prices which he could not pass on that enterprise would be checked. International control of consumers' demand must therefore, we believe, be accompanied by an international control of raw materials.

We may anticipate that at the end of the war, while it is possible that certain surplus stocks of raw materials and foodstuffs may have been accumulated, the general situation will be one of shortage. Later this scarcity may be succeeded by conditions of plenty or superabundance, and it is clearly desirable to design measures in advance which may meet both situations.

5. THE INTERNATIONAL DEMAND FOR RAW PRODUCTS, ETC.

Let us begin with the problem of scarcity. There will quite certainly be a world-wide scarcity of certain products; in addition there will be local scarcities of almost all products due either to transport difficulties or to lack of means of payment or both. These scarcities will ultimately be made good by improving means of transport, by the utilization of stocks which will be mainly in gov-

ernment hands, by the conversion of scrap, redundant munitions, etc., which will also be mainly government owned, and from current production, much of which governments will have contracted to purchase for varying periods in the future. Governments will therefore be in a position to control the situation, and they will already have established much of the machinery of control in the inter-allied shipping, supply and other organs. How should this control be exercised? There are clearly three primary objects of policy:

(a) to prevent a scramble for raw products, tonnage, etc., at the end of hostilities;

(b) to secure an optimum distribution of supplies when supplies are short;

(c) to prevent a collapse of prices when supplies later become abundant.

The first and last objects are easy to define and are not likely to be questioned. The second object clearly requires fuller definition and whatever definition is given is likely to prove controversial both in theory and practice. We are concerned here with securing full employment of resources as rapidly as possible over as wide an area as possible in such a way as to minimize the risk of a subsequent breakdown. Would this result be best attained were scarce supplies of raw materials to be distributed for instance on the basis of the productive capacity of different plants or in such a way as to provide work for a maximum number of unoccupied workers? Is it better to secure maximum employment in one area or some sub-maximum average in all? What is the relative importance of the immediate and subsequent risks?

In practice, we do not believe that precise and clear-cut answers will or indeed can be given to these questions, and it may be preferable to employ negative criteria. The most important of these negative criteria are

(a) that real social distress, especially such distress as is likely to threaten the social fabric must be mitigated;

(b) that conditions likely to lead to inflation or accentuate inflation must be avoided;

(c) that commitments likely to lead to a subsequent financial breakdown must not be entered into.

Were the market left free, the risk of an inflation of the prices of raw materials, of local currency inflations and of subsequent general and local collapse would, we believe, be greatly enhanced. Nor is there any reason to suppose that such freedom would lead to maximum immediate output, for the power of a plant or a country to purchase raw materials in the conditions we contemplate is as likely to depend on its chance capacity to effect purchases abroad as on its productive capacity. The greatest productive capacity may be where the ready funds are least.

In order to prevent a scramble for commodities, we believe it will prove necessary for governments to continue or institute a machinery for the joint or non-competitive purchase of raw materials, for the sale (or provision) of these raw materials in such a manner as to secure as widespread and as full employment of resources as possible, and for the joint control of tonnage so long as a serious shortage of tonnage persists.

Once the world shortage of goods (or tonnage) is overcome, the difficulty of distribution disappears. Certain areas may still require financial assistance, but distribution can be determined by price. Before this point is reached, there must be some form of international allocation, comparable to the national rationing of individuals but more difficult to apply. The difficulty arises from the fact that there is no comparable physiological basis for such international rationing.

If at the end of hostilities considerable quantities of raw materials are in fact held in the hands of certain governments, the possibility of control will, of course, be much greater than if there were no cushion to meet the onrush of demand. We attach importance, therefore, to policies adopted by governments during the course of the war to acquire such stocks or to acquire control over the flow of supplies. It is in any case highly desirable that stocks should be held in strong hands and that their owners should deliberately refrain from trying to make a maximum profit from them and should use them to prevent wide price movements.

To assure both equitable distribution between states and the public backing for measures taken that will be so essential in this difficult period, it is clearly desirable that any international machinery set up should be on the widest possible basis.

Gradually, as supplies become plentiful, the need for joint purchase to check a steep rise in prices will disappear and an increasing part of the total transactions in crude products will presumably be conducted by the trade. We would not recommend, however, that at this stage governments should divest themselves of all interest in raw materials. On the contrary, we believe that the machinery set up should be retained and employed to co-ordinate the supply and demand and to control the movements of raw material prices by means of agreements between governments of producing and consuming countries and, in some special cases, by the establishment of buffer stocks. We shall revert to this question in the second part of our report and only mention it here in order to indicate the possible evolution of this type of action.

6. THE INTERNATIONAL DEMAND FOR CAPITAL AND CREDIT

Reversing the order of ideas in Chapter II, we have dealt so far in this chapter with commodity controls, leaving credit questions to be considered next. This change is deliberate; for the kernel of the problem we considered in the last chapter was the risk of excessive liquidity. In the international field, the kernel of the first problem is likely to be a lack of goods accentuated locally by a scarcity of means of payment.

Both lack of goods and lack of means of payment are forms of capital scarcity; until that scarcity is overcome, full employment of resources is impossible. Let us consider first the form that the demand for capital is likely to take.

(a) In the first instance, there will arise the demand for food, raw materials and certain finished goods to feed and clothe the populations and, step by step, to restart the productive mechanisms of the stricken areas.

(b) Simultaneously, or almost simultaneously, there will be a demand for capital, domestic and foreign, to repair the physical damage and make good the wear and tear that has been suffered during the war.

(c) Thirdly, there will arise a demand for international working capital for the reserves of Banks of Issue and for exchange stabilization funds.

(d) Finally there must arise—whether it is satisfied or not—a demand for capital for the general development and reorganization of the industrial structure in countries where boundaries are modified, where the existing structure has been rendered inappropriate to the postwar world distribution of productive capacity, in countries suffering from demographic pressure and in countries which are in the process of industrialization and are themselves poor in capital.

It may be feared that, if there is failure in international understanding or if there is domestic dissension leading to administrative weakness, to these demands will be added a demand for capital to help governments in covering budget deficits and to put a stop to runaway inflation.

If we consider these various classes of demand, it is evident that unless the prospective situation is faced with great courage and at the same time with great caution, it will give rise sooner or later to serious depression and social unrest. For the sake of clarity it may be well to enumerate the risks inherent in this situation before attempting to submit proposals regarding it.

(a) Obviously if the demand is not met, if raw materials or food or essential machine parts are not forthcoming, business will not revive, the demobilized or repatriated will not be re-employed. That is the risk of the non-fulfillment of the demand.

(b) If the demand is met so scimpily that economic activity recovers to some extent, but not confidence, then any slight recession in business activity may develop into a major depression.

(c) But if the demand is met by loaning funds at high rates of interest, then the burden of debt may become excessive, may later so weigh in the balance of a country's payments that it is forced to dump goods where it can, let its currency depreciate, default on its debt, or resort to economic autarky. That is what happened after 1930.

In classifying the demand for capital above, we have deliberately grouped food and raw materials together in accordance with the argument we have pressed that relief should not be confined to the one or the other. One means of satisfying this class of capital hunger is obviously relief. How far it will go towards satisfying this demand it is clearly impossible to foresee. But it is quite cer-

tain that it will not go the whole way. Before considering other means, it may be well to make quite clear the difference between the first and third types of demand.

Normally the capital represented by or, to put it in other terms, the credit required for the import of raw materials and semi-manufactured goods imported by those countries in Europe and elsewhere which are dependent money markets is obtained from London, New York and other financial centres in the form of short-term credits. There is at any moment of time a volume of such credits outstanding which have as their obverse these materials in process. The rest is covered by domestic credit outstanding.

At the end of the war there will be a lack of these goods, and such short-term credits as may still be outstanding from prewar days will, we believe, either have been written off or require to be consolidated on such reasonable terms as may be obtainable. If short-term lending, which became greatly curtailed during the 'thirties, is resumed, then the natural credit equivalent for a considerable part of the stocks of goods in process which have to be reconstituted will be the reconstitution of a volume of outstanding short-term credit. Only that part which is not normally covered or cannot now be covered by foreign credits will present a new problem. But, and this is the point we wish to emphasize, a large part of the capital needed for this purpose should require no amortization but remain outstanding as renewable and renewed short-term credits.

The demand for this capital increases as activity increases and falls off when activity wanes. The capital required, on the other hand, to meet fluctuations in a country's balance of payments situation, which normally takes the form of the gold or foreign assets reserves of Central Banks and in more recent years in certain countries of the reserves of Equalization funds, is normally owned outright by those who employ it or is constituted from the proceeds of a long-term loan. The demands on this capital are likely, in the case of dependent money markets at any rate, to increase when business is inactive and to diminish when business is active. It is not therefore a type of demand that can be appropriately met by the provision of short-term credits any more than the

capital required to reconstitute stocks of commodities in process constitutes a type of demand that could suitably be met by a long-term loan with provision for regular amortization.

In normal times, strains on a country's foreign exchange reserves are likely to arise owing to short crops, to the seasonal nature of crops, to business activity substantially in excess of that in its export markets, or to the fact that domestic prices and costs have got out of line with the rest of the world. Abnormal strains may be caused by lack of confidence in the currency, spasmodic capital movements, etc. But the present war has given rise to conditions which will cause quite exceptional strains on the resources of certain countries owing to the changes brought about in the international distribution of capital. These countries, more especially the United Kingdom which previously paid for a very large proportion of her normal imports of food and raw materials from the revenues received from foreign investments, will be deprived of much of that revenue. They will be compelled therefore either to cut down their imports or to find markets for greatly increased exports. But their whole economic organization will have been adapted to a quite different balance and volume of trade from what will be required in the future. It will have been twisted and reshaped during the war to expand not exports, but munitions of war. We must anticipate therefore a long period of experimental adaptation. How successful attempts to effect such adaptation will be it is impossible to foresee; but it is at least likely that there will be unforeseen successes and unforeseen failures. Large funds will be required therefore to meet deficits in the balance of payments of these countries both at the initial stage and later when some anticipated source of external purchasing power fails to materialize. The situation will be still further complicated by the existence of large frozen balances in clearing accounts which will require settlement between the parties concerned.

The period of adaptation will be all the more difficult because these changes in the distribution of foreign assets will affect adversely not only the balance of payments of the countries which have lost assets, but the whole delicate mechanism of multilateral trade. The United Kingdom and certain other European creditor countries did not, in general, obtain the funds due to them for

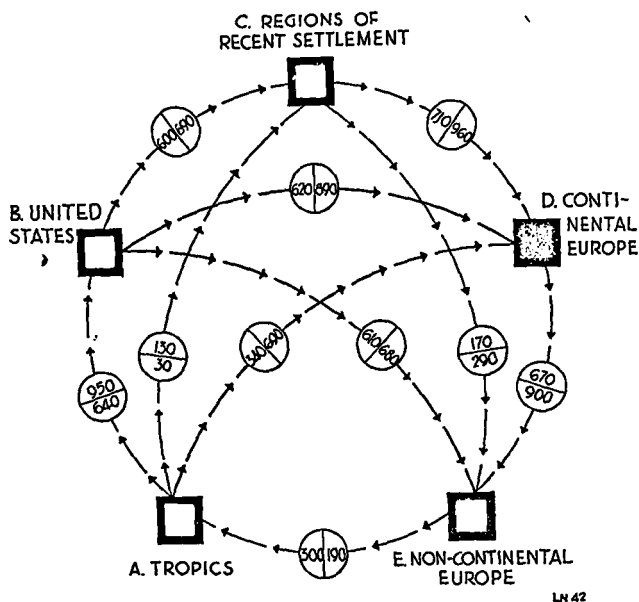
services and on investments directly from the countries owing them, but along roundabout routes and by means of a complex system of trade balances. This system has been analyzed in a recent publication of the League¹ and we shall not repeat the analysis here. The diagram on the following page, reproduced from that publication, adequately illustrates how the system worked.

It will be observed that the United Kingdom—the chief country of “Non-Continental Europe”—had an active balance with the tropics, although about a third of her overseas investments were in the tropics; the tropics had an active balance with the United States of America, the United States with the British Dominions and Argentina; this last group had an active balance with Continental Europe; and finally Europe had an active balance with the United Kingdom. So the circle was completed and with the aid of cross channels the final transfer of funds was effected. The trade, and behind it the productive capacity of the world, was geared to this system; in the 'thirties the system was seriously damaged by the collapse of the international gold standard and the autarkic policies of certain states; after the war it will be still more seriously distorted by the later changes in the balances of payments of creditor states just mentioned. All countries will be affected; all countries will find that for this reason alone some of their plant and other means of production may become redundant; the difficulties of the countries that have lost assets in securing new markets will be *pro tanto* increased; the need for funds to meet foreseeable and unforeseeable demands during this transition period will be so much the greater. Foreign demand will not only be jerky like domestic demand because of the abnormal age distribution of the goods in the hands of the consumer, it will be uncertain because before the test of experience it will be impossible to ascertain what fixed assets and what plant and equipment are really productive.

We have enlarged somewhat on this point, because it has seemed to us important to bring out the fact that these difficulties resulting from loss of foreign assets will not affect one or two countries only, but in one way or another almost all countries.

¹ *The Network of World Trade, 1942.*

The System of Multilateral Trade, as reflected by the Orientation of Balances of Merchandise Trade in 1928.



Note: The Diagram shows the balances of trade, in millions of dollars, among six groups of countries, representing together nine-tenths of world trade, namely:

- A. The tropical regions of Africa, America and Asia.
- B. The United States.
- C. Regions of recent settlement (in the temperate zones), comprising the British Dominions, the Argentine, Paraguay and Uruguay.
- D. Continental Europe (excluding U.S.S.R.).
- E. Non-Continental Europe, represented chiefly by the United Kingdom and Ireland.

The balances are calculated from figures for imports and exports, adjusted so as to represent "frontier" values (imports C.I.F. and exports F.O.B.) and to show the geographical distribution of imports according to the country of origin and of exports according to final consumption.

Both import and export balances are shown; the smaller of the two figures in each circle represents the export balance of the group from which the arrows originate, and the larger figure the import balance of the group to which the arrows point. The difference between the amounts in question is due largely to the inclusion in imports of transport costs between the frontiers of the exporting and importing countries.

How then in the face of this situation can the first and second types of capital requirements mentioned above—the demand for the initial supply of essential goods and the demand for reserves to allow of balance of payments adjustments—most suitably be met? What, granted credit is available, is the most appropriate type of credit?

As we have already stated, if short-term commercial loans and discounts outstanding are reconstituted, they will automatically cover a part of the capital required to restore stocks of goods in process. There is in our opinion every advantage in relying in so far as possible on this source of credit and on the normal operations of banks which have had experience in this type of business. But special measures are likely to be required to revive this business. Three difficulties present themselves: (i) The London market which in the past had done the major part of the European business will be scarce of exportable funds; (ii) The total demand is likely to exceed the amount of credit normally outstanding, the amount available and the amount which could safely be left on short term; (iii) Almost all countries will enforce exchange control, and if that control results in bilateralism and unilateral impediments to the repayment of loans, lenders will be reluctant to put their money into a trap from which it may prove impossible to extract it. Owing to exchange control, or the manner in which it was operated, short-term commercial lending had been greatly curtailed before the war, and various proposals were under consideration for overcoming this difficulty. In their final analysis all these proposals were reducible to two: (a) the exemption from exchange control of certain new operations—specifically the provision of additional commercial credit; (b) the institution of a system of multilateral clearing.

7. EXCHANGE CONTROL AND MULTILATERAL CLEARING

We believe that governments will for some considerable time after the war be reluctant to abolish their exchange controls or at first to accept derogations from them. Countries which have been left seriously impoverished by the war will desire to maintain day-to-day control over imports in order to prevent the expenditure of national resources on goods of a luxury character or goods which,

while not luxuries, can be ill afforded during hard times. Countries which have been cut off from their export markets during the war will wish to ascertain how far and how fast they can re-establish their former business connections. Above all, countries in which inflation is taking place or has recently taken place will want to have time in which to restore order in their public finances and domestic monetary situation.

These preoccupations do not lessen but, on the contrary, increase the need for establishing a system under which multilateral trade may be resumed as rapidly as possible and national price levels thrown out of gear by the war may be brought once more into mesh with each other; for the willingness and the ability of countries to purchase abroad will depend on their ability to sell and the existence of a mechanism for affecting transfers from one currency to another. Such a mechanism should greatly facilitate their power to obtain the raw materials and other essential goods they require for the revival of their industry both by permitting of such transfers and by affording an interval of time in which a country may effect a balance between its economic relations and the rest of the world.

At the same time, until confidence is restored, control over capital movements by means of an exchange control not designed to hamper the movement of goods will, we believe, prove indispensable in many countries. The maintenance of such a control over capital movements is not incompatible with the restoration of multilateral trade, nor indeed even likely to force governments to conclude bilateral clearing agreements, provided an effective mechanism for multilateral clearing and for facilitating the initial imports of countries short of foreign means of payment is set up in time. It is less likely to be abused and converted into an instrument of commercial policy or commercial warfare if it is operated with the aid of some co-operative international machinery than if it is effected by unilateral action alone. We attach great importance, therefore, to the early establishment of some such machinery.

Two proposals for the institution of an international clearing fund have recently been put forward as a basis of discussion by

the American and British Treasuries, the objectives of which, though not identical, are broadly similar.

We give these objectives in full in Annex II. The following objectives are common to both plans:

(a) The creation of a system by which multilateral trade and clearing may be re-established and blocked balances and bilateral clearings are rendered unnecessary;

(b) The determination of the relative exchange values of currencies in such a manner as to avoid unilateral action and competitive devaluation and to maintain the necessary stability of exchanges;

(c) The adjustment of disequilibria in balances of payments and the provision of the reserves necessary to allow countries to make the initial adjustments that will be found necessary in the transitional period.

Just as on the domestic markets we shall be faced by a series of controlled commodity prices which will not reflect relative values accurately, so on the international market we shall be faced by a series of controlled exchange rates that have long ceased to reflect the relative external purchasing powers of the various countries.

Each country at the end of the war will tend to be an independent price island severed from any market relationships with other countries. The gradual adaptation of exchange rates and through them of domestic price levels to a world level that will only be formed by this process of adaptation will be one of the most difficult problems of the whole transition period. After the last war this was effected by each country independently, frequently after a protracted period of wild exchange fluctuations and, in some cases, after a complete collapse of a currency's purchasing power.

Orderly adjustment of rates can scarcely be expected to result from unilateral action or in the absence of some suitable international mechanism, nor can the relaxation of exchange controls over trading operations be expected until rates of exchange have been established that reflect the relative price-cost structure of each country. These relative values cannot be determined in advance; they can only be determined by a process of trial and error. But this process should be greatly accelerated and the risk of error reduced if a fund is available which will at once perform the func-

tion of a shock absorber and afford a guarantee that any rate agreed upon will not be considered by other countries as competitive devaluation justifying restrictive trade measures on their part.

There are in fact two dangers in the fixing of rates, the first that governments will be unwilling to devalue their currencies when devaluation is necessary; the second, that they will pursue a course of competitive devaluation. We believe that the first danger will, owing to fears of inflation and a widespread misunderstanding of the relationship between devaluation and inflation, prove to be by far the gravest.

Any country which persistently overvalues its currency will tend to have an adverse balance of payments and be in debt to the Fund. Both of the proposals mentioned above contain suggestions for meeting such a situation and for the reverse situation of countries whose balance of payments on current accounts tends to be and remain positive. The final objective after the preliminary adjustments have been accomplished must be to maintain an equilibrium in the price-cost structure of all countries without involving the danger of deflationary processes leading to unemployment. This result can, we believe, be attained only by the close co-ordination of policies for the maintenance of the fullest possible employment of productive resources.

The institution of a fund such as we have been discussing should, we believe, greatly facilitate the provision of the areas impoverished by the war with the products they require to restart the mechanism of production. The extent to which commercial credits and other forms of private lending are likely to become available is, as we have already indicated, likely to depend, among other factors, upon the assurance that funds lent will be freely transferable once the credit operation is completed, and upon the prospects of a revival of international trade. The restoration of multi-lateral trade and transfer are two of the primary objects of the fund. Furthermore, governments will, when weighing the possibility of affording relief or granting credits, naturally be influenced, we believe, by considerations concerning the probability of such aid resulting in a genuine restoration of economic activity throughout the world from which all may benefit. If this result can

be achieved, then the aid rendered becomes a profitable investment and not simply an act of beneficence or an insurance against social or political instability. Moreover economic activity will be restored by a gradual process of regrowth and expansion and during that process, once the initial shortages have been overcome, the fund itself will furnish the respite that constitutes the essence of all credit.

We do not propose to enter into any discussion concerning the details of the future currency system or systems of the world. The essentials during the transition period will be to enable governments to effect their indispensable foreign purchases, to arrange for a system of multilateral clearing and to avoid inflation.

8. INFLATION

The monetary situation varies widely from country to country; some countries which have rigorously controlled consumption and prices have been remarkably successful in checking wartime inflationary tendencies; in others inflation has already gone far, though not generally so far as it did during the course of the last war. Moreover, the German costs of occupation and the spending of credits which occupied countries are compelled to grant to Germany through their clearing accounts constitute a persistent cause of further inflation.

Although reliable indices of price movements are impossible to compile in countries in which the black market is of any importance, all the available evidence points to the conclusion that at present the expansion of the currency or at any rate of the note issue in most European countries has been appreciably greater than the rise in prices and that there has thus been no increase in the rate of its turnover. On the contrary, there is clearly currency hoarding. This means that there is a danger at some stage and especially after the end of the war that prices may rise as a result of an increase in the velocity of the turnover of currency and quite irrespective of any further issue of notes. In the Near East, this discrepancy is either non-existent or much less marked; but in this area also and in India there has been a large expansion of the means of payment. In China, which has been at war now for six years, a stage of inflation has been reached at which the govern-

ment has found it necessary to collect certain of its taxes in kind.

We must face the fact therefore that inflation in the war areas constitutes a danger which may wreck the best laid plans, unless effective measures are taken to halt it. We shall appreciate the magnitude of this danger the better if we recall that the inflation resulting from the last war assumed its most serious proportions, not during the war, but during the first two or three years of peace. It became serious when confidence in the government's power to meet its obligations by means other than resort to the printing press, or confidence in the power of the currency to acquire the foreign goods that were needed, was undermined. If we examine the record of these early postwar years, we shall find that the three fundamental causes of the runaway inflation which undermined the whole social fabric in many countries and constituted the major impediment to economic recovery were (1) the lack of an adequate political and administrative machinery for the collection of taxes, (2) lack of confidence in the government or even in some cases of the economic future of the whole country, (3) inability to purchase abroad the bare essentials for restarting domestic production.

Before their currencies were finally stabilized *de jure*, eleven European countries felt compelled to issue long-term stabilization loans and nine to obtain temporary stabilization credits. But a number of these were successful in stabilizing their currencies *de facto* without any external assistance and certain others in establishing or re-establishing the gold standard without any help. Ability to achieve these results was not determined by the degree of inflation which the country in question had undergone. It was determined primarily by the authority and administrative competence of the government and by the ability of the country to sell its goods abroad or to obtain foreign exchange via other ("invisible") items in its balance of external accounts. The problem of inflation is therefore only to a limited extent distinct from the other questions we discuss in this chapter. If adequate assistance is afforded in the initial provision of foodstuffs and raw materials, if trade is reopened on a multilateral basis by means of a clearing fund and if commercial policies are adopted which unblock the channels of trade, we should be able to prevent a repetition of the

history and tragedies of the past. If we fail along these major lines of policy or if we fail to establish political conditions permitting a revival of confidence, then the situation is likely to degenerate even more rapidly than it did between 1918 and 1926, because peoples as a result of past experience have become inflation minded.

But circumstances may render it possible to prevent the currency inflation which has already taken place from exercising its full influence on prices in countries where it has not already done so and therefore subsequently on rates of exchange. As we have already remarked, prices appear to have risen less in most European countries than the note circulation, and wages have risen still less than prices. These and other facts suggest that notes are being hoarded and that the turnover of deposits has slowed down.

If the surplus notes could be withdrawn from circulation and surplus funds in general absorbed, the threatened rise of prices might be checked or prevented. Various measures to this end have in fact been adopted in Europe. Special bonds in forms expected to be attractive to the classes of the population, especially the peasants, believed to be hoarding, have been issued by governments or banks, compulsory savings have been enforced, hoarding of notes has been prohibited and penalties imposed, etc. But, where the increase in currency has greatly exceeded that in prices, it may be necessary after the war to take more severe measures to restrict the note circulation and to control the utilization of bank balances in order to prevent a runaway price inflation.

But we do not propose to consider here the domestic measures designed either to mop up surplus currency or more generally to control inflationary tendencies. We are concerned in this chapter rather with international issues. An international problem may arise at once in any occupied area that is liberated, and the solution of that problem may affect the subsequent transition from war to peace economy; for if liberation is effected with the aid of foreign armies, the expenditure of those armies may exercise an inflationary influence. The importance of this influence will depend on the rate of pay of the individual soldiers, the rate of exchange, the extent to which the pay received can be expended on goods other than those brought in by the armies themselves and, finally,

on the extent to which the domestic currency of the liberated country is increased to meet the needs of their armies.

We only propose to comment on two of these points, the rate of exchange and the origin of the domestic currency rendered available. In certain countries, the determination of the appropriate rate of exchange may present very real difficulties. For if the rate fixed is low, the expenditure of the armies may have a seriously inflationary influence, while if it is too high, the exports of the liberated country may be jeopardized. The difficulty will be greater in countries with a low standard of living in which services and locally consumed commodities are likely in any case to be cheap compared with countries with a higher standard of living. So long as the liberated country's major sales against foreign currency consist of sales to friendly armies on its own territory, it will benefit from a high rate of exchange, and such a rate will have an anti-inflationary effect. But this rate may have to be lowered later when the export trade becomes more important. We would observe, however, that there is no reason for assuming that it would have to be lowered more than would a lower initial rate; for the lower initial rate will result in more domestic currency being put into circulation and consequently higher prices.

The amount of additional currency that will be required will depend on many factors, especially upon the increased military expenditure of the liberated country itself. But, if liberation is accompanied by economic aid, whether on a relief or mutual aid basis, that aid should constitute a means for mopping up part of the surplus currency or alternatively of furnishing the allied armies with the currency they require. For whether the aid is in the form of food, or raw materials or essential manufactured goods, the greater part of it will ultimately be sold to individual persons and firms and the monies received in this way from circulation can be put into a blocked account or used for military purposes as required. In any case they will constitute a brake on actual or potential inflation.

Against the expenditure of the liberating armies and the possible increased military expenditure of the liberated countries, therefore, we have to set this automatic return of money from circulation and the cessation of the previous payments on account

of armies of occupation and positive balances in the clearings with Germany. The relative strength of these various factors will inevitably vary from country to country; but the nature of the broad lines of the policies required to counteract inflation is, we believe, obvious enough. Much may depend upon the success with which those policies are carried out.

9. LONG-TERM LENDING

We have dealt so far primarily with needs for working capital whether for industry, agriculture or for the monetary authorities. There remains for consideration the demand for fixed capital whether for the repair of war damage or for development. This demand for fixed capital will be in part private and in part public, but whatever its form, there are certain principles concerning foreign long-term investment on which we would insist.

The first of these principles is that whenever possible preference should be given to equity investment over debt. So long as the risk of wide variations in either business activity or prices persists, foreign borrowing on the basis of certificates of indebtedness carrying fixed monetary obligations to transfer the service abroad must involve dangers, and may well accentuate both a drop in prices and a tendency towards depression by forcing the debtor states to throw increasing quantities of their products onto foreign markets in order to meet their obligations. We shall deal with this question in Part II and do not wish to expand further on it here. The risk of lending at fixed interest is, however, less when the object of that lending is the development of industrially backward areas than when the object is to make good the loss of capital equipment destroyed during the war or reconstitution of monetary reserves, or the re-establishment of a foreign country's budgetary equilibrium. Certain industrial states, more especially the United States and the United Kingdom, will, as we have remarked, be in possession of greatly expanded heavy metal, machine and machine tool industries. To lend the products of such industries to such countries as China for the improvement of communications or the development of local industries there, may so greatly and rapidly increase the productive and the exporting capacity of the borrower as to involve little risk, especially if some elastic system of amor-

tization is arranged. Loans for reconstruction, physical or financial, on the other hand, will not necessarily increase the transfer capacity of the recipient countries over what it had been before the war damage was wrought.

We realize moreover that there is very little probability of equity finance satisfying or nearly satisfying the postwar needs. On the one hand the taxation of risk-carrying capital is likely to be so high for a time at any rate in capital exporting countries that potential investors will tend to be timorous. On the other hand much fixed capital will be required for bridges, and railways and other public services which are in many countries government-owned. Furthermore, risk capital in any case will shun the areas of political and economic danger, and it is precisely to these areas that capital may have to be directed if social stability is to be re-established.

To these difficulties there is no simple or unique solution. It is often argued that some radical change in financial mechanisms will be required, and this indeed may be true. But new financial mechanisms may well increase the intensity of depressions later if they involve the substitution of government lending for equity or direct investment. There is a real danger, in our opinion, of attention being so concentrated on the satisfaction of immediate and pressing capital needs that subsequent effects will be ignored. To pump capital into stricken areas by the most perfect pumping mechanisms will benefit no one in the long run if the strain imposed by the reverse movement later, when amortization and interest payments exceed new lending, leads to a breakdown similar to that of 1929. It is far wiser to open every possible channel of foreign investment and to control the flow, giving preference to real investment over loans.

For a number of years before the war the weight of taxation on risk capital was steadily increasing and this tendency was natural as national capital equipment became more and more ample. But after the war there will be an unprecedented demand for equipment and plant, that is, for capital, and the importance of the function of the entrepreneur will have increased. The entrepreneur may be the State—in varying degrees in different countries and as regards different enterprises. But the fact that it is the state

diminishes in no wise the risk of financing by debt. We would recommend therefore that the taxation of risk capital should be overhauled after the war and that in those countries where the organization of the capital market is so defective that long-term financing is effected mainly through the banks at fixed interest, that organization should likewise be overhauled.

Governments already hold a preponderant interest in a number of joint stock companies which are thus government controlled and have constituted a number of Public Utility Companies (or Public Corporations) with equity capital but limited dividends. If this system could be extended to other government undertakings, the whole economic structure would become more supple and adaptable. But whatever measures along these lines are adopted, there will remain large unsatisfied demand which cannot be met by the sale of equities to the public. Part at any rate of this demand will probably necessitate direct government borrowing abroad. By what principles should such foreign borrowing be guided?

Let us consider first capital required for physical reconstruction. Is it sound practice for a country to borrow foreign capital to perform work (e.g., the reconstruction of a road or a harbour) on which only domestic labour and raw materials need be employed? The foreign capital can only assist by helping the borrowing country to obtain goods required for current consumption (or for other capital building) which cannot be produced because the labour and other productive resources required for that purpose are engaged on this particular capital construction (in this case the road or harbour). Though foreign borrowing may facilitate domestic saving later by increasing productive capacity and hence the national income, the immediate purpose the foreign capital serves is to render domestic saving, the contraction of current domestic consumption, *pro tanto* unnecessary, to prevent the standard of living falling as much as it would in the absence of foreign capital. The foreign capital need not be, on that account, a luxury; it may be an urgent necessity. But it involves real dangers, for it is extremely difficult to guarantee that it will be expended on the necessities labour cannot produce and will not be expended on luxuries the community might well forego when savings are scarce. Insofar as that is practicable, it would seem preferable to

direct foreign financial assistance for physical reconstruction to those undertakings for which foreign machinery or plant, or raw materials, are directly required. We would venture to insist on this conclusion because we believe that lack of control over the expenditure of the foreign currency proceeds of loans raised in the 'twenties was a not unimportant cause of the collapse in the 'thirties. We recognize, however, that this principle cannot be applied in all cases.

Indeed, there is one consideration which weighs in favour of foreign lending even when the purpose of those loans is to obviate the necessity of domestic saving. For when such domestic saving lowers temporarily the standing of living in a country where the standard is already low, it may through the force of international competition threaten living standards elsewhere. However this may be, it is important in our opinion that foreign loans should be made conditional upon the maintenance of decent labour standards by the enterprises or countries benefiting from them. The purpose of foreign lending should be to raise the standard of living in the areas to which the money is exported, to assist these areas to revive economic activity and, that done, to share in the general economic expansion of which modern means of production permit.

The second point we would make about direct government loans for reconstruction is that they should, save in exceptional circumstances, be intergovernmental; or between the borrowing government or its agency and some governmental lending agency. With the direct or indirect guarantee of the lending government obtained in this way, the rate of interest will be lower and therefore the pressure on the borrower's balance of payments will be less. More important still, the unique lender will be in a position, as anonymous owners of bearer bonds are not, to agree when necessary to a suspension of amortization in bad times, and thus to afford relief when relief is required. Moreover, if governments are themselves the creditors, they may prove more willing than they have been in the past to accept the logic of the fact that, in the long run, debtors can only pay in goods and adapt their commercial policy to this logic.

The demand for what we may call the physical repair capital will be succeeded, we anticipate, by the demand in certain areas

for large-scale readaptation and development. It is possible that to meet these needs and many of the earlier needs it may prove desirable to create some special institute in the form of an international reconstruction and development corporation. If so, then we would suggest that the principles we have outlined should be borne in mind in its constitution and specifically that (a) its operations in the countries to which the capital goes should be conducted as far as possible on an equity basis, or failing this, possibly by some form of income debentures; (b) that when loans are made to governments, they should be at as low a rate of interest as possible and allow contractually for suspension of amortization in bad times; (c) that preference should be given to capital exports required for the purchase of reproductive commodities such as machinery or locomotives; (d) that when such preference proves impossible, care should be taken that the monies received are not expended on the import of what to the receiving country may be classed fairly as luxury goods; (e) that adequate labour standards in the borrowing countries should be required.

International lending may aggravate economic depressions if the consequential burden of debt acquired by the borrowing countries proves too heavy for them to shoulder when trade is slack. It may, moreover, increase the risk of depressions if such lending tends to be concentrated in years of great business activity when available savings are absorbed in any case in the domestic market, by giving rise to an inflation of credit. On the other hand, if international lending can be stimulated when business is slack, the resultant expansion of credit and fillip to business might exercise an important anti-cyclical influence.

Up to this point we have been considering the international commodity and financial mechanisms and processes that will be required to effect as smooth a transition as possible from war to peace and to make good the loss and damage suffered. We have looked also a little beyond the period of physical reconstruction to that of organic development, and we have postulated a commercial policy compatible with the general tenor of our suggestions. It remains for us to consider what principles should guide commercial policy if economic activity is to be sustained.

10. COMMERCIAL POLICY

There is a tendency to assume that, if national full employment can be maintained, international trade will look after itself. Reciprocally it might be argued that, if a very large volume of trade can be permanently maintained, employment will look after itself. Measures to maintain full employment will greatly promote trade; measures to promote trade will promote fuller employment.

What is important in our view is to recognize the factors that give rise to trade and employment through trade, and to abstain from policies which prevent that trade taking place. The volume and direction of trade, obstructions apart, is determined by the economic structure of different parts of the world—by, that is, (a) the geographical distribution of natural resources, human skills and productive equipment; (b) the financial claims that one country has on another.

These are the basic factors which are constantly changing, but which at any moment of time give rise to the push and thrust that express themselves in trade. In each country they create a situation conducive to a certain form of balance of payments. Countries with large financial claims or with income from shipping and other services will require to receive a surplus of goods. Industrial states will need some raw materials from abroad; agricultural states, some manufactured goods; and both types of states some of the classes of goods which they produce themselves.

We have already drawn attention to the fact that the foreign assets of one or more creditor nations are being rapidly reduced. This is causing a not necessarily equivalent reduction in the indebtedness or strengthening of the creditor position of other countries. These latter countries will therefore be able to import more goods for any given amount of exports after the war than they did before. If they fail to facilitate these greater imports, strains will be caused which will render world recovery more difficult.

Let us take first, by way of illustration, any agricultural debtor country in this group from which the United Kingdom previously obtained foodstuffs, part of which were paid for from the service of long-term loans that have now been repatriated. This trade in foodstuffs can be restored if the debtor country is prepared to buy

additional goods directly from the United Kingdom, or indirectly from some third party which imports from the United Kingdom, to an amount equivalent to the reduction in the debt service. If it does not do this, there is a risk that trade will tend to diminish or in this case fail to revive, and the farmers in the debtor state will suffer. Indeed, the whole community will suffer because the whole economy has been geared to a certain amount and composition of exports which it will be difficult otherwise to revive. The same reasoning applies *mutatis mutandis* to creditor states, whose balance of foreign assets and liabilities has improved.

There are three ways by which the necessary adjustments can be made:

(a) If the countries whose capital balances have been strengthened are successful in maintaining a fuller employment of resources than they normally had before this change took place, that will probably, though not necessarily, result in an increase in their imports. Such fuller employment of resources is, of course, wholly desirable and is indeed the prime object of our report. But no policy should be based on the assumption of its own success in all circumstances. We must underpin our structure to meet the impact of possible misfortune. Such a policy is right, but it is not enough.

(b) These countries could establish an equilibrium in their balances of accounts by capital exports. Capital exports, as we have said, will be both desirable and necessary after the war. But they are at the best only a temporary solution of this particular problem, which (ignoring all still more temporary solutions such as relief, etc.) will in the end increase the magnitude of the problem. For, by foreign lending, the creditor position of these countries will be still further strengthened—or debtor position ameliorated; the gap to fill will have grown. Capital exports, however necessary on other grounds, constitute no long-term solution of this problem.

(c) The third and surest solution of this problem in the long run is that the countries whose position has improved should adapt their commercial policy in order to permit larger purchases of foreign goods. This increase in imports will not, it should be observed, cause any contraction of business opportunities at home

compared with what they were before the change in the international debt situation. In fact, the national income of these countries has been benefited to the extent of the change in debt services; some consumers' incomes have been raised; if this increase in their income is spent abroad they will not on that account have less to spend at home than they had. On the contrary, if foreign goods are not allowed to enter in greater quantities, it may prove impossible to maintain exports in the long run and the whole domestic economy, directly distorted by the war, will be further distorted by failure to adapt to these international changes likewise caused by the war.

Important as trade agreements are for the reduction of tariff barriers, these great structural changes cannot be met by the peacetime methods to which we were accustomed, by the gradual evolutionary influence of such agreements. They are radical and profound. They can only be met by radical and courageous measures, taken unilaterally by the countries whose creditor position has been strengthened.

We have insisted on this point first, because the first condition of commercial policy is that it should not run counter to the quasi-permanent factors in the balance of payments situation or to the fact that those factors necessarily render trade multilateral. Moreover, the measures of adaptation we advocate could, we believe, most easily and certainly most efficaciously be adopted during the war when the productive resources are so fully occupied. The first effect of a reduction of tariffs may be to cause dislocation and unemployment in one industry or another, though later it increases employment by increasing demand and the real national income. Governments will therefore find it much easier to effect the reductions that the changes in their balance of payments situation demand during the war when there is no risk of unemployment than later when they may be subjected to the full pressure of sectional interests.

The general objectives of commercial policy have already been laid down in the Atlantic Charter and in Article VII of the Mutual Aid agreements, and these objectives are, we believe, wholly in accord with the desiderata of sound anti-depression policy. But they can at best only be realized gradually. At the end of the war

trade will still be subject to rigorous government controls; it will be largely conducted directly by governments or government agencies, reduced to a fraction of its prewar volume and its direction determined by bilateral agreements. A difficult period of evolution will have to be passed through before an international price system and multilateral trade can be restored.

We have suggested that during the opening transitional stage of world scarcity, rations should be maintained, and that food will be distributed in part on a relief basis, and in part, together with certain raw materials at any rate, will be distributed not as a result of market forces, but by joint government action. This does not of course imply that the private trader will necessarily be eliminated or that he may not be employed even for those commodities the international distribution of which is determined mainly by governments. But direct government trading will no doubt play an important role and all trading will be subject to government control and assent. Governmental control is required during this period of stringency, as we have stated above, to assure optimum distribution and to prevent a price boom. As supplies become more plentiful, price ceilings will disappear, more and more trade will presumably be conducted in most countries by private firms; gradually a pattern of relative prices in each market will be formed. The function of commercial policy should be to allow this pattern to spread and become a world pattern. We have already shown the steps by which this merging of national patterns may be expedited by currency measures, and by the opportunities for the reopening of multilateral trade offered by the Clearing Fund.

There remains, however, the danger that in spite of this Fund certain governments concerned about their balance of payments situation may endeavour to prevent the reopening of multilateral trade and refuse to abandon their clearing agreements or bilateral practices. We are concerned about this risk and anxious to see multilateral trade re-established as rapidly as possible, because transfer, except such initial transfer in kind on a mutual aid or relief basis as may be made, is likely to require roundabout routes and the formation of a connected series of balances. The very object of bilateral clearing agreements is to prevent such balances

arising in so far as possible, and therefore they necessarily prevent one of the parties, or both parties as regards certain goods, from buying to the best advantage. Full employment will not be achieved after the war if nations refuse to purchase the goods they were in the habit of obtaining from others and those others have organized themselves to produce; and the full benefits of such employment of resources as is achieved will be enjoyed by none if all are forced to buy at higher prices than would otherwise be necessary by restricting trade to bilateral exchange.

There may, of course, be cases in which, owing to the special conditions of production, control to maintain prices is necessary. Buying in the cheapest market, that is, easy access to markets, and uneconomic cheapness in any particular market resulting from a slump in prices are two very different things. What we want is stable prices and the power to take advantage of them. Control is particularly likely to be necessary when there is any inherent tendency to overproduce, such as exists, for instance, in the case of certain agricultural products. In such cases it may be necessary to plan both production and sale by international agreement. Agreements of this sort between governments, controlling the production and international exchange of certain crude products such as wheat, may indeed prevent individual traders and countries from obtaining supplies in all conditions in the cheapest market and at the same time benefit trade as a whole by helping to smooth out cyclical movements and by preventing wide fluctuations in prices and the money income of farmers. They may perform a service as anti-cyclical instruments in the international field—at a cost—similar in some ways to that rendered by unemployment insurance funds. Whether they will do so will depend very largely on the manner in which they are administered.

Bilateral clearing agreements on the other hand are intended not to secure an all-round immunity from the risk of dangerous fluctuations, but to prevent the participation of other countries in certain intended advantages. Governments, instead of facing up jointly to the common risk of depressions, endeavour by such agreements to pass on the risks and difficulties of the situation to others and by weakening them they increase the risk to all.

But we have to face the fact that many governments, although

conscious of these facts, repeatedly employed such offensive and exclusive commercial policies during the interwar period. We have to consider, therefore, whether the forces that drove them to do so are likely to recur and, if so, whether they can be counteracted.

As we have mentioned above, the most compelling reason for the reluctance of European governments to open up the channels of multilateral trade in the 'twenties and for their haste to block those channels in the 'thirties was political and economic insecurity. We do not believe that multilateral trade will fully revive until effective measures, in which the peoples of the world have confidence, to consolidate political security have been adopted. Nor do we believe that these measures can be built on economic prosperity; they are a prior condition of real prosperity. Indeed, no economic policy is likely to prove successful in the absence of political security.

Economic security and multilateral trade, on the other hand, are mutually dependent. If governments wait for absolute economic security before opening up the channels of trade, they will wait forever; for economic security cannot be attained so long as the trade of the world is dependent on sudden and arbitrary changes in commercial agreements made between pairs of states in their own apparent short-term interests alone and without consideration of their effects on the trade and economic activity of other trading nations.

To restore multilateral trade it is necessary either to employ some automatic system such as the M.F.N. clause to spread benefits, or to plan multilaterally, or both; it is necessary, too, for governments to think of commercial policy as part of economic policy as a whole and as one instrument in the struggle against the menace of depressions.

But the Most Favoured Nation clause which was for so long the accepted mechanism for the spread of multilateral trade became also to some extent an impediment to the conclusion of trade agreements in the interwar period and this may well happen again if the causes of the distrust of the clause are not removed.

Two major causes would seem to have been the existence of high non-negotiable tariffs in certain countries and the fact that the clause was used to prevent the formation of Customs unions or

preferential areas in Europe. It was indeed natural that governments should have been loath to conclude agreements with others, when they knew that the benefits of these agreements would be automatically extended to countries which refused to extend any benefit themselves. The first step to any solution of this difficulty lies in the total abolition of non-negotiable tariffs. The other cause of the disrepute into which M.F.N. fell reflects the absence both of an accepted body of principle concerning the formation of closer commercial unions and of adequate international machinery. Had there been an international body of recognized authority endowed with adequate powers, it might have become impossible for a state to exercise its veto rights under M.F.N. acting at its own discretion. The chances of securing a smooth working commercial policy throughout the world would, we believe, be greatly advanced by the constitution of such a body.

A third factor which influenced the attitude of certain countries to the multilateral system of trade based on M.F.N., and was in part the cause of those discriminatory tariff specifications that often rendered tariff concessions of little value to third parties, was fear of the competition of countries with a low standard of wages and of living. The growing competition of these countries in the world's markets for industrial products seriously threatened the established industries in certain of the older industrial states with higher living standards and made them unwilling to grant advantages in commercial treaties to other countries from which in fact these low labour cost producers might alone benefit.

In the long run, the development of industry will no doubt raise the standard of living of the economically backward countries and hence their demand for all classes of imports. The expansion of their trade will tend to increase trade in general. But in the meantime serious unemployment and loss of capital may be caused in other countries. This particular danger is not fundamentally different from the risks involved by the invention of new processes or new instruments of production. All change, all progress, necessitates adaptation. But we have to face the fact that after the war, as a result of the expansion of mechanical industries and of the simplification of manufacturing processes, the expansion of industries in backward areas may be so rapid as to render adaptation

in other countries to changing competitive conditions extremely difficult and painful.

There is no single simple solution of this problem. It will present itself in different forms at different times and to different countries. Some cushion against the incidence of too rapid change may be required. But there would, we believe, be a very real advantage if, instead of leaving this problem to be settled when it arises by unilateral action, it could be discussed by an international body which would review it in all its aspects and tender advice to governments.

We are influenced in drawing attention to the need for some body with appropriate powers to deal with questions of commercial policy not only by the lessons of recent history but by considerations of the very nature of international trade. Trade is the means by which depressions are spread from one country to another, and any country of major weight as an import market has the power to depress prices here or there or indeed generally by blocking the channels of trade. It may do so unwittingly by concluding a treaty with a single country which blocks the natural outlet for the exports of a third party. The whole network of trade and trade balances, dependent as they are on the distribution of natural resources, industrial capacity and foreign-owned capital throughout the world, is so complex that this is likely to happen unless the greatest foresight is shown. But for every government to study independently the play of the forces determining trade channels and the pattern those channels form is obviously impossible. This is work for a central organ of governments, in the light of which policy should be directed. So long as commercial agreements are looked upon as a form of horse coping on a grand scale between pairs of governments, there is little hope of policy being so directed.

An international organ might, we believe, help governments to devise commercial policies conducive to economic stability in three different ways:

(a) By studying and analyzing the facts concerning the development of trade, the interdependence of different trading areas, the trade in different groups of commodities, the movements in prices, and the changes in the terms of trade;

(b) By giving advice about means for promoting trade, for clearing blocked channels of trade, about the difficulties arising from sudden changes in production or in the competitive power of different areas, etc.; possibly, in the execution of its advisory functions, participating in trade negotiations between governments in order to watch the effects of proposals submitted during such negotiations on the whole body of trading nations and on the general development of trade;

(c) By mediating, when so requested, in connection with both direct disputes between states, and on such wider issues as the formation of Customs unions.

The primary function of such a body should be advisory. It should analyze and study the facts, prepare careful plans for the promotion of trade between groups of countries or along this or that natural transfer route and endeavour by bringing the parties together, by demonstration of the benefits that would arise, by persuasion, to secure the adoption of its proposals.

II. INTERNATIONAL ORGANS

In the course of this chapter we have mentioned a number of international functions which will require to be performed by appropriate organs whether temporary or permanent. Some of these functions, such as those relating to commercial policy or the co-ordination of policies for maintaining full employment, are advisory in nature; others—those of the tonnage board and those relating to the immediate post-war distribution of scarce materials, to the stabilization of raw material prices, to long-term investment—are executive; others again such as those of the Clearing or Equalization Fund are partly advisory and partly executive. Some of these functions, for instance that of relief, will be required, we hope, for but a short period; others will change and develop. It has not been our purpose to draw up any exhaustive list or to attempt to deal in this report with more than a selected number of the infinite range of problems that the transition from war to peace economy must raise.

But with regard both to the special international functions that we have mentioned and to others that may be required, and with regard also to the organs that may be entrusted with their execu-

tion, we desire in conclusion to make two remarks. First, if we are to avoid international economic anarchism, an anarchism which would be rendered rather more than less dangerous by the existence of a number of high-powered but headless international organs, means must be found for coordinating their policies. Secondly, economic policy must be correlated with political. Economic issues form a major part of political life. All political action has economic effects. Military security cannot be devised in an economic vacuum, nor economic security in the face of the threat of war.

ANNEX I

WARTIME INTERNATIONAL AGENCIES

(i) *The Combined Food Board*, a policy-influencing rather than a policy-making body composed of the United States Secretary of Agriculture and the head of the British Food Mission in Washington, which considers problems concerning the supply, production, transportation, disposal, allocation or disposition of food and food-producing equipment.

(ii) *The Combined Raw Materials Board* which allocates strategic materials controlled by the United States and Great Britain among the United Nations and collaborates with other countries to secure the maximum development and utilization of their raw material resources. This Board has recommended specific production projects in many parts of the world.

(iii) *The Combined Production and Resources Board*, consisting of the Chairman of the United States War Production Board, the British Minister of Production and a Canadian representative which combines the war production programmes of these three nations in a single, integrated programme to meet the military requirements and the essential civilian needs of the United Nations as a whole. One of the Board's prime objectives is to achieve such a utilization of the resources of the three countries as will require a minimum of shipping space.

(iv) *The Inter-Allied Committee on Post-War Requirements*, which is collecting and collating the data provided by the European Allied Governments on their postwar needs for foodstuffs, raw materials and articles of prime necessity.

(v) *The International Wheat Council*, composed of representatives of the United States, Canada, Australia, Argentina and the United Kingdom which deals with the administration under the Wheat Agreement of production controls, stocks and exports and the pooling of wheat for postwar relief purposes.

(vi) *The Munitions Assignment Board*, with two co-ordinate branches, sitting in London and Washington, which assigns munitions produced in the United Kingdom and the United States to the fighting forces of any of the United Nations. It also integrates requirements and specifications of the various nations in order to standardize production.

(vii) *The Combined Shipping Adjustment Board*, which integrates the shipping policies of the British Ministry of War Transport and the American War Shipping Administration as well as the movements of the Norwegian, Netherlands and other United Nations fleets chartered to these two agencies.

ANNEX II

1. EXTRACT FROM THE "PRELIMINARY DRAFT OUTLINE OF PROPOSAL FOR A UNITED AND ASSOCIATED NATIONS STABILIZATION FUND" ISSUED BY THE UNITED STATES TREASURY ON APRIL 6, 1943.

I. PURPOSES OF THE FUND

1. To stabilize the foreign exchange rates of the currencies of the United Nations and nations associated with them.
2. To shorten the periods and lessen the degree of disequilibrium in the international balance of payments of member countries.
3. To help create conditions under which the smooth flow of foreign trade and of productive capital among the member countries will be fostered.
4. To facilitate the effective utilization of the abnormal foreign balances accumulating in some countries as a consequence of the war situation.
5. To reduce the use of foreign exchange controls that interfere with world trade and the international flow of productive capital.
6. To help eliminate bilateral exchange clearing arrangements, multiple currency devices, and discriminatory foreign exchange practices.

2. EXTRACT FROM THE WHITE PAPER, DATED APRIL 7, 1943, CONTAINING PROPOSALS BY BRITISH EXPERTS FOR AN INTERNATIONAL CLEARING UNION.

I. THE OBJECTS OF THE PLAN

About the primary objects of an improved system of international currency there is, today, a wide measure of agreement:—

(a) We need an instrument of international currency having general acceptability between nations, so that blocked balances and bilateral clearings are unnecessary; that is to say, an instrument of currency used by each nation in its transactions with other nations, operating through whatever national organ, such as a treasury or a central bank, is most appropriate, private individuals, businesses and banks other than central banks, each continuing to use its own national currency as heretofore.

(b) We need an orderly and agreed method of determining the relative exchange values of national currency units, so that unilateral action and competitive exchange depreciations are prevented.

(c) We need a *quantum* of international currency, which is neither determined in an unpredictable and irrelevant manner as, for example, by the technical progress of the gold industry, nor subject to large variations depending on the gold reserve policies of individual countries; but is governed by the actual current requirements of world commerce, and is also

capable of deliberate expansion and contraction to offset deflationary and inflationary tendencies in effective world demand.

(d) We need a system possessed of an internal stabilizing mechanism by which pressure is exercised on any country whose balance of payments with the rest of the world is departing from equilibrium in either direction, so as to prevent movements which must create for its neighbours an equal but opposite want of balance.

(e) We need an agreed plan for starting off every country after the war with a stock of reserves appropriate to its importance in world commerce, so that without due anxiety it can set its house in order during the transitional period to full peace-time conditions.

(f) We need a central institution of a purely technical and non-political character, to aid and support other international institutions concerned with the planning and regulation of the world's economic life.

(g) More generally, we need a means of reassurance to a troubled world, by which any country whose own affairs are conducted with due prudence is relieved of anxiety, for causes which are not of its own making, concerning its ability to meet its international liabilities; and which will, therefore, make unnecessary those methods of restriction and discrimination which countries have adopted hitherto, not on their merits, but as measures of self-protection from disruptive outside forces.

ANNEX III

SUMMARY OF THE REPORT

INTRODUCTION

The report opens with a statement of the objectives of postwar economic policy. These objectives, it is suggested, should be to assure

(a) that the fullest possible use is made of the resources of production, human and material, of the skill and enterprise of the individual, of available scientific discoveries and inventions, so as to attain and maintain in all countries a stable economy and rising standards of living;

(b) that in so far as possible, no man or woman able and willing to work should be unable to obtain employment for periods of time longer than is needed to transfer from one occupation to another or, when necessary, to acquire a new skill;

(c) that in the use of these productive resources, the provision of goods and services to meet the essential physiological needs of all classes of the population in food, clothing, house room and medical care is a prime consideration;

(d) that society distribute, as far as possible, the risk to the individual resulting from interruption or reduction of earning power;

(e) that the liberty of each individual to choose his own occupation is respected and is promoted by equal educational opportunities;

(f) that the liberty of each country to share in the markets of the world and thus to obtain access to the raw materials and manufactured goods bought and sold on those markets is promoted by the progressive removal of obstructions to trade;

(g) that the benefits of modern methods of production are made available to all peoples both by the progressive removal of obstructions to trade and by courageous international measures of reconstruction and development.

However difficult such objectives may be to attain, their acceptance, it is felt, should make it easier to avoid or mitigate economic depressions in the future. Part II of the Report will deal with these longer term issues; Part I now published is confined to problems of the transition period.

The emphasis laid on maintaining employment does not imply that the disastrous effects of depressions on agricultural countries is overlooked. But the responsibility for securing greater economic stability and for accelerating economic development must lie primarily with the industrial countries.

The second objective is discussed at some length in a section of the

Introduction entitled "The Right to Work." This term does not, it is pointed out, imply that no person should be unemployed while in search of a job, but rather that governments are responsible for avoiding large-scale and protracted unemployment. This they can only hope to do if they have adequate powers, the backing of public opinion, and especially the support of employers and workers in checking monopolistic practices.

The last section of the Introduction traces the struggle in the 'twenties to restore a working and world-wide economic system and the breakdown of that system in the 'thirties. Owing to that breakdown, statesmen will be faced with a triple task

- (a) of reconstructing a world system;
- (b) of assuring as smooth as possible a transition from war to peace economy;
- (c) of seeing that forces giving rise to renewed depressions are counteracted.

The report is mainly concerned with the means by which a smooth transition may be effected from war to peace economy and conditions restored under which private enterprise may flourish; but no assumption is made regarding the socio-economic system or the degree of participation or supervision of the State in economic life that may be desired in different countries. It is, however, postulated throughout the report that peace is restored in such a manner as to revive confidence, and that therefore an effective system of collective security is established.

CHAPTER I

The first chapter describes those characteristics of war economy and those effects of the war itself that are likely to involve difficult problems of readjustment—the shifts in demand; the structural changes, national and international; the pent-up demand and purchasing power; the growth of debt; the changes in the international distribution of capital, the destruction wrought by war, etc.

CHAPTER II

The second chapter is primarily concerned with the problems of transition in countries in which the possibility of maintaining full employment after the war is not likely to be impeded by lack of raw materials or inability to buy them abroad. It opens with a consideration of the probable nature of postwar demand in these countries and the risk of this leading to a runaway price boom and subsequent collapse and unemployment. In view of this risk it is urged that measures taken to control prices and effect an equitable distribution of supplies, whether to the producer or to the consumer, should not be abandoned suddenly but relaxed gradually as shortages are overcome. The different types of control, financial and physical, and the different types of demand—for consumers' durable and

non-durable goods, for machinery and other capital goods, for raw materials, etc.—are successively surveyed. In every case the main preoccupation is to get men re-employed and production redirected towards consumers' needs when the war demand falls off, as rapidly as may be possible without causing a boom and consequential slump.

Although the shift from government to private demand will perhaps be a major characteristic of the transition period, government orders and public works are bound to play an important role in facilitating or impeding a smooth transition. Two major dangers are foreseen: the first is that projects indispensable for getting the whole national or international economic mechanism functioning again will not be ready; the second, that governments will hamper economic recovery by launching too many schemes or launching them at the wrong moment. In many countries, especially in Europe and Asia, the repair of damage suffered during the war will be an urgent necessity. But it is suggested that when projects can be postponed, governments should rather endeavour to fill gaps in demand than to compete with the market. When the first onrush of consumers' demand is spent, postponed government undertakings may exercise a useful stabilizing influence.

Stress is laid in this chapter on the importance of fiscal policies which will encourage enterprise and of government schemes for teaching new skills to meet the new needs that will arise and for helping workers find employment.

CHAPTER III

The third chapter deals with the international problems of transition and emphasizes in its first two sections the need for government action and international co-operation. The lack of any general international plan for getting business started in the war-stricken areas after the 1918 Armistice was, it is argued, an important cause of the economic breakdown in Europe and the collapse of currencies in the 'twenties. The difficulties after this war are likely to be even greater than they were in 1918 and the need for an agreed plan of action imperative.

Many of the countries whose needs of food and of raw materials and capital goods to reconstruct their economic life are likely to be most pressing will lack adequate means of making payments abroad. Their problem is obviously an international one, and, unless it is solved, the whole future of international economic relationships may be jeopardised.

Relief.

In so far as relief is required, its purpose should not be simply to feed and clothe starving populations but to enable them to produce and exchange what they produce and so feed and clothe themselves. Relief and reconstruction, it is urged, should be looked upon as a single problem, the problem of restarting productive activity and world trade. It is a problem,

therefore, in which all nations are concerned, the solution of which will depend upon the willingness of states, large or small, to participate in a common effort.

Effective programmes of relief and reconstruction will depend on the availability of the essential foodstuffs, raw materials and other goods and therefore upon the equitable distribution of supplies while supplies are short. For this reason an international understanding is advocated regarding changes in rations and in the maximum prices fixed for rationed goods in the early postwar period.

The International Demand for Crude Products.

In order to prevent a scramble for raw products, tonnage, etc., it is recommended that governments should continue or institute a machinery for the purchase and international distribution of such products and for joint control of tonnage so long as serious shortages persist. As supplies of raw materials become more plentiful, this machinery might be employed to stabilise prices by co-ordinating supply and demand and, in some cases, by the creation of buffer stocks.

International Demand for Capital and Credit.

International funds will be required for a number of purposes. There will be

(a) in the first instance, a demand for food, raw materials and certain finished goods to feed and clothe the populations and gradually to restart production in the stricken areas;

(b) a demand for capital, domestic and foreign, to repair the physical damage and make good the wear and tear suffered during the war;

(c) a demand for capital, for the reserves of Banks of Issue and for exchange stabilization funds adequate to permit of adjustments required on account of balance of payments difficulties;

(d) finally, a demand for capital for the development and reorganization of the industrial structure in countries where boundaries are modified, where the existing structure has been rendered inappropriate to the postwar world distribution of productive capacity, in countries suffering from demographic pressure and in countries which are in the process of industrialization and are themselves poor in capital.

The availability of funds is likely to be dependent, *inter alia*, upon the relaxation of exchange controls and the possibilities of effecting multilateral clearing and conducting multilateral trade. For this reason among others, the recent United States and British Treasury proposals to establish some form of international clearing or equalization fund are welcomed.

Exchange Control and Multilateral Clearing.

Amongst other objectives these proposals aim at establishing a system by which (1) multilateral trade may be resumed as rapidly as possible and blocked balances and bilateral clearings rendered unnecessary; (2)

national price levels which are out of gear may be brought again into mesh with one another and (8) the disequilibria in balances of payments may be adjusted. These aims are discussed with reference to post-war problems, the general outline of which is already apparent.

The Control of Inflation.

Attention is drawn to the risk that postwar inflation in the war areas may endanger the best laid plans unless effective steps are taken to halt it. Adequate assistance in the initial provision of foodstuffs, raw materials, etc., the institution of such a mechanism as that just mentioned for the revival of international trade on a multilateral basis, and appropriate commercial policies should, it is felt, do much to diminish this risk.

Various measures have been taken in Continental Europe to prevent the currency inflation which has already taken place from having its full effect on prices, and measures of this kind will no doubt continue to be required after liberation. But much will depend on the policies adopted in these areas as they are liberated—on the rate of exchange fixed for their currencies, on the extent to which pay received by the Allied armies is expended on local goods, on the extent to which liberation is accompanied by economic aid and that aid can be employed for mopping up part of the surplus currency. But the ability of countries to check inflation will depend above all on the authority of national governments, on political security and on the availability of foreign markets.

Long-term Lending.

Certain principles regarding foreign lending are formulated which anticipate to some extent Part II of the Report, as the question of lending is considered primarily in connection with the long-term problem of the maintenance of economic stability.

(a) While it is taken for granted that direct government lending will probably be indispensable, it is pointed out that lending on an equity basis, or failing this by some form of income debentures, would impose a less severe strain on the balance of payments of the borrowing country when prices fall.

(b) When loans are made to governments, they should be at as low a rate of interest as possible and allow contractually for the possibility of suspension of amortization in bad times.

(c) Preference should be given to capital expenditures required for the purchase of reproductive commodities, such as machinery or locomotives.

(d) When such preference proves impossible, careful control should be exercised over the import of what to the receiving country may be fairly classed as luxury goods.

(e) Adequate labour standards in the borrowing countries should be required.

Commercial Policy.

However important the contribution of an international clearing fund towards the restoration of world trade, that restoration can, the Report points out, neither be complete nor permanent if commercial policies run counter to the fundamental factors in the balance of payments situation. The war is producing profound changes in the structure of international claims and indebtedness which could best be met by such changes in commercial policy as will permit a substantial increase in the purchase of foreign goods by those countries whose creditor position has been strengthened.

Bilateralism and autarky have been largely the product of economic and political insecurity. But for several reasons the system of multilateral trade based on M.F.N. became somewhat discredited in the inter-war years:

(a) Countries have been unwilling to extend concessions to others which made no such concessions.

(b) The M.F.N. clause was on certain occasions used to prevent the conclusion of special customs arrangements between small countries.

(c) One reason for the discriminatory tariff specifications which often rendered the clause of little value to third parties was the fear of competition from countries with low standards of wages and of living.

The first of these difficulties might be partly solved by the total abolition of non-negotiable tariffs. There is, it is submitted, no single or simple solution of the others; but a very real service might be rendered by an international body with adequate authority which might help governments devise commercial policies conducive to economic stability in three different ways:

(a) by studying and analyzing the facts concerning the development of trade, the interdependence of different trading areas, the trade in different groups of commodities, the movement in prices, and the changes in the terms of trade;

(b) by giving advice about means for promoting trade, for clearing blocked channels of trade, about the difficulties arising from sudden changes in production or in the competitive power of different areas, etc.;

(c) by mediating, when so requested, in connection with both direct disputes between states, and on such wider issues as the formation of customs unions.

International Organs.

Two points are emphasized in conclusion: first, that means must be found for co-ordinating the policies of the various international organs which may prove necessary; secondly, that economic policy must be correlated with political. Military security cannot be devised in an economic vacuum nor economic security in the face of the threat of war.

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