The Dollar-Sterling Problem

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THE DOLLAR-STERLING PROBLEM

ROY HARROD

I DO not propose, in this paper, to discuss the problem of how to sell goods in the dollar market, or the effects of devaluation. When I was in the United States in March and April 1949, a number of people of different types agreed that in their view the British had not yet begun to try to sell in the United States. I think things have improved since then. Various more strenuous efforts are now being made. I am sure a great field of exploration is still before us there. It is obviously very difficult to sell specialities and all sorts of miscellaneous products in such a vast area, with probably only a small trickle going to any particular town in the Middle West, or wherever it may be. This presents an appallingly difficult sales problem, and I do not think it can be expected that we should master it quickly. I hope that the amount of our trade will increase not merely in months but in years; I think that if we set our minds to it, a great market is available.

So far as devaluation is concerned, I think that the effects ought to be good, but to some extent slow-working. I rely more than anything else on the effects of devaluation in reducing the dollar imports of the non-United Kingdom sterling area. That is where I see the biggest possibility of a change in the balance of payments.

When one contemplates a theme of this sort, one sometimes stares directly at the problem in vain—how we are going to do without American goods? How we are going to sell British cars in the United States? One may suddenly find that the right course is not to continue to stare point-blank but to look to one side to seek clues for the solution of the problem in a quarter where one would not at first expect to find them.

It was rather on that line that over two years ago I published a book entitled *Are These Hardships Necessary?* [1] in which I suggested that so far as the United Kingdom overall balance was concerned—I was not concerned specifically with the dollar balance—we should not look primarily at the problem of foreign markets, but at what we were doing at home; my diagnosis was that our own internal capital outlay was on such a scale as to make it impossible to export because our resources were too much tied up in our internal programmes. That was the main theme in the book, but I also had a secondary theme about our treatment of the sterling balances and the problem of sterling convertibility or, more broadly, external capital movements. I am quite convinced that this secondary theme is now the all-important and the central problem. It is the central

[1] Roy Forbes Harrod (London, Hart-Davis, 1947).

problem in relation to the dollar gap, and it is the central problem in relation to the economic solvency and the economic prosperity of Britain.

I propose to present certain figures, interpreting them a little, in the hope that they will build up a picture; I will then suggest the lines of policy which emerge therefrom. My first figures are derived from the White Paper, *The United Kingdom Balance of Payments*.[1] I have taken the two and a half years 1947 to mid-1949 because the figures are available, and because to go closer to the war period involves special complications, for in 1945–46 our external relations were still, in a certain sense, on a war-time basis.

The interest and redemption on our war debt, and the movement of capital out of Britain, as shown in this White Paper—money for which in the two and a half years in question we have had no tangible return—amounted to no less a sum than £1,130 million.[2] We received, through the generosity of the Americans and Canadians in that same two and a half years, from the United States Loan, the Canadian Loan, and such part of Marshall Aid as came in during that period, £1,234 million; we therefore paid out almost the whole. It has gone through us as through a sieve, and we have not enjoyed it ourselves. That is entirely contrary to the intention, I think, of those who partook in the negotiation of the Loans for us. In the great and glorious days before 1914, when we were on the high tide of our opulence and prosperity, a great investing country—supporting the world (so many books tell us nowadays) by our liberal policy of investment abroad, unlike the Americans in the inter-war period—we invested abroad on an average £53 million a year. To allow for the difference in the value of money it is not necessary to multiply the £53 million by more than three to get a comparable figure. Even if it is put at £200 million a year, that does not compare with the £1,130 million paid out in these two and a half years. It is quite true that during the ten years before 1914, the heyday of our heyday, our foreign investment was running at something like £150 million a year, but even allowing for the change in the value of money, that figure is overpassed by what we have been doing in these days of distress, trouble, and post-war reconstruction.

The figure of £1,130 million is, if anything, an understatement because certain items, such as investment in oil equipment in the sterling area, where the capital is provided by the United Kingdom to buy the equipment in the United States, are not included. Again, the figure does not include a kind of expenditure which is novel to us compared with the pre-war period—Government expenditure on military matters, on rehabilitation, and in Germany. All this last mentioned expenditure totals no less, according to the White Paper, than £382 million which, added to the £1,130

[1] Cmd. 7793 (1949).

[2] This assumes that the whole increase in our outward payments of interest, profits, and dividends compared with 1938 was due to the debts contracted between the outbreak of war and the end of 1946, and may therefore contain an overestimate; it is not however large enough to affect any argument.

million *plus*, brings us near the £1,600 million mark, not far from half our total exports in the period. So that nearly half our total exports in the period, it may be said, were given away. No wonder that we needed American and Canadian aid to pay for what we had to import. All these great sums of money were not simply paper transactions; it was not a case of signing a bit of paper promising to pay something at some time, it was an actual outflow within the period without any offset, a net figure. In other words, this £1,130 million, plus the Government expenditure, etc., debited to us, amounting together to nearly £1,600 million, went out either in unrequited exports—in actual British goods from British factories—or in gold. In gold I include dollars made available from the United States or Canada, which we can for these purposes equate to gold.

A familiar reaction to this extraordinary state of affairs has been: Was not much of this money honourably due to those to whom we owed it in consequence of the war? After the war we were owing £3,700 million (end of 1946). In the year after the war there was a great deal of talk about the scaling down of this war debt on the grounds that other countries might suitably make a contribution. A large part of it was incurred in such matters as servicing our forces overseas. It was known that some of it was incurred on the basis of inflated prices. In certain countries prices had suffered a gross inflation and grossly inflated prices were paid for goods, and yet those prices in local currencies were converted into sterling at the old pre-war rates of exchange, so that the sterling debt thereby arising was far in excess of the real value of the goods received. I do not now intend to consider the scaling-down proposal; I am supposing that we brush all that aside and assume that we pay these debts in full. What is the honourable obligation? Considered in terms of the original amount without any scaling down, I think everyone would have thought it wonderfully generous if we had offered to pay four per cent for interest and redemption. Exactly what that represents in interest depends on the length of the annuity. One may think in terms of two or three per cent, and therefore a payment of four per cent including amortization would have been acclaimed as very generous. But of the £3,700 million, it is commonly agreed that probably £1,000 million should be set aside for working balances such as we always had before the war; if a normal rate is paid on working balances, one per cent or whatever it may be, and four per cent on the remaining £2,700 million, a payment of £120 million a year is reached. If we had said we will pay on these debts £120 million a year on a four per cent basis, people would have said, 'You are quixotically generous'. Most people would have said that we should at least be accorded two or three years' grace. We were given a long period of grace, of course, on the United States Loan. It might have been thought that we were entitled to defer this four per cent on the other debts for two or three years. But suppose that we had begun to pay it straight away. £120 million in two and a half years would have amounted to £300 million. That would have been the most that anybody could have said was honourably due—a generous payment in redemption of these debts, some of which were of doubtful origin.

'Well,' people say, 'even if it was not necessarily honourably due, no doubt the £1,130 million has done good to the world. People have used the goods and got value for it, and is not it a fine thing that Britain should have financed so much?' There are various aspects of that. Very often one of the first reactions is talk about the Indian situation and the need for financing imports of food to avert famine there. The payments for food to relieve India were, however, trivial by comparison with this £1,130 million.

I do not propose to discuss the merits of capital projects that have been executed, such as the groundnuts scheme. Whatever its merits, the amount has been excessive and untimely and absolutely out of the picture in relation to our post-war situation. I firmly believe that Britain has work to do for a long period in the future in assisting in the development of the backward parts of the world, both in our own dependencies and elsewhere, and that we may have to give large sums of money for that purpose in due course at the proper time—but to have done so now seems to me insane. It will not help the countries which are dependent upon us or which look to us for leadership.

A couple of months ago in Brussels a famous statesman of international repute said to me, 'What I cannot understand is, don't the British people realize that it is far more for the good of these dependencies and these undeveloped peoples whom they wish to benefit that they should be strong now than that they should rush into premature philanthropy?' That absolutely expresses my view. In the long run it will not benefit any of these territories that we should go bankrupt. We must get strong first, be solvent first. Then, over a long period, by all means let us help them.

But a large part of the £1,130 million, perhaps the greater part of it, has not been our deliberate contribution to the well-being or reconstruction of any country, it has been an unauthorized and unintended outflow. It has gone away not by the will of our authorities, but despite their will. It represents a failure of the control system to control. The moral is that this sort of control system is impossible in a great wide-flung system such as we attempt to run. If you have a tight little economy, like the German economy under Schacht, a very complicated system of control is practicable, but with the sterling area and the whole sterling connexion, not only our own Commonwealth and our Empire and its great trading connexions, but all the nations outside the area who use sterling as their medium of exchange and account, such a system of control cannot be effective. It has not been effective, and the money has gone away despite the control.

Controls have brought what was once a great and distinguished currency, sterling, into an appalling state. It is no longer sterling; there are many, eighteen, different kinds of sterling according to the quotation in *The New York Times*. Many people in Britain who use pound notes and pay their bills and have deposits at the bank think that there is one type of sterling, a unique currency; from the United States, or any other part of the world for that matter, England looks like a country with eighteen different sterlings. Before the war we used to be amused by all the different kinds of German mark. We are now ourselves in that position. Am I allowed just one crack? Of the eighteen different kinds of sterling, that which comes at the bottom of the list is usually 'British Government Securities sterling', sterling which can only be used to purchase British Government securities. When an American wants to buy wool from Australia he says, 'What's the cheapest sterling today?' Now, through the infinite complications of this system, with free markets existing in many places, skilful financial brains are applying themselves to make money out of this diversity of sterling both inside and outside the area. In Shanghai and Hong Kong, in Tangier and in Switzerland, people are making millions by manipulating with these different kinds of sterling. The result is that goods from the sterling area are sold not against dollars which come to the Bank of England and help our balance of payments, but against dollars which go into the hands of holders of these various kinds of sterling. Control in such a wide flung system as ours cannot succeed, and sooner or later we must come to a parting of the ways. The system of controls leading to eighteen kinds of sterling must either be given up in favour of a freer and simpler system, or the controls must be intensified—which will tend to break up the sterling area.

The direct dollar gap between the United Kingdom and the United States and Canada was £125 million in 1938 and £172 million in 1948;[1] thus, allowing for the change in the value of money it is quite clear that our direct dollar gap was far smaller in 1948 than it was in 1938. 1938, it is true, was not a particularly good year. But it is worth noting that, with the present value of the dollar at not much more in terms of goods than between a half and a third of what it was then, the £172 million gap is far less in terms of goods than £125 million. That is contrary, I believe, to what many people suppose. Statistics show that our imports from the United States and Canada are down to 70 per cent in volume of what they were, while exports are up to 130 per cent in volume. It is true that this is partly offset by the fact that the terms of trade have gone against us—but not fully offset, and in fact we are in a much better direct relation with the United States and Canada than we were in 1938. There has been a slightly greater deterioration, if we include services, but even so, we are in real terms considerably better off (adverse balance of £90·4 million in 1938 and £166 million in 1943). I might note in passing that the reason why the service balance has deteriorated somewhat more than the trade balance is because of our loss of dollar investments. The question is often raised in general

[1] United States Department of Commerce and Dominion of Canada Bureau of Statistics.

discussion: How can you expect this country to do well and prosper when it has lost all its dollar investments? The loss of annual income on dollar investments was £36 million, a sad loss, a serious loss, but think of that figure of £36 million a year compared with the £1,130 million in two and a half years discussed above. It is remarkable that our direct balance of dollar trade was not too bad.

In the bulletin of the U.N. Economic Commission for Europe for the second quarter of 1949, reference is made to the figures I have just quoted from American and Canadian statistics, and another figure of great significance is introduced. This is the figure for the gold and dollar liability of the whole sterling area in 1948, the same year in which the adverse balance of payments between the United Kingdom and the United States and Canada amounted to £166 million. The gold and dollar liability in that same year for the whole sterling area is estimated at £600 million. That is a very different kind of figure from £166 million. It is a terrible figure to have to face; that £600 million has to be paid in gold, or in Marshall Aid if, and when, we get it. The key to this whole problem is the difference between those two figures. Why is there this wide discrepancy? We have on the one hand what may in a sense be called the hard kernel of the dollar problem, the direct trading relations with the United States and Canada and our difficulty in selling goods there, which is represented by the smaller figure of £166 million, and the larger dollar problem which the sterling area has to face, represented by the figure of £600 million. What is the relation between the £1,130 million which we poured out so lavishly in two and a half years in gold and unrequited exports to other parts of the world and this dollar gap of £600 million?

The essence of the matter is—it is really the main object of my paper to show it—that the one is a reflection of the other. Why is it that we have to pay out all this gold and these dollars? The difference between those two figures (the £166 million and the £600 million) is accounted for in two broad ways. First we have to pay gold or dollars not only for our deficit with the United States and Canada, but also to all sorts of other countries—not only the 'American account' countries, but any country with which we tend to have an adverse balance of trade: Switzerland, Belgium, and so on. That is one reason why the £600 million is so much bigger than the £166 million. The other reason is that we have to pay deficits for the whole sterling area to all sorts of countries. We have to pay dollars out right, left, and centre for ourselves and for others. Why is that? The reason is that we made that £1,130 million sterling available to all these people.

The figure of £1,130 million is the key to an understanding of what the dollar gap really is. The reason for the larger dollar gap is that we have made sterling so abundant. Everybody has more sterling than they know what to do with: they have £1,130 million worth of sterling in addition to what they earn by exporting into the United Kingdom and to the rest of the sterling area. The result is that no one wants sterling. Consequently, whenever we have a favourable balance of trade, we are never paid in dollars for it for there is always sterling forthcoming in abundance; but if we have an unfavourable balance of trade people say, 'We can't take sterling for that, we have got far too much, we want dollars for it'. The same applies to the sterling area: they have got so much sterling in hand that they can pay for a large excess of imports of goods from the United Kingdom and can also afford to run up larger dollar deficits which they ask us to pay, by tendering to us sterling for conversion.

Before I clinch that argument I want to give a few more figures. The sterling area has a direct deficit, like our own direct deficit between the non-United Kingdom sterling area and Canada and the United States, which has gone up from £17 million in 1938 to £136 million in 1948. That is a considerable rise and the sign of a very considerable increase in the purchase of dollar goods. Unfortunately, the total rise of the gold and dollar deficit of the sterling area is greater because of all the gold and dollars that have to be paid by the sterling area to other people besides the United States and Canada. The non-United Kingdom sterling area gold and dollar deficit for the year 1948 was £225 million, compared with what we may call a rough balance before the war. That is part of the burden we have to carry.

Certain parts of the sterling area have been extraordinarily lavish in their dollar purchases. They did not lack goods from Britain—by no means; British exports to the sterling area in 1948, a large part of them unrequited, were little short of double in volume what they were in 1938, and yet the sterling area felt they had to have a great many more dollar goods as well. India, for instance, had four and a half times as many dollar goods as before the war; South Africa, three times as many. I do not want to criticize in any way payments made to relieve Indian food shortage, but that was a small part of the total; nor do I want to suggest that we have not great responsibilities and duties in regard to the future development of India, or that we should not supply her with all sorts of capital equipment, but it is a question of timing. The food imports to India from the United States in 1948 were £17 million, and all her imports from Canada £10 million, but the metals, chemicals, and machinery which she purchased from the United States were worth £50 million, while she got £59 million's worth of them from the United Kingdom.

May I just sum up this diagnosis? By making this extraordinary quantity of sterling (£1,130 million) available in the world, or allowing it to become available, we have created this larger dollar problem for ourselves. The sterling area buys dollar goods lavishly, as well as buying British goods lavishly. Before the war Britain had a balance of payments deficit to the United States and Canada, but had a favourable balance of trade with the sterling area. This favourable balance was financed by the import to the United Kingdom of South African gold which we then remitted to clear the dollar position. That was a natural triangle of trade. We bought more from the United States and Canada than we sold to them. We sold more to the sterling area than we bought from them. For exports to the sterling area we got South African gold which we sent to the United States and Canada in discharge of our deficit there.

Our trading relations with the United States and Canada are now more favourable than they were before the war, but meanwhile the sterling area has been lavish in its dollar imports and lavish in its imports from Britain. The South African gold does no more than cover about half the direct non-United Kingdom sterling area dollar deficit. The result is that, so far from having any gold sent us to meet our own deficit, we have to supply dollars for the sterling area deficit.

By allowing sterling from Britain to become so abundantly available in the world, we have thus produced a two-fold effect. One is that we always have to pay dollars whenever we have an adverse balance of trade with any particular country. Now, while we have adverse balances of trade outside the dollar area, we have many more favourable balances of trade outside that area, and those countries with whom we have favourable balances of trade should be short of sterling. Sterling should be much sought for in order to pay us in respect of the favourable balances of trade; in regard to unfavourable balances of trade we would then be able to pay them in sterling; thus we should have to pay no gold or dollars outside the United States and Canada. But if we previously make sterling so superabundant in the world, no one is short of sterling, so that they insist on being paid in dollars. Similarly, in regard to the sterling area, we have made sterling so abundant that they can buy all the dollar goods they want and all the sterling goods they want and ask us to pay for their deficits. That amount of sterling cannot be made available in the world and have no effect. It has enlarged our dollar gap from a moderate size to vast proportions.

Let me, therefore, come briefly to the policy which seems to be indicated. We shall never cure the dollar gap solely by selling more motor cars, etc., in the United States. I am all in favour of our pressing on with the export drive. The main part of the problem, however, is the far larger gap of £600 million which can never be met in that way. I shall suggest that there are two or three approaches to the cure for that position.

First, we have to deal, as I implied earlier in this paper, with the sterling balances question. We must deal with that quite firmly, and say that not more than a reasonable, honourable amount will be paid away in each year on sterling balances as capital and interest together. I suggest that four per cent on the whole is the most we should consider. It is not enough merely to say that in the abstract; we want it to be absolutely 'buttoned up' and it can only be buttoned up by Parliament. Parliament pays the most superficial attention to all these questions, if I may say so. The amount to be paid on these sterling balances should have Parliamentary sanction. It is unfair to put Treasury officials and Bank of England officials in a position where they are sitting on the opposite side of the table to a nation which may be in distress, which may have some very important need, which may have some special economic or political means of pressure, some bargaining counter by which to extract money from us. What we want is an Act of Parliament authorizing what payments are to be made. Our officials ought to be in the same position that the E.C.A. administrators are in now. A European country may go to the E.C.A. administrators and put up a tremendously strong plea for something in Europe. The E.C.A. administrators say, 'It is not in Congressional Appropriations and you can't have it'. It is up to Parliament to put itself in this position, and it could do so any day it chose.

The interest and redemption on sterling balances I take to have been running at £265 million; this should be reduced to £100 million or £120 million per annum. Next we come to the ordinary capital outflow, additional to the release of sterling balances, which has been running at £187 million. This capital outflow is a very crucial problem for the country. It divides into two parts, the capital which goes into the sterling area, which is legal and allowed, and the capital which goes into the sterling area in order, by some way or other, to get beyond the sterling area. No-one knows how much of the £468 million (for the two and a half years) belongs to either category. Ostensibly it merely goes into the sterling area and settles happily there, but I beg leave to think that a good deal of it goes further, and indeed is one of the components of that big dollar gap of £600 million.

We should be more modest in our capital aid to the sterling area in the short period. Maybe something can be done by ordinary administrative methods; we can keep a curb on the different departments which indulge in premature large capital outlay schemes within the sterling area. But this is only part of the problem. I do not think anyone believes that a figure of this order (£468 million) can be accounted for by actual investments in the sterling area. We hear all sorts of comments on groundnuts, but what distresses me is the lack of perception that this groundnuts scheme is part of the dollar gap problem. It is just the groundnuts scheme *et hoc genus omne* that has created this dollar gap.

I come now to the parting of the ways so far as policy is concerned. As the gold runs out and Marshall Aid dries up, we shall be driven to do something. One philosophy is that if we cannot allow this capital outlay we must close it up and apply the same restrictions to the countries of the sterling area as we have applied to countries outside it. We should increase the controls, become a tight little island, a rigidly managed economy, such as Germany was under Herr Schacht. That solution is already finding certain supporters. The only other solution is to revive natural forces which prevent what may properly be called the flight of capital from Britain. Taking just the flight from Britain to the sterling area, a tight system of control is possible, but it means in effect breaking up the sterling area. A tight system of control cannot be put into effect over such a diversified area—right out to the Dominions, right out to Hong Kong. The sterling area breaks in pieces once the more or less free flow of money within that area is abandoned. That would be a very sad thing for the future of Britain because it would mean breaking many trading connexions, but that may be the line which we shall follow.

The only alternative is to revive the profit potential of British industry and thus destroy the motive that has led to this colossal flight of capital. The way to alter that situation needs no elaboration. Taxation and control must be reduced, dividend limitation must be abolished and the potential of earning money must be revived in the country.

I do not think that completely solves the problem. There is the problem of money that goes from Britain to the sterling area, and the problem of money that goes beyond the sterling area. By making Britain a home of confidence and reviving the profit potential of British business, part of the problem can be solved; but, so far as the flight of capital beyond the sterling area is concerned, something more must be done—sterling must itself be retrieved. So long as sterling is in its present diseased condition there will be a tendency, anyhow for the non-British holder of sterling, to want to get out of it; the eighteen different kinds of sterling do not and cannot inspire confidence. I am absolutely confident that the only solution of the sterling problem is sterling convertibility, an inherently simple thing over which we badly blundered in 1947.

Those are the three arms of my policy: to deal with the sterling balances and thus check the great outflow under the head of interest and repayment of the sterling debt; to deal with the capital outflow from Britain—the flight of capital from Britain, as it should be called—by restoring confidence in the use of capital in Britain; and thirdly, in order to restore confidence in sterling, to make sterling convertible.

By the convertibility of sterling I mean that instead of there being eighteen sterlings in the world, with each of which certain things only can be done, there should be—one would like to say—one sterling, but, in deference to the realities, I will say two sterlings in the world. One of those sterlings would, in fact, be the blocked balances, and the characteristic of that sterling would be that nothing could be done with it whatever except to wait for the repayment at a pre-arranged rate. Of course, there are blocked balances at this moment; I believe that those blocked balances are traded in—to say 'below the counter' would be putting it mildly, but somewhere far down below the cellars among the rat-holes. There are said to be people who are trading very surreptitiously even in those blocked balances, selling them to each other at a very low price. That might continue, but it would be of no importance after the precise terms of redemption were laid down. It would not matter to the United Kingdom what foreigner held these promises to pay. All other sterling should be of equal status, and should be usable for any purpose whatever at the will of the holder. Only so can confidence in sterling be revived and the flight from it checked.

In defence of that proposal I must point out that out of this inconvertibility system, out of this system of eighteen different kinds of sterling, we are getting nothing at the moment, because so far as the crucial question of our dollar goods, our imports from America and Canada, is concerned, sterling is convertible. As regards the sterling area, sterling is also in effect convertible; we are constantly adjuring the Governments in the sterling area not to let their people spend so much money on dollar goods, but when they spend the money we always pay the bill. So that in a very large trading area of the world sterling is already in effect convertible. In the rest of the world we are scarcely gaining anything by inconvertibility, since as soon as we develop a substantial unfavourable balance of trade, we find that we have to pay in gold. The gold reserve is steadily being drained away; I have not the slightest doubt that if there were the confidence in sterling which would result from sterling convertibility the gold drain would be rapidly reduced.

I think we ought to press on very hard with the schemes which have recently been put forward by the Council of Europe for intra-European currency convertibility. In our trading relations with European countries under present conditions, when we have an adverse balance of trade we have to pay gold after a certain point; when we have a favourable balance of trade, we get nothing. The sum of adverse balances of trade may at any time easily become quite a serious matter. If there were an intra-European convertibility scheme in operation, we should only be liable on our net debit to Europe as a whole—a much smaller liability.

Well, I have trespassed much on your patience, and, I fear, wearied you with my figures. But I have the inner conviction, which I hope I may have in some measure conveyed to you, that what I have been discussing is The Problem of Britain. I have put forward what I believe to be a series of practical proposals which, if implemented, would make all the difference in the coming time—the difference between a decline and a break up of the sterling area and a renewal of a more prosperous state of affairs in Britain.

SUMMARY OF DISCUSSION

SIR ARTHUR SALTER asked the speaker whether he would explain the difference in conditions now, in which he would like to make the pound convertible, from those in 1947 when a brief attempt was made which rapidly failed?

MR HARROD replied that the answer was two-fold. First, in 1947 we had an overall adverse balance of trade of £630 million; now the overall balance of trade was nearly enough balanced, as it was in the pre-war period. Secondly, the sterling balances had not been properly handled in 1947. As soon as sterling became convertible in that brief period of about six weeks, a vast drain outwards of sterling took place suddenly, which meant that the existing balances had not been properly dealt with. Those conditions should not apply now.

Lt Col Crocker asked the speaker, in view of the recent statement that unemployment in Britain without Marshall Aid would be at least one and a half million, what he thought would happen this year or next year when Marshall Aid expired?

Mr Harrod did not necessarily subscribe to the estimate put forward, but thought that if sterling were made scarce in the sterling area, we should certainly be able to replace part of the Marshall Aid by gold. It was unnatural that we should receive no gold from South Africa. We had a large favourable balance of trade with South Africa, but they did not have to pay us in gold because so much British capital had moved to South Africa, which was equivalent to a release of sterling to South Africa; we should get a portion in gold.

Mr W. Allen Young recalled the lecturer's reference to the pre-war 'triangle' of trade by which the United Kingdom settled an unfavourable balance with the United States by means of gold drawn from the sterling area. After emphasizing that gold was the only commodity the dollar price of which had not risen in conformity with that rise of the general price-level to which the lecturer had adjusted his comparative figures, Mr Young asked what difference would be made to the overall problem of the great dollar gap between the sterling area and the dollar area if the dollar price of gold were raised by the United States?

Mr Harrod replied that the more the price of gold was raised the greater would be the difference made. The failure of gold to rise in line with other commodities was undoubtedly an adverse factor in the total situation: probably a bigger factor than the loss of our overseas investments, about which a great deal more was heard. It was very difficult to see, however, what arguments other than those of altruism could be supplied to the United States to induce her to alter the price of gold. They would say, 'We are a flourishing country, we have big gold reserves, our production is up, our balance of trade is good, we have a good dollar, why on earth should we depreciate it? Why should we engage in what might become a sort of vicious circle of inflation?'

Major A. H. Stuart Menteth asked whether the recent announcement in the press that the Central Banks of Europe were beginning to prefer gold to dollars was a straw in the wind indicating a tendency to inflation in the United States, and that the banks were attempting to have gold at its real price instead of at the price which the United States were paying for it?

Mr Harrod suggested that if the free markets in gold in European countries assumed large dimensions, the United States had only to release a very small part of their gigantic stock to satisfy them.

Mr G. H. Whitehill suggested that there seemed a certain inconsistency in Mr Harrod's case. On the one hand, all the sterling balances were to be blocked; on the other hand, confidence in sterling was to be restored by various internal measures, so that foreigners should freely invest in the United Kingdom. But the blocking for an indefinite period of the sterling balances was not the way to restore confidence in sterling. Who would be willing to buy sterling, or invest in the United Kingdom, unless with some assurance of a free remittance, but any such assurance would be gravely weakened by a blocking of the sterling balances. Further, nothing had been said of the underlying reasons for the continued release of these sterling balances since the war. What would be the effect on employment in Britain of releasing or not releasing those sterling balances? If releases were throttled down as Mr Harrod suggested, he thought the temporary effect on employment in the country might be very serious, and this had possibly been one of the reasons why releases had been made so freely since the end of the war.

MR HARROD admitted that the first point was a serious one. He felt it would have been much better for the country if the decision could have been taken in a clean and bold way within a year or eighteen months of the end of the war. Everyone would then have understood that war balances were in a totally different category from ordinary sterling. But the fact that we did not do that had not removed the problem. He maintained that it would provoke far more confidence to have two sterlings: the old war debts, blocked for ever and representing a promise to pay four per cent a year; and all other sterling freely convertible, with which securities or goods could be bought in any part of the world.

PROFESSOR R. G. HAWTREY expressed some doubts on Mr Harrod's interpretation of the official figures. He would quite agree that an excessive capital outlay abroad was a serious matter and beyond certain limits should be checked. He pointed out, however, that a part of this investment abroad consisted in the provision for the recovery of our direct investments, which had been starved of capital during the six years of war, and required various renewals and arrears of maintenance, very similar to the needs in Britain for re-equipment, which were at the root of our post-war difficulties.

We were faced with two quite distinct dollar problems. There was the short-term dollar problem arising from the urgent needs of re-equipment, a dollar problem which was at present being assisted by the Marshall Aid. That need for re-equipment existed also in the sterling area and the Empire, and, when we were contributing unrequited exports to these various countries, we were merely passing on Marshall Aid for the same kind of purpose for which it was to be applied in Europe. The arrears of capital maintenance and renewals were as acute in the sterling area as they were in Europe.

We were under a two-fold obligation to the sterling area. We had incurred a debt, which was the main subject of Mr Harrod's address, but we were also under a current obligation to provide the sterling area with foreign exchange so far as needed. That obligation was certainly subject to possible abuse. It might well be that certain countries of the sterling area were much more lax in acquiring imports, to be paid for by foreign exchange, than they should be. The remedy for that would no doubt be to induce them to be less lax and more severe. But he insisted that it was an *obligation*: that the whole sterling area system, which was an important part of Mr Harrod's programme of restoring the credit of sterling, depended on this obligation. The other obligation, the indebtedness, was merely incidental, it had been incurred during the war, incurred on the strength of the credit attaching to sterling. People were willing to accept payment in sterling during the war because they believed in sterling, and therefore there was a serious moral obligation not to let them down. That moral obligation, of course, could not stand against the stern facts of disability; if we were unable to make payments, that would be a great pity, but he thought there was a good deal to be said for paying off the sterling balances as rapidly as was feasible. At the present time we were paying them off at the rate of £200 million to £250 million a year (at the rate of four dollars to the pound). Henceforward, no doubt, it would be more like £350 million a year. That made an appreciable impression on the total.

In addition to the short-term dollar problem arising out of our immediate needs for re-equipment, there was a long-term dollar problem the extent of which we still had to discover by experience. The country had been impoverished by the war, it had been deprived of some of the means for triangular settlements with the economically strong countries of the world, among which the United States was pre-eminent, and we could not be sure that we should be able by the free working of prices in markets to maintain a balance in the future. We might have to have recourse to controls for a relatively prolonged period. Everyone recognized that we must have controls at present, and if that were so, the faster we paid off our indebtedness the sooner we were likely to come within sight of getting rid of them. If we saddled ourselves with a fifty year annuity of £120 or £150 million, that, along with certain other indebtedness, was likely to postpone the period at which we could establish a balance by the working of free prices and free markets.

MR HARROD replied that Professor Hawtrey had raised questions which were too great to be discussed at that meeting. He agreed with Professor Hawtrey that there was an obligation upon Britain to meet the sterling–dollar deficit of countries in the sterling area by providing dollars, and that if we stopped doing it the sterling area would come to an end; it might, however, come to an end because we might not be able to do it. That was what he wanted to avoid. Professor Hawtrey seemed to suggest that the only alternatives were that we should break down the sterling area, or say to them, 'Please do not import so many dollar goods'. This was to neglect the point that the reason why they imported so many dollar goods was because we had given them so much money. Stop giving them the sterling and things would automatically come right; they could not buy what they had not the money to pay for.

MR J. W. A. CALVER asked Mr Harrod to comment on an article in *The Observer* on 11 December 1949, in which it was written 'A political grand strategy for Asia, an Asian counterpart to the Marshall Plan for Europe, is lamentably lacking in Britain and America alike. The Indian sterling balances are a fortuitous by-product of the late war. This does not diminish their present importance. Indeed, if they did not exist, they would have to be invented. . . . Asking Europe to withhold or divert her exportable surplus goods from Asia, where they are desperately needed, and to push them to America, where they are not needed and hardly wanted, may be orthodox economics, but it is suicidal politics.' In this connexion, Sir Robert Sinclair, President of F.B.I., was advocating a joint economic staff to grapple with the economic crisis similar to the joint planning staff which was established before the war.

MR HARROD thought this aspect of the development of South East Asia over a long period was vitally important, and the pity was that instead of having a Royal Commission and long range bodies who were working it out, we had overstrained ourselves in the short period at the risk of becoming bankrupt. The sooner we got out of bankruptcy, the sooner we could concern ourselves with long range policies, and with more hope of success. He suggested that, insofar as the money was urgently needed in South East Asia, we should state that our contribution to the problem had nothing whatever to do with our sterling balances. As *The Observer* article said, they were fortuitous. We can only do what we can, and that is, pay four per cent on them. All we in Britain ought to say is that we cannot take a bigger financial commitment this year and next year until our balance of payments problem is solved and we are solvent; that anything required above the four per cent which we are prepared to pay on our debts should be dealt with internationally by ourselves and the Americans; we may contribute to the International Bank if we can afford it. That is the way to handle the problem for the time being. We should not just wash our hands and take a selfish point of view, but we should recognize that it is in the long run in the interest of all that we become solvent as quickly as possible. That was our prime job now.

Address at Chatham House
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