Should Sterling be devalued?

by

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The Marshall Plan and Western European reconstruction have plainly arrived at a most critical point. The next six months must give an answer to the question whether the steady improvement which we witnessed in 1948 will continue. The progress towards re-establishing the disturbed equilibrium between Europe and the Western Hemisphere was admittedly slower than the internal recovery in the former. But one could hope that the practical demonstration of the success of the conception underlying the Marshall Plan would lead to its broadening and intensification in order to reduce the grave discrepancy in the international distribution of wealth and income.

The U.S. slump inevitably complicates and aggravates the long-term problem of the dollar shortage from which, however, it should be severely distinguished. It will inevitably depress U.S. demand and increase the pressure of U.S. exports. It will therefore worsen the dollar shortage. Thus it underlines the importance of reinforcing the policy of Marshall Aid and Mr. Truman's Fourth Point as the only hopeful way of escaping from a competitive vicious circle of deflation and depreciation. It would be a mistake to suppose that a premature abandonment of the discriminatory unification of Western Europe as an economic unit and planned expansion of its trade with other countries would lead to anything but a catastrophic drop in international trade and income.

Unfortunately the short-sighted pressure of American business to secure foreign markets has led to a recrudescence of the earlier « free market » dogmas associated with the names of Mr. Cordell Hull and Mr. Clayton. Ignoring the fact that dollar purchases are limited by the supply of dollars only they demand a devaluation of European currencies and a restoration of convertibility at least within Western Europe. Especially the need and probability of the devaluation of sterling is being canvassed with unfavourable consequences on British exports.

No-one would deny that there is always a degree of deflation and unemployment which will balance the current account of any country at any rate of exchange without restrictions. But the question is whether the position then reached will represent the highest standard of life in the poorer countries. In the present paper the view will be put forward that it is likely to endanger the recovery in Europe and lead to unnecessary hardship. In particular it will be contended that:

(a) devaluation *at present* would do little to improve our dollar unbalance and might worsen it;

(b) apart from the grievous consequences of the decrease of U.S. imports there is little reason to fear increased competition of the U.S. in « third » markets so long as pressure in favour of (even partial) convertibility of European currencies into gold or dollars is resisted;

(c) on the other hand a devaluation might lead to a breakdown in the policy of price stabilisation and thus of the policy of planned full employment;

(d) in the meantime the Export Credits Guarantee Department should be enabled to grant insurance policies against devaluation so as to remove the unfavourable effects of the irresponsible talk about an impending devaluation on current exports;

(e) eventually, when the extent of the U.S. slump and the nature of the measures contemplated in that country are better known, a readjustment of all currencies might be contemplated, combined possibly with a revaluation of gold;

(f) immediate steps should be taken to call a Western economic conference to take steps to arrest the threatening slump emanating from the U.S.

1. Two somewhat divergent arguments are used to support devaluation in the immediate future.

(a) It is suggested that the U.S. slump would aggravate the direct dollar gap: the U.S. will undoubtedly buy less in Great Britain and the sterling area. Devaluation is, therefore, advocated to counteract the effects of the slump, by cheapening British exports.

(b) It is argued that there is growing discrepancy between British (European) and American export prices. Hence British (European) manufactures will be displaced by American exports, thus impeding the restoration of economic viability to which we are pledged by the Marshall Plan.

2. The first line argument implicitly applies to the present highly peculiar position considerations which are based on assumptions which do not hold. In particular it is assumed that world demand is given and will not be affected by devaluation, and that free competition obtains (that is, that international markets are perfect). This is patently untrue.

It is not specified whether an *isolated* move by Britain is to be contemplated or a *general* revaluation of currencies in terms of the dollar. Nor are there any indications given as to the quantitative aspect of the measure. It should be remembered, however, that the Bretton Woods agreement precludes a unilateral devaluation of a currency (*i.e.* a devaluation without the consent of the Fund) by more than ten per cent and that in principle only countries which suffer from « fundamental disequilibrium » can ask for permission to change the value of their monetary unit. Most countries, one presumes, would qualify on the latter ground for permission to devalue their currency. They all suffer from a dollar shortage. Most of them also suffered from a sterling shortage and only the more liberal attitude on non-essential imports and the release of blocked balances has ameliorated their position.

The question is therefore resolved into what degree of devaluation is to be contemplated by most countries (1). A unilateral devaluation of the £ not followed by most other currencies can be ruled out as extremely improbable (2). On the contrary it is probable that in a race of competitive devaluation, sterling will not on the whole (as happened in the 1930s) be left behind, having eventually a greater rather than a smaller problem to face in its relation to the non-dollar area. The relation of the smaller countries to Britain and the sterling area is more vulnerable than the position of the non-dollar countries as a whole to the United States. As the following table shows, their trade with each other has been much more evenly balanced. A disruption of this trade, which has been intensified at great cost and effort, coming on top of the dollar shortage would hardly be bearable.

THE TRADE OF O.E.E.C. COUNTRIES WITH NON-PARTICIPANTS (3)

Period	Dollar trade		Non-dollar trade		Total	
	Exports	Imports	Exports	Imports	Exports	Imports
1948–49	1,539	6,340	4,614	6,131	6,153	12,471
1949–50	1,921	6,326	5,341	6,238	7,262	12,564

(1) It is difficult to feel that even countries like Belgium could be kept at the present parity with the U.S. if most others devalued. Their severe unemployment would be further accentuated. Even in cases such as Australia whose most important export prices are determined by the dollar market would hardly be able to maintain the old parity on account of the pressure of imports on their own industries. The German and Japanese parities are determined by the Allied (U.S.) Occupation Authorities. But it is difficult to believe that in the case of either those Authorities would be willing to face the worsening of the balance of trade and of unemployment inevitable if they did not follow their non-dollar currencies.

(2) Indeed it is more probable that the problem of sterling will arise as a result of a devaluation of the currencies of those European countries which have adopted a more or less laisser-faire policy. From the point of view of effective planning of their recovery and of social justice decontrol was obviously premature. And a devaluation will further worsen internal social conditions because of the fall in real wages, which is its first impact effect. Nevertheless it will be as difficult to isolate Britain from the effects of a devaluation in Europe (as the growing unemployment will lengthen the period of wage adjustments) as it would be for the Continental countries to ward off the consequences of an isolated British devaluation. It is this point at which the fate of an ordered European reconstruction will in effect be decided.

(3) O.E.E.C. Report on the 1949/50 Programme, Tables II and IV, pp. 115 and 117.

The problem of the degree of devaluation necessary will be determined mainly by the flexibility of European demand for dollar imports and the changes of U.S. demand for European exports. We must bear in mind, however, that these relations are exceedingly complex: they are by no means determined by the reactions of buyers to price changes alone (4).

(a) On the European side imports from the U.S. are not in most countries (and certainly not in Britain) limited by an interaction of domestic price and income but are directly determined by direct regulation (5). Devaluation and a rise in price as such would, therefore, not necessarily affect them. A cut in imports from the U.S. as they represent necessities, would have to be enforced by rigorous measures directly cutting demand or, alternatively, by a general and severe deflation. In the case of Britain the visible import surplus from the United States which in 1948 had been reduced to below £ 10 million per month (£ 113.6 m.) has in the first two months of this year again risen to £ 11.5 and £ 12.8 million respectively. The Canadian trade showed a deficit of £ 12.3 (£ 149.4 m. for the year) and £ 8.1 and £ 9.7 million respectively. Imports from these two countries were running last year at an average monthly level of £ 15.4 and £ 18.1 million respectively.

The share of imports from the Western Hemisphere was to have decreased from 46 per cent in 1947 (or £ 697.4 m. of which £ 121.8 m. Argentine and £ 168.2 the rest of the hemisphere) to 28 per cent in the first half of 1949) (6). Moreover part of the Western Hemisphere imports (*e.g.* Argentina) need no longer be reckoned as dollar imports as they are not burdened with a convertibility clause and British export capacity is being restored. Nevertheless the residue, especially Canadian wheat and U.S. tobacco, consists of items difficult to compress. Nevertheless cuts will have to be undertaken, especially with respect to petroleum, paper-pulp, etc. imports if only to strengthen our bargaining power (by showing the disastrous consequences of the present trend to the U.S. herself). It should be noted, however, that such measures would in part aggravate the problem of Western Europe as Britain would force them to switch from sterling to dollar purchases. But this power of curtailing European sterling supplies may be valuable when it comes to working out a common policy for Western Europe. Should the volume of dollars available for imports from U.S. be severely cut the reintroduction and cutting of rations will have to be considered in order to equalise the sacrifice enforced. In any case no further relaxation of control at any stage of the production process involving dollar supplies must be contemplated.

So long as the U.S. deflation continues unabated, the argument for devaluation as a means of cutting imports would favour not a devaluation of a fixed percentage but « letting the pound (and other European currencies) finds its own level », *i.e.* the abandonment of a fixed parity with the dollar, as U.S. prices will fall further, necessitating a repetition of the experiment. The effect of this policy on confidence and thus on the capacity of the Authorities to enforce exchange controls, however, would be devastating. The advocates of devaluation therefore must be in favour not merely of devaluation but also of the simultaneous adoption of deflation and decontrol. They do not hope for « equilibrium » from a « *cut in prices* but really *from unemployment and a fall in demand*. No doubt almost any rate of exchange is compatible with « equilibrium » in this sense. But it cannot be held to « maximise » welfare in any sense of the word.

(b) The case is equally weak so far as exports are concerned. The most massive of sterling exports to America consist of raw materials and foodstuffs from the sterling area and their

(4) Cf. my essay « The International Implications of Full Employment ». Oxford Institute of Statistics *Economics of Full Employment*, 1944, esp. pp. 152-4.

(5) It depends directly on the supply of dollars.

(6) The impact effect of a (say) 20 per cent devaluation with respect to Northern North America and dependencies only (and provided there is no fall in prices in that area as a result of the devaluation) would increase the price of roughly 10 per cent of total available supplies in Britain. This represents an increase in sterling price of some £. 100 millions as dollar imports amount to, say, £. 500 m. out of a total supply of goods of some £. 6,000 m. Thus devaluation would raise the price-index by perhaps 2 per cent. It is to be feared, however, that even an almost imperceptible rise might unleash wage-demands of much greater magnitude as wage stabilisation has been subjected to a number of irritating strains already.

dollar price is fixed by American demand (7). Indeed an increase in supply consequent to an increase in £ prices due to devaluation might cause a further fall in total proceeds, as demand is not likely to increase with declining dollar price. There is no appreciable competitive supply available in the Western Hemisphere which could be displaced by sterling exports. The most important are as follows:

Merchandise	in $ m.
Cocoa	193.7
Tea	45.1
Rubber	320.6
Sisal	34.4
Whisky	62.7
Wool	307.7
Gold U.K.	1,095.4
» S.A.	491.4
» Br. Pac. Islands	2.6
Total from U.K. (excl. whisky)	202

It is much to be hoped that the U.S. Government will accelerate the stockpiling programme and similar measures to stabilise the increase of primary producers hitherto postponed for fear of creating inflation. It would be folly to permit the foundering of non-Soviet recovery at this stage. This would be the most important step in stabilising the supply of dollars to Europe.

As far as direct British exports to America are concerned, it is not probable that American demand would expand sufficiently if British exports are made generally (in contrast to *selectively*) cheaper as to more than offset the fall in dollar prices, especially if Britain tried to force the pace during a depression. The American markets for British products are mostly limited because outlets to, and knowledge on the part of, the final consumer in the Middle and Far West of America are lacking. Even in the Eastern Seaboard they are little known. It is the imperfection of markets, the consequences of U.S. product differentiation and advertising which are the main obstacles in increasing sales, apart from the U.S. protectionism. To open up a market represents a heavy capital investment and this capital investment is only practicable if the extreme uncertainties consequent on the vagaries of American customs procedure and tariff policy could be eliminated (8). Even then it seems unlikely that the typical small firm in Britain could do much. The larger firms have their own factories or are allied to American factories and will not compete there.

A collective (trade or state) financed sales campaign and the establishment of collective representation of British industry in the U.S. is a much more hopeful method (9). If successful, however, it would come up against vehement hostility, especially in a period of declining prices and output. The insistent gossip about a pending devaluation of sterling has created an objective problem in relation to all countries which do not expect to follow sterling. In all these countries importers will be chary in committing themselves to orders as they hope for a fall in prices (in terms of their currencies). Denials, however profuse, do not eliminate this effect. In order to counter the danger the Export Credit Guarantee Department might be instructed to issue 6 months insurance policies against devaluation, or the Bank of England should sell 6 months forward dollars against sterling, against legitimate exports to hard currency areas.

These observations would seem to hold good for any situation in which there is no over employement, in which, that is, U.S. demand does not increase at a rate faster than U.S. productive capacity.

It would be possible to stimulate American demand for foreign imports by a simplification

(7) The authorities fortunately seem to have retreated from the principles of Bretton Woods which prescribed devaluation as the panacea for « fundamental disequilibrium ». It is curious that it has only recently been realized that so far as the dollar area is concerned, the sterling area is a *primary producer* and not a manufacturing world demand and the consequent *improvement* of the terms of trade of the U.K. *proper* (as against the sterling area) aggravates rather than improves the dollar gap. It is, moreover, certain that (being exporters of luxuries and capital goods rather than basic necessities) our volume of trade suffers more than proportionately when world demand declines.

(8) The importance of customs procedure is shown by the fact that while average duty collected on dutiable commodities has decreased from 36 per cent in 1938 to 25.4 per cent in 1946, 19.4 per cent in 1947 and 13.7 per cent in 1948, the volume of dutiable imports did not increase more than could be expected from the increase in non-American production and in the U.S. national income.

(9) The extreme respectability of the new U.K. Export Committee and their limited power do not presage a very aggressive and successful sales campaign.

of customs regulations and practices or by a unilateral abolition or lowering of the U.S. tariffs. Certain promises have been made with regard to the former at the time of the conclusion of the General Agreement on Tariffs. Their implementation is as yet uncertain because of the unlikelihood of any early consent of Congress. The general reduction of U.S. tariffs has had disappointing results. While the maintenance of quantitative regulations by most countries outside the U.S. has had the effect of bringing about a *de facto* unilateral decrease of American protection, *de jure* the concessions were multilateral and balancing. The U.S. however retained the right of revoking concessions should they prove « detrimental » to domestic producers. This uncertainty must have had (even apart from the stringent customs procedure) a discouraging effect on would-be foreign exporters to the U.S.

Uncertainty has been further increased by the recent slump in the U.S. While national income has only fallen from 233 billion to 220 billion, or 5 per cent, imports in May show a decline of not less than 14 per cent or almost double the rate. The apprehension that U.S. marginal propensity to import was relatively higher than the average (though absolutely still very low at even the 1948 demand levels) seems to be borne out (10). A total decline of U.S. imports from 7.1 billion in 1948 to the level of 1947 (5.7 billion) is a distinct possibility and a considerable part of the loss might well fall on the sterling area. The fall in the supply of dollars might represent a large portion of U.S. exports to this area which they now contribute to finance.

We must conclude that the argument for devaluing sterling (and other non-dollar currencies) has little to commend itself at the moment. It is unlikely to improve the dollar balance and might worsen it. In any case it is bound to depress the standard of living unnecessarily and might retard an inflationary spiral.

(10) It must be feared that an aggravation of slump will make even greater inroads on imports as the demand for motorcars, which has not yet been affected, will also certainly begin to suffer. An attempt at aggressive competition by Europe would under those circumstances have serious political consequences on the U.S. domestic scene, and, thus, on the fate of E.R.P.

3. Another train of thought represented by the more sophisticated critics (*e.g.* the *Economist*) argues that devaluation has become necessary, not so much because of the desire to gain American markets but because of the need to retain third markets against American competition. This is a more plausible argument but one which is still not sufficiently discriminating.

(i) We must, first of all, differentiate between a discrepancy of prices due to a disproportionately large increase in British wages; a discrepancy due to discriminating high prices being charged for exports, and, last but by no means least, the consequences of a redirection of imports from the dollar towards the sterling and other « soft » currency areas.

(a) Calculations made by the Economic Commission for Europe (11) show that British wages per hour increased 14 per cent less than those in the United States, if account is taken of the depreciation of the pound in 1939 (12). Productivity in the latter, however, increased more than in the U.K. Relative efficiency wages, therefore, are practically unchanged. Such calculations are subject to a large margin of error; they leave out of account the need for increased European exports but they tend to show that the pressure on Europe originates in the much higher rate of technical progress in the U.S. and her more aggressive selling policies which secure important monopolistic advantages for her products (*e.g.* tied loans). It is probable that the depression will very much increase this pressure, to which all other European countries are also exposed. The explanation is provided by the colossal expansion in the U.S. during and immediately after the war, when Europe and other countries were in the doldrums. It would be contrary to the spirit of the Marshall Plan if readjustment were to be enforced by a sudden sharp cut imposed on the European standard of life.

(11) *Ibid.*, p. 107, Table 68.

(12) This depreciation was also undertaken at a wrong moment as it lead to decreased dollar proceeds, despite of the fact that U.S. business was expanding. A subsequent adjustment during the war would have been entirely in accordance with the agreement put forward in this paper. The short and long term policies in these matters conflict and it depends on the historical situation when the switch between them should take place.

Unilateral U.S. help, *e.g.* by onesided tariff reductions or by Marshall Aid, might in due course diminish this particular cause of disequilibrium.

Thus the discrepancy between the price of British (European) and American supplies due to the higher rate of technical progress in the U.S. would make it desirable to discriminate multilaterally against American exports and thus deliberately to worsen U.S. terms of trade, if the British and European standard of life and employment are to be maintained without continued and increased direct aid. In other words, Europe needs better treatment in the U.S. and preferential treatment in other markets if the dollar shortage is to be eliminated and a return is to be made to « market economics » in international trade in the teeth of America's disproportionately growing competitive power, without a sharp rise in the international inequality of incomes.

(b) Secondly, attempts have been made by countries, including Britain and the soft currency area, to charge discriminately high prices for the exports of essential products to other soft currency areas, the discrimination being in proportion to the softness of the currency. Thus (so far as some of these deals are concerned) a system equivalent to a hidden devaluation of the soft currencies in varying proportions has been practised. The new report of the European Economic Committee (especially Chapter 5, sub-section 3) gives an excellent account, and tries to estimate the extent, of some of these discriminatory practices. In the case of steel up to 50 per cent, in the case of coal up to 100 per cent, discrepancy was found. The discrepancy between the home and export price index [February 1949 222 (1938 = 100) as against 192.3 for manufactures on the home market] shows that these practices are not restricted to a few instances. In so far as home market prices cannot be said to be below costs there is a very substantial margin in at least a considerable number of export prices for a readjustment without undue hardship and without devaluation. A roughly ten per cent cut in export prices should be manageable in the less competitive trades. But it is more favourable to Europe to cut export prices only where necessary and where some favourable result is likely instead of cutting it by a given proportion through devaluation.

Decontrol over a large field of home consumption even in Britain (not to talk of the Continent) has much weakened the power of the Authorities to force exports despite the possible fall of profit margins below those still obtainable in the home trade and tends to favour the adoption of a general deflationary policy in order to discourage home sales. In view of the unfavourable developments European Governments should take steps to restore those controls on home consumption (rationing and limitation of supplies) which would enable it to impose selective pressure on industry instead of having to enforce a general cut in incomes, consumption and consequently mass unemployment (13).

(c) The last problem involved in this growing price discrepancy is the problem of the redirection of trade due to the dollar shortage. Certain supplies which could hitherto be acquired in America must increasingly be purchased in the soft currency area. Accordingly, demand for sterling or other soft currency supplies has increased. This would inevitably have brought some disorder into price relations, tending to raise soft currency prices above dollar prices at official rates of exchange. The difficulties have, however, been increased by the almost simultaneous fall of demand and employment in the dollar area. This decline in the U.S. was not entirely due to the shift of European demand away from American markets though the latter must undoubtedly have intensified the trend. There is little that can be done by Europe to remedy this particular problem due to the exceptional position of the U.S. in the world economy. If as we have argued it is probable that Europe's dollar receipts for exports in the short run would decline as a result of deva-

(13) Direct subsidies can hardly be employed in our effort to capture the U.S. market. It would invite immediate retaliation. It might be worth investigating whether remission of taxation especially whether increases in depreciation allowances could not be granted in respect to exports to hard currency areas. The unexpected lag in establishing Development Councils which would have cooperated with Government agencies in overcoming sales resistance is much to be deplored. The finance of these expenditures by a general (and possibly graduated) levy on the whole output of the industries concerned could, moreover, have contributed in equalising the burden of selling in the U.S.

luation, then we should have to curtail further purchases from the dollar area. Thus unless we are content to cut income and employment, we should have to increase purchases elsewhere *i.e.* intensify the cause for the discrepancy between dollar and sterling prices as sterling prices will rise further. A vicious circle would be generated which would decrease the national income of England and other European countries unnecessarily while at the same time recreating the very same anomalies which we tried to overcome, until, if the « orthodox » solution were pursued far enough, « equilibrium » woud be insured by unemployment and the decline in the standard of life.

(ii) We must now consider the consequences of these price discrepancies on « third » markets. These markets can be divided into two categories.

There are, first of all, those which have at present dollar surpluses and, secondly, those which have no dollars or use all dollars they can obtain to purchase in the U.S. There are exceedingly few countries which are in the first favourable position; Malaya, because of rubber and tin, and West Africa because of cocoa, being the two important exceptions within the sterling area. Should the American slump worsen, obviously less countries will achieve this position, mainly because American imports from them will fall further. Moreover U.S. exporters will try to sell abroad even at prices which do not cover full costs, and thus attract dollars, now used multilaterally to cover imports from other non-dollar countries, who in their turn use the dollars to pay for U.S. exports. Thus the multilateral character of European trade which the U.S. will further diminish. The U.S. will not gain: instead of exporting primary products to Europe, she will export manufactures to tropical areas.

Nevertheless, as it would seem essential for Europe to try to obtain dollars by triangular trade, *e.g.* in South America, this argument must not be dismissed without due consideration.

(a) In the case of Malaya and West Africa the British Government can, by administrative measures, direct their demand for imports towards England. This would undoubtedly mean that they would lose, as they could make purchases at better terms in dollars. At a certain point the problem therefore would have to be resolved whether some compensation should not be granted in order to offset their loss, caused by the fact that they had to buy in the dearer sterling market. A devaluation of sterling would go some way in equalising supply prices. It would be most unfortunate, however, if non-dollar countries were to devalue on this account alone because of the consequent likely worsening of their *direct* balance with America.

At the moment the discrepancy between U.S. and other, especially U.K., prices is till within bounds. But in consequence of the U.S. slump it might become so wide as to render the maintenance of a prohibition of the use of « free » dollar balances in the U.S. by the surplus countries difficult to defend. Should there be any need for action to lessen the dollar-earning Colonies, indirect ways of compensation might be initiated, *e.g.* by giving these territories grants and thus enabling their decreasing indirect taxation falling on the poorer classes. There are, of course, a few other countries in the same position; in the case of which such complicated administrative arrangements are not possible. Only a few, like Israel, could be an important source of dollars. In these cases indirect measures might be employed in order to overcome the price difference. It was rumoured, for example, that Israel would be prepared to give Britain 60 cash for every £ 100 capital investment. Such schemes should be very carefully investigated. It is probable that there will be some falling off of exports and of employment. Unrequited exports which are combined with current transactions which bring in dollars and subsequently increase our invisible exports would represent an exceedingly profitable Public Works Programme.

In other cases outright subsidies will have to be considered to bring down the price of our exports (14), without worsening our terms of trade wich the U.S. It is sometimes argued that no further subsidies even for such vital purposes can be granted because taxation has reached its « limits ». This argument cannot

(14) Cf. however above on the disproportionately high prices of British exports, which should first be permitted to disappear.

be advanced by those who advocate devaluation. A devaluation means nothing more than a flat indirect tax on all imports and a flat subsidy on all exports. But, as we argued, it might not be wise to increase indirect taxation indiscriminately and equally on all imports; in the case of many exports moreover there is no need to grant an export subsidy which is automatically given by devaluation. A selective system of indirect taxation, plus subsidies, would therefore be less dangerous to the stabilisation policy than devaluation, and its incidence can be made juster. The only telling argument against this method is that it might be too difficult to administer. This argument has been used often before. In the majority of cases, after some time had been lost, events forced the adoption of the policy considered « impossible ». In view of the fact that only a small number of countries and a narrow range of commodities would fall into this category it would seem advisable to work out detailed programmes immediately.

It is unfortunately only too likely that our exports to the « dollar surplus » countries will suffer as a result of the decline in the American markets and the consequent decline in dollar prices and in the volume of U.S. purchases. Unless alternative (sterling) markets can be found in areas not affected by the U.S. slump, incomes and demand in these areas will decline. Thus both dollar earnings and British exports are likely to be affected. Far too little attention has as yet been paid to the problems of intra-sterling-area stabilisation (15).

(b) Secondly, there are countries which at the moment have no dollar « surplus ». These again can be divided into two categories: those who have no (considerable) dollar earnings at all and those who at present use what dollars they can obtain for purchases in the United States. Most of these countries would like to increase their purchases in the U.S. still further. They are prevented from doing so by their inability to obtain more dollars. Theoretically Britain (and Europe) could transform even the latter countries into « net dollar surplus » countries by displacing U.S. exports. And we might presume that those who wish this and other countries to devalue hope that such displacement could be effected.

The answer to this argument is that while it might theoretically be possible to displace American goods sufficiently to obtain dollars in this « triangular » fashion in practice it is not possible to do so in the short run as supplies now obtained in the United States are either not available elsewhere or if available are severely handicapped by market imperfections (taste etc.) in favour of the U.S. products. Nor is it evident that a competitive devaluation and deflation necessary to displace the U.S. by straight price competition will result in optimum real income in Europe.

It is a mistake to suppose that the U.S. depression will necessarily affect the volume of British (and European) exports to the non-dollar areas. There is no « manifest destiny » in the course of our trade. Provided we refuse to compete with American depression dumping and isolate ourselves, Europe might restrict the losses suffered by the U.S. slump to the consequences of the decline of American imports. These will in all possibility be serious (16). The overwhelming majority of the non-Communist world consists of countries which have no seizable dollar earnings or which spend such dollars they have on U.S. supplies. How much they buy in the U.S. is therefore determined by their dollar earnings. They cannot increase their purchases in the U.S. beyond that level however « cheap » American supplies may be. If they want to buy foreign goods (mainly manufactures) beyond the level permitted by their dollar earnings (even of the same general type as those which they buy from the U.S.) they can only buy these from countries to which they can sell and earn foreign exchange, *i.e.* Britain and Europe. Moreover it is more important for them to sell at relatively attractive prices than to snatch transitory profits by buying cheaply because they must be well aware of the fact that the inevitable and ultimate consequence of the transitory gain by « buying cheap » will be that their export prices will also be cut. That this is being realized is

(15) Cf. p. 16.

(16) It might be advisable to explore the possibility of instituting buffer pools in the European-sterling Area system to maintain the income of primary producers should a negotiation with the U.S. not result in joint action of all Western Powers.

shown by the successful conclusion of a 5-year agreement with Argentina which circumvents the dollar shortage (17).

It might be objected that they will refuse to buy the same goods « dearer » elsewhere than they can obtain them in the U.S. This objection is founded on a double fallacy. These countries cannot obtain all the goods they desire from the U.S. (over and above their dollar

EXPORTS AND IMPORTS OF MERCHANDISE
OF THE U.S. TO SELECTED COUNTRIES

(January-December 1948)
in $ million

Countries	Exports of domestic merchandise (1)	General imports
Europe	4,242	1,091
United Kingdom	637	283
Middle East	357	169
India (2)	297	266
Pakistan (2)	17	26
Ceylon	29	53
Burma	5	2
British Malaya	82	270
Netherlands Indies	92	76
Australia	114	129
New Guinea (Australian)	—	1
New Zealand	34	39
British Western Pacific Islands (3)	1	—
Western British Africa:		
Gold Coast	6	74
Nigeria	10	31
British West Africa, n.e.s. (St. Helena and Dependencies, Gambia and Sierra Leone)	1	1

(1) Export figures for 1948 include Army Civilian Supply shipments; figures for 1947 do not. Dollar values for Civilian Supply shipments for the twelve months ending December 1947 were as follows: Germany, 456,925,163; Austria, 32,687,413; Italy, 9,108,005; Korea, 57,426,591; Japan, 354,380,255.

(2) India Pakistan combined as India and Dependencies in 1947.

(3) Formerly reported as New Hebrides and Brithis Oceania n.e.s.

earnings) for they have no dollars. An attempt to extract dollars from their trading partners — as, for example, Belgium has attempted — would merely result in retaliatory decrease of their exports, for no country has « surplus » dollars. It is the dollar shortage which forces a decrease of U.S. exports and not the « wickedness » of « planners ». The *only* question which is open is whose purchases from the U.S. will be reduced. This question can be answered by planned distribution of available dollars (by those countries having relatively greater supply paying for some of their imports from their less favoured partners in dollars) or by an internecine struggle for dollars through competitive deflation and devaluation hoping to achieve extra-U.S. surpluses convertible into dollars (18). In the latter case they might try to snatch transitory gains by insisting on being paid in dollars in order to buy in the U.S. The consequence inevitably will be a further narrowing of trade. Thus gains obtained by buying « cheap » will fade as every country will find itself unable to export. Their own prices will begin to drop either because of an enforced deflation in Britain (and Europe) or because the value of their currency in terms of sterling (or other European currencies), has appreciated. The U.S. contagion will spread. On the other hand by concluding reciprocal purchase agreements and maintaining a tolerably stable price-level the consequences of the U.S. slump can be restricted to the losses suffered by not being able to sell to U.S. at better prices and in larger quantity. Even this will be inconvenient and might be extremely damaging; but the real catastrophe of a multiple shrinking of foreign trade could be avoided.

If we bear this in mind the clamour about « defending » « third » markets is difficult to understand (with the exception of those few in the first category which still have dollar surpluses).

The problem of the third countries is exactly analogous to our own. The import requirements from the U.S. at a tolerable standard of life are far higher than dollar earnings. In the short run the « free » play of price mechanism will not make available non-dollar supplies in sufficient quantity to take the place

(17) The reported protest of the U.S. against this agreement shows a regrettable lapse back to the Hull-Clayton theology. Nothing that Britain has done will diminish Argentinian purchases in the U.S. On the other hand no dollars are available to finance Argentinian purchases in the U.S. except by cutting British purchases. The Marshall Plan recognised that Britain would have to expand her sales to South America.

(18) The loss of gold by Britain of £. 12.2 million to Belgium, £. 5.6 million to Switzerland, and £. 4.7 million to Germany suggests that too little attention has been paid in the flush of recovery of 1948 to these questions.

(19) The uninterrupted increase of British imports indicates, however, that, as in 1946, the Government has relaxed controls too much. A repetition of the 1947 exchange crisis is a distinct possibility.

of goods now supplied by America. This is as much true of machinery and manufactures which South America needs, as it is of food and raw materials we need. If dollars *were* available, the change in taste towards American products, the superior capital resources enabling aggressive sales and the grant of credits, will attract sales to the United States. The drastic decrease in the standard of life needed to match U.S. competition without discrimination is politically so dangerous as to be ruled out. Nor could the nondollar world escape this dilemma by a general devaluation — because of the probable fall in dollar earnings and because of the consequent inevitable further aggravation of the U.S. slump.

There is not the slightest reason to doubt that even a partial convertibility of European currencies into dollars would now cause a wholesale restriction on European trade, especially if, as is unhappily probable, the American deflation continues, and an internecine struggle for dollars would be started. The inter-convertibility of currencies in Europe will follow as soon as a greater monetary unification has taken place in Europe. It is not possible so long as only Britain is engaged in keeping on an even keel, neither inflating nor deflating. Intra-European payments and trade should be encouraged. But this can be done most effectively by a tentative *relaxation of quantitative restrictions*. Even that would have to be accompanied by a much closer co-ordination of investment and general economic policies than has hitherto been the case. Dollar convertibility can be restored even partially after European reconstruction has succeeded in diminishing the inequality of opportunity between the two Continents, and the U.S. regained her equilibrium.

It is from this point of view that recent proposals in favour of « liberalising » intra-European trade must be judged (20). To these we now turn.

4. These considerations suggest that a devaluation of sterling and of other non-dollar currencies should not be contemplated as long as the extent of the U.S. slump is not calculable. A devaluation would aggravate the dollar shortage and might aggravate the slump and thus intensify the original problem. In the meantime the policy hitherto pursued by O.E.E.C. to strengthen the productive capacity of the non-dollars world should be intensified and steps taken to reinforce controls needed to isolate Europe from the consequences of the U.S. slump which would otherwise retard capital investment and thus slow down the increase in European productivity.

The essential task, as we have seen, is the prevention of a competitive struggle for dollars. In relation to non-American territories this could be achieved by reciprocal bulk purchase agreements. As most European (and British) imports are standardised this should present little difficulties. European (and British) exports are more difficult to deal with as they mainly consist of an infinite variety of manufactured products. This difficulty can most easily be overcome by securing agreements which leave the vendor of bulk purchase goods free to choose between the goods forming the exportable surplus of the bulk purchasing country. The vendor would, however, not be free to spend the money earned by the bulk purchase contracts anywhere else except with the permission of the purchaser.

The liberalisation of trade promised to the Americans should be undertaken by relaxing quantitative controls rather than by automatic transferability and steps should be taken to review drawing rights frequently and liberalise administrative transferability. Thus competition for dollars might be avoided and a shrinkage in trade prevented; final judgment must wait for the exact wording of the agreement to be published.

It is in our relations with the non-dollar

(20) The desire of the Bank of Egland to eliminate dealing at below par of sterling which cannot be freely used for the discharge of current obligations in Britain (*i.e.* payment for exports or services) seems once more to have overcome prudence. It is reported that in the new Swiss agreement up to £. 6 million has been sacrificed in gold by accepting claims on Britain by non-bona-fide residents in Switzerland. This particular mistake is an old one: it has been committed to a much more disastrous extent in the « phony » war period (cf. my papers on Foreign Trade and Exchange Policy, *Economic Journal* 1940, and on the Drift towards a Rational Foreign Exchange Policy, *Economics*, 1940 repeinted in *Essays on War Economics*, Oxford, 1940). It is a consequence of the age-old yearning after « reasserting the position of London as an international center », which was so ruinous in 1925. The result is invariably and inevitably a collapse, followed by a far stricter application of the bilateral principle of exchange discrimination than would be economically desirable.

area, however, that British economic statesmanship will be tested. A split in the policy of these countries, the spread of the deflation among them, would narrow the area in which a satisfactory level of foreign trade can be maintained. Already Belgium and Germany suffer from unemployment of a severity not much better than 1929/32 and show an export surplus with all other areas of Europe and the sterling area. The wider the spread of the degree of enforced self-sufficiency: as exports shrink imports will have to be curtailed.

Britain will have to make active contributions if she wishes to regain leadership in a group of countries dedicated to full employment policy. Her standard of life is greater than that of any of the other countries. Thus any programme to counter the inevitable losses in dollar-markets (21) will have to give priority to a scheme of foreign investments (unrequited exports). This is the more desirable as it would to a considerable extent avoid the large-scale shifting of labour inevitable if the usual « public works » programmes were undertaken and which seem politically unmanageable. The offer of unrequited exports by the grant of Loans or permission to draw on « blocked » sterling balances could be combined with agreement which either promptly or eventually bring in foreign income or improve our supplies, *i.e.* our terms of trade. With the increase in steel production we should be able to do this without undue strain as most overseas areas would wish to increase their imports of capital goods. The investment programme in the Colonial Empire could be speeded up. Britain could also participate in the investment programme of Israel which, as mentioned above, would bring in some immediate dollars. We might come to some combined trade and payments agreement with India by which our selfbalancing trade with India would increase, provided we permitted them to draw additionally on their blocked balances *i.e.* their exports would increase while our exports expand by even more. Finally the Overseas Food Corporation might well consider extending its activities to Western, and possibly even Eastern, Europe by agricultural investment against favourable long-term reciprocal purchase agreements for part of the increase in production made possible by our investment. It is to be hoped that these possibilities are being explored and the trade negotiations with Eastern European countries intensified. But before any further steps are taken which would deflect the trend of the world economy from the hopeful cooperation with the United States in restoring the balance lost through the War a conference should be called to consider steps to arrest the consequences of the American slump on the European economics and envisage the expansion and widening of the scope of Marshall Aid.

Conclusions.

We might sum up:

1. The problem of the long run « viability » of Britain and Western Europe without direct U.S. Aid should not be confounded with the problem of the short-run consequences of the U.S. slump, though the latter inevitably raises similar problems as, and tends to aggravate the (slow) process of dealing with, the former.

2. The effects of the U.S. slump on direct British exports to northern North America (U.S. and Canada) of a slump in that area should not be considerable over-all: a decline of 20 per cent of our direct visible exports would only mean a shortfall of some $ 100 million. Much more awkward are the consequences of the slump on sterling area exports. The loss sustained might be of the order of $ 400-500 million or even more. The total loss for the world as a whole in dollar supplies might amount to 10 per cent of the total trade of the world which (excluding northern North America and the Soviet countries) amounted to $ 14,600 million in 1948.

3. Efforts to mitigate the slump in manufactured exports should be concentrated:

(21) On the negative side, the sacrifice due to the fall in U.S. supplies should be equitably distributed. It will probably be necessary to re-introduce clothes rationing and a combination of tobacco and sweets rationing. The size of newspapers will have to be curtailed and, less likely, bread rationing re-introduced. It would be sensible to explain the potential need for these measures — as an alternative to mass-unemployment — at the earliest possible moment, so that the common sacrifice exacted should not lead to astonished exasperation.

(i) on securing not so much a further cut in U.S. tariffs as a simplification and standardisation of Customs procedures which have more and more assumed a prohibitive character and neutralised the nominal concessions in tariff rates secured at Geneva;

(ii) on building up a State financed sales organisation in the new, expanding areas of the U.S. The establishment of Development Councils which could contribute to this task should be speeded up.

Much hope cannot be based on these effects (mainly because of the inevitable hostile reaction in the U.S.).

More important than these steps would be an expansion of U.S. buying of strategic raw materials to prevent the demoralisation of the extra-U.S. primary markets (the U.S. primary producers are protected by the system of parity prices) and the spreading of the U.S. slump.

4. As long as the U.S. slump continues unabated and the steps under (3) are not well under way there is no case of a devaluation of the non-dollar currencies. It would hardly ameliorate the dollar position, and might aggravate it because of the unfavourable conjuncture of factors determining the volume of exports and imports of the U.S. and Canada. Thus it is inappropriate quite apart from its internal (inflationary) consequences.

5. In order to enforce exports despite the worsening of relative export prices without general deflation and to distribute the diminished supplies from the dollar area justly, certain controls will have to be reintroduced, others strengthened.

6. The existing higher profit margins in exports provide some shock-absorber for British and European exporters. But in the main our hopes of maintaining income and employment will depend on our success:

(i) in preventing an internecine struggle between non-dollar countries for dollars, in the main by reciprocal bulk purchase agreements;

(ii) in further import substitution.

7. It is to be hoped that other non-dollar countries will follow our policy of not indulging in competitive depreciation or deflation. Otherwise international trade would have to be restricted still further. As dollars will become scarcer U.S. competition will become *less* effective, provided we can avoid dollar convertibility in extra-American trade. The Argentine agreement and the proposal of O.E.E.C. to liberalise intra-European trade are moves in the right direction.

8. In respect to exports of some commodities to certain countries some compensation will have to be given for their willingness to forego U.S. depression-dumped goods. This compensation should be indirect so as not to conflict international agreements to which unfortunately we are already committed.

9. Once the U.S. deflation has been arrested by cooperative action and the long-run tendencies and policies can be gauged, a devaluation of the non-dollar currencies should be envisaged. Provided U.S. demand re-expands sufficiently, devaluation would help in bringing about realignement of non-dollar — dollar prices due to the superior U.S. rate of technical progress (22). It is to be hoped that a continuation and intensification of the policy outlined in the conception of the Marshall Plan and in President Truman's « Fourth Point » will permit the resumption of general world recovery. We should aim at restoring multilateral *payments*, and, after the reconstruction of the European-British Commonwealth economic system has been carried out, also of multilateral *trade*. This depends (as we have pointed out in an earlier paper (23):

(22) In the absence of more reasonable domestic economic policy coupled with a liberalisation of customs procedures, etc., in the U.S. a sharp increase of the price of gold would give (rather wasteful and silly) relief. The increase of the price of gold to, say, $ 100 per fine ounce would represent an addition to the worlds dollar supply of well over 1,5 billion per annum as a result of the consequent increase in gold production. The fear of the more uninstructed members of Congress of deficit spending would also be eliminated. The « profit » on gold revaluation of some $ 50 billion (at $ 100 an ounce) should go some way in helping to maintain business activity. Admittedly this is a frightfully wasteful way of curing the monetary disequilibrium. But it is better than the present absence of policy which has already cost the U.S. in loss of national income more than the cost of Marshall Aid already incurred, and bids fair to cost them more, within a year or so, than the total cost of the whole European Aid Programme.' Such is the curse of Midas.

(23) Britain, O.E.E.C. and the Restoration of a World Economy, Bulletin of the Oxford University Institute of Sta-

(i) on the success and determination of U.S. domestic economic policy in maintaining an excess demand in the U.S. as is indicated by the « rules of the game » for a gold-gaining country;

(ii) on the degree of unilateral concessions in commercial policy by the U.S.;

(iii) on the volume of U.S. grants or lending to (non-European) outside areas during and after the Marshall Aid;

(iv) on the success of British policy in providing leadership in reorganising the European-Commonvealth productive structure. Should the U.S. continue to be plagued by business fluctuations, give no commercial concessions, or diminish or discontinue the supply of dollars, and breach the organisation of a viable economic unit in Western Europe by insisting on convertibility and non-discrimination, the inevitable logic of events will push Britain and Western Europe to a much greater degree of national autarky combined with bilateral deals and closer economic relations with the Soviet bloc. It is to be hoped that an early Conference will be called to avoid a disorganisation among the Western world by co-operative action.

tistics, February-March 1949, esp. pp. 47-52. These conclusions have been strikingly reaffirmed by the Economic Survey of Europe in 1948, *op. cit.*, esp. pp. 216-19.