CABINET

BALANCE OF PAYMENTS: NON-DOLLAR PLAN FOR 1948

Memorandum by the Chancellor of the Exchequer

The Cabinet on 20th October, when approving the dollar programme for 1948, asked that a further memorandum should be submitted to them on our balance of payments plan for non-dollar countries (C.W.(47) 81st Conclusions, Minute 3).

The attached report has been prepared by officials, in accordance with the procedure described in C.P.(47) 287.

This report has been considered by the Economic Policy Committee, who endorse its recommendations.

I now ask the Cabinet to take note of the recommendations made in the report and, in particular, to approve the following specific recommendations:

(a) that a survey be made of our possible long-term scale of import, the desirable composition of the import programmes that would be practicable and the sources from which such imports might be drawn (paragraph 12);

(b) that, where there is no danger that inessential supplies will cost us gold or dollars, we should import them if they satisfy a general consumption demand; and that we should also be prepared to continue the import of inessentials on a diminished scale as a means of helping a "soft" supplier to change over from production of inessential goods to essential goods for export either to ourselves or to sterling area countries (paragraph 13);

(c) that a progress report be submitted to Ministers before the end of November on the further steps required to secure co-ordination between sterling area countries (paragraph 14).

R.S.C.

Treasury Chambers, S.W.1.
22nd November, 1947.
THE 1948 NON-DOLLAR BALANCE OF PAYMENTS PLAN

The Cabinet at its Meeting on 20th October (C.M. (47) 81st Conclusion, Minute 3) took note that the Chancellor of the Exchequer and the Minister for Economic Affairs would submit a further memorandum on the balance of payments position. The following report has been drawn up in accordance with the procedure set out in C.P. (47) 287.

2. This paper deals with certain general questions of policy affecting both the dollar balance-sheet and the non-dollar balance-sheet. It may be pointed out, however, that determination of the non-dollar programme does not in the short-term involve crucial decisions on ration levels, major raw material supply, &c.; in almost all cases, these depend in the short-term upon imports from the American Continent and are governed by the dollar programme.

3. We are entering upon a difficult series of negotiations covering both trade and finance; the conduct of these negotiations will require a flexible import/export policy, in order to secure the results we want. This inevitably will mean some interruptions in the normal flow of import procurement, and we shall have to be in a position to take quick decisions. This paper sets out:

(i) The objectives which should govern the conduct of the negotiations.
(ii) Recommendations on certain general points on which policy decisions are required covering the whole field, and in particular on the problems of assuring future supplies, of so-called "unrequited" exports, and of direction of exports.
(iii) Recommendations on liaison with sterling area countries.
(iv) Analysis of the conditions governing our trade relations with those countries to whom we may have to pay gold—i.e., those covered by the dollar ration of £20 million in 1948 (paragraph 15 of C.P. (47) 283).
(v) Proposals on United Kingdom import policy towards the rest of the sterling area and other countries to which there is no danger that we shall lose gold or dollars.

Decisions are urgently required on all these points, in order to set the negotiations in train, to start appropriate action in the export field, and to reduce to a minimum Departments' uncertainty about import policy.

Objectives

4. Our objectives should be as follows:

(a) To increase exports to and reduce imports from all sources to which we have to pay gold or dollars.
(b) To build up and draw essential supplies to the greatest possible extent from sources to which we do not have to pay gold or dollars; the dollar problem is not a short-term one, and continuing action will be necessary on these lines for as far ahead as we can see.
(c) To conduct trade with countries to which we are in danger of paying gold or dollars at the highest level compatible with not paying gold or dollars, or with paying annually the minimum amount, and not building up undue sterling balances.
(d) To trade at the highest possible level with other countries; it is against our interest to adopt measures which restrict international trade in less essential goods more than is absolutely necessary.
(e) To seek to maintain the acceptability of sterling as an international currency, and to foster multilateral trade as far as we can without damaging our gold and dollar reserves.
(f) To seek to ensure that the import and export policies of the other sterling area countries conform with these objectives.
Balance of Payments

5. The following table sets out the 1948 balance of payments resulting from the various Departmental statements of import requirements, export targets, and other estimates of receipts and expenditure. The dollar estimates take account of recent Cabinet decisions (C.M. (47) 81st Conclusions, Minute 3):

<table>
<thead>
<tr>
<th></th>
<th>American Continent</th>
<th>Sterling Area</th>
<th>Rest of World</th>
<th>Total*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Imports</td>
<td>-519</td>
<td>-603</td>
<td>-434</td>
<td>-1,595</td>
</tr>
<tr>
<td>Government Expenditure</td>
<td>-21</td>
<td>-88</td>
<td>+10</td>
<td>-105</td>
</tr>
<tr>
<td>Exports and re-exports</td>
<td>+275</td>
<td>+724</td>
<td>+533</td>
<td>+1,552</td>
</tr>
<tr>
<td>Other net income</td>
<td>-17</td>
<td>+143</td>
<td>-36</td>
<td>+150</td>
</tr>
<tr>
<td></td>
<td>-283</td>
<td>+180</td>
<td>+91</td>
<td>-18</td>
</tr>
<tr>
<td>Rest of sterling area†</td>
<td>[-88]</td>
<td>[-180]</td>
<td>[-50]</td>
<td>[-318]</td>
</tr>
</tbody>
</table>

* Including certain items which cannot be allocated.
† These figures take no account of gold exports by the rest of the sterling area, estimated in C.P. (47) 283 at £90 million.

6. These figures are based upon the following Departmental estimates:

Imports.—Cuts from dollar sources are taken into account; figures from sterling area and rest of world represent Departmental requirements.

Food.—These do not represent full availabilities; if all useful non-dollar supplies were bought, an extra £25 million would be added, mainly from relatively easy sources (see paragraph 22 below).

Raw Materials.—These represent availabilities.

Manufactured Goods.—These represent availabilities of useful machinery and of essential goods for industry; 1947 import quotas of less essentials.

Government Expenditure.—Allows for reduction in size of Services; assumes substantial repayments by Belgium, Russia, &c.

Exports and Re-Exports.—Assumes exports average 128 per cent. of 1938 volume in the first half of 1948 and 140 per cent. in the second half, at steadily increasing prices. The recorded export figures are lagged to represent actual payments. Allows for maximum diversion to the American Continent, including the additional £45 million proposed in C.P. (47) 283.

Other Net Income.—Forecasts of income from shipping, foreign investments, &c.; assumes no tourist expenditure outside sterling area in 1948.

Rest of Sterling Area.—The deficit of these countries with the American Continent is as set out in C.P. (47) 283. Both these and their prospective deficit with the rest of the world are very rough estimates and the latter assumes no substantial policy change by them. Nor does it credit them with the value of their current gold exports (say £90 million).

7. It must be emphasised that these figures are not forecasts of the 1948 balance of payments; they show the relation between the various Departmental requirements and programmes in these fields; very large variations are possible, as a result both of shortfalls in these programmes and also of world changes, e.g., in prices and markets. In any event they will require adjustment in the light of our negotiations. The decisive figures also are differences, and these change very markedly corresponding to relatively small changes in the major items.

8. The table in paragraph 5 shows that if our export targets are achieved, we shall be broadly speaking in overall balance in 1948. By the end of 1948, if our exports rise to an annual rate of 160 per cent. of 1938 in volume, there will be a substantial favourable overall balance. But there will be a large deficit with the American Continent, and a large surplus with the rest of the sterling area and the rest of the world. The deficit with the American Continent is a direct drain upon our reserves. The United Kingdom surplus with the rest of the world is largely offset by the deficit of the rest of the sterling area with these countries, and whilst with some countries we should expect the sterling area as a whole to be in surplus, there are others with which it would be in or near deficit. The United Kingdom will have a large surplus with the rest of the sterling area (even after allowing for gold receipts) and this, together with our responsibility...
for financing the rest of the sterling area's deficits with the other countries, presents very serious problems. Our trade pattern, indeed, will become increasingly unbalanced geographically as our exports grow. In the absence of multilateral convertibility, this situation raises a number of general problems.

"Unrequited" Exports

9. This problem will not appear in an acute form immediately since at the moment the sterling area is in deficit with the great majority of the non-American countries. Nevertheless, not only as between the sterling area and other countries, but also within the sterling area itself the problem is actual in the case of certain countries, e.g., India, certain Colonies, Egypt, Norway and probably Holland. While, therefore, we must seek to expand exports generally in the case of such countries, we shall have to consider means of avoiding continuing loss on this account. "Unrequited" exports are highly undesirable where they could go to dollar countries or could be more effectively used in the United Kingdom, but are in fact going to countries from which we secure no adequate return. As our exports rise, this question will become more important and will have to be dealt with product by product. An expansion in exports beyond 140 per cent. of 1938 (i.e., beyond what would bring us into overall balance) would be of very limited value, and a severe drag on home consumption and investment, unless imports could be simultaneously increased from non-dollar sources, or exports to dollar markets could be expanded, or exports could be used to build up foreign sources of supply. But a volume of exports which results in a moderate reduction of sterling balances should not be considered as giving "no adequate return," particularly where the balances are near the point at which gold would be payable under our agreements. There is a danger that exports may be frustrated because countries will not have the sterling with which to pay for them; in such cases, this disadvantage could to some extent be met by securing the agreement of that country to draw sterling from the International Monetary Fund with which to pay us. By reducing the amount of sterling in the Fund this will increase our ability to acquire dollars from it—a type of operation for which the Fund was primarily designed.

10. It would be mistaken to suppose that the deficit with the dollar world will disappear or be covered by convertible earnings elsewhere within any short time. Even granted all success in our export drive and in the diversion policy, a substantial dollar deficit is likely to remain in 1950 and to be supplemented by payments on the American and Canadian loans in 1951, by which time our drawing powers on the International Monetary Fund will have been exhausted and we shall be under pressure to use any improved earnings or windfall income to repay what we have drawn. This obstinate unbalance between our inevitable deficit with the dollar world and our potential surplus with the non-dollar world is largely an inheritance from the wartime concentration of supply on the North Atlantic route. Deliberate effort and very great expenditure first by ourselves and latterly by the Americans and Canadians were devoted to building up this concentration of supply in North America. Its financing has from the outset required heavy capital transactions—the mobilisation and sale of our own reserves, Lend Lease, Mutual Aid and finally the loans. Unless deliberate policy and effort, comparable to that which built up strategically accessible supply during the war is now devoted to acquiring financially accessible supply we shall not escape from the old unwelcome choice between continued and perhaps increased restrictions on consumption and a state of dependence on American lending. There are two ways of approach: to increase our exports to the areas where supply is available or to increase supply in the areas which are natural buyers of our exports. We shall need to use both.

Direction of Exports

11. Direction in one form or another is the chief method of increasing our exports to dollar and difficult countries. In the absence of direction, many goods that have a ready market in the dollar and hard currency countries will be sold elsewhere, and priority in delivery dates will not accord with our present needs. The present commodity pattern of our export targets is not in balance with the most pressing needs of our dollar customers. A reshaping of our production plans may therefore be a condition of success in any large-scale diversion of exports. While there may be strong arguments both long-term and short-term against pushing direction too far, the following action is being taken in order
to ensure that we are in a position to derive the maximum advantage from this policy:

(a) The Board of Trade has prepared a list of key products of prime importance in trade negotiations, and a provisional market allocation as between various countries is being drawn up. (Coal was dealt with in B.P. (O.N.) (47) 53.)

(b) The Board of Trade is preparing an analysis of existing and potential imports into the United States, Canada and the Argentine, from all sources so that we may know how we can expand our exports to these markets, and adjust our production and export targets accordingly.

(c) The Board of Trade is making an analysis of the present destinations of potential dollar earning commodities so that we may assess the possibilities of diversion.

(d) The Board of Trade and the other Production Departments are examining the methods and powers already existing for influencing the direction of exports and priority of deliveries. They will also consider what other methods could be used and what additional powers are necessary.

(e) Departments are also considering the possibility of furthering these purposes by a Government Trading Organisation.

We recommend that this survey be completed at the earliest possible date and that decisions should then be taken accordingly. In the meantime, all possible administrative action should be taken to expand our exports to the dollar and other difficult markets.

Building up of supply where we can pay

12. But no likely degree of export diversion will cover even our present curtailed imports from the Western Hemisphere, let alone cover the greater imports which will be needed if there is ever to be an end to restrictions on consumption. Even if by great efforts we were to increase our market in the United States beyond present expectations, our exports would mainly be in the luxury class for which the market is most liable to fall away in the event of an American slump, while our imports would be minimum essentials which we could only reduce with grave inconvenience. Nor is the possibility to be dismissed of tariff increases by a new Administration faced with unemployment in America. It will be necessary, therefore, to seek out and build up supply in markets which are natural and willing buyers of our goods. Any such operation, on the scale that is now called for, will take time and will require a major effort. There may be three years in which to achieve it, but a beginning must be made at once if the results are to be available in time. Provision is needed for an organised administration of the effort and clearly there is scope for co-ordination with the Colonial Development Scheme.

We therefore recommend that a survey shall be made of our possible long-term scale of import, the desirable composition of the import programmes that would be practicable, and the sources from which such imports might be drawn and of the consequential administrative machinery.

Less Essential Imports

13. A further means of adjustment is by taking an increased quantity of less essential imports from sterling area countries or from countries with which the sterling area as a whole is in prospective surplus. To the extent that these additional supplies enable us to draw less from the American Continent, this is a direct contribution to the dollar problem; the scope for this, however, is not great. Wherever this is possible, the imports should be taken, and they may of course also have to be taken as part of negotiations. Apart from such cases, the less essential imports should not be taken unless they have intrinsic value to satisfy general consumption needs. It is difficult publicly to justify the import of less essentials from some countries while we cannot afford to import essentials; the additional imports increase our overall deficit and thus threaten our overall balance of payments recovery; their acceptance from some countries opens the door to claims from other countries which are politically difficult to resist. There may also be difficulty over non-discrimination (see paragraphs 25 and 26). On the other hand, if we keep out all less essentials, we establish a dangerous international doctrine that international trade consists only of essentials—a doctrine which would be most damaging to ourselves as large exporters of less essentials.
We recommend, therefore, that where there is no danger that the less essentials will cost us gold or dollars, we should import them if they satisfy a general consumption demand. We should also be prepared to continue the import of inessentials on a diminishing scale as a means of helping a "soft" supplier to change over from production of less essential goods to more essential goods for export to ourselves or to sterling area countries.

Sterling Area Co-ordination.

14. The table in paragraph 5 shows the crucial importance to us of the rest of the sterling area countries. These countries are of vital importance as the source of 35-40 per cent. of our imports, none of which costs us dollars. But they are also a serious potential source of weakness; their actions can upset a balance which we laboriously build. If the rest of the sterling area countries could revert to their pre-war position as substantial net earners of dollars and foreign exchange, we could readily see a righting of our position; insufficient and inadequate control by these countries, on the other hand, can dissipate our common reserves.

15. There is too little direct contact in both directions between the United Kingdom and the other sterling area countries. We have no reliable forecasts of their expenditure and income; it takes so long to collect returns of actual expenditure that it is impossible to take remedial action in time; and they often have inadequate warning of our difficulties and proposals for meeting them; in brief, there is insufficient day-to-day contact and consultation. The effect of this is a dangerous weakness in our negotiations, for our picture of the sterling area situation towards the country with which we are negotiating is incomplete and the execution of policy uncertain.

16. We cannot hope to secure complete integration of policy to safeguard our common reserves. The geographical mechanical and constitutional facts prevent it. But we consider that it is urgently necessary that the liaison and co-ordination arrangements should be greatly improved. A start has been made at the Sterling Area Conference; we understand that this is being followed up as a matter of urgency, and we recommend that a progress report be submitted to Ministers before the end of November.

Import Programme: "Rest of World"

17. The table in paragraph 5 shows that the United Kingdom has a prospective surplus of some £90 million with the non-American non-sterling world (which would be reduced to some £70 million if we took useful available food supplies); this is partly offset by the deficit of some £50 million of the rest of the sterling area countries.

18. There is wide difference between these countries, and they cannot be treated uniformly. For various reasons, there is a danger that we may have to pay gold or dollars to Sweden, Switzerland, Portugal, Belgium, Denmark, Persia and Finland; with Italy and Spain we have large prospective deficits; our position with Russia is uncertain. Our policy, of course, is to avoid, so far as possible, paying any gold or dollars to these countries; and our negotiations with them must aim to make such arrangements as will maximise trade in both directions while minimising the risk of gold or dollars passing. It would not be a satisfactory solution to achieve this merely by letting sterling balances accumulate in the hands of such countries, for these will ultimately be a charge on our export capacity and might again create the sort of difficulty which precipitated the crisis last summer. Hence a main object of our negotiations must be to assure an entry for our exports which otherwise stand in danger of being frustrated by the import restrictions now being imposed in many countries. Both here and in the sterling area, which is referred to below, this is essential if our export targets are to be achieved.

19. In C.P. (47) 283, an allowance of £10 million in each half of 1948 was made for these countries. We consider that it should be possible to keep within this limit, but this will mean that our import policy must be adjusted as necessary to accord with their readiness to accept exports from us. The position in the individual cases is:

Sweden (sterling area deficit 1947, £5.4 million): We should be able to avoid gold payment in 1948, and take our essential imports (including some switchings from Canada); no expansion of less essential imports will be possible, except, of course, in special negotiation items; continued strong exports effort needed.
Switzerland (sterling area deficit 1947, £14.9 million): We should avoid paying gold in 1948, as our exports grow and provided there is no tourism. We are, however, unlikely to earn gold.

Portugal (sterling area deficit 1947, £3.9 million): We should avoid paying gold, provided that arrangements can be made to enable our exports to be charged as far as possible as current receipts (we are under an obligation to the Portuguese to send them some capital goods in repayment of the balances accumulated during the war, which were funded on favourable terms). There should in that case be a margin available for buying canned fish, thus enabling other food savings to be made elsewhere.

Belgium (sterling area deficit 1947, £22.4 million): This is the most dangerous situation; if imports are cut on the same criteria as if they were from United States, we could probably avoid gold payments; there is a large trade in less essentials which could be cut, but the negotiation will be difficult.

Denmark (sterling area deficit 1947, £5.5 million): Negotiations on bacon and butter are suspended on price; we should have to give the Danes some dollars for feeding-stuffs if we took these supplies, but otherwise we could adopt a liberal import policy, for if we have a deficit, the Danes pay off debt to us.

Persia (sterling area deficit 1947, £13.5 million): Some loss of dollars is inevitable.

Finland (sterling area deficit 1947, £20.2 million): We shall incur some loss of dollars unless we find alternative sources for timber and timber products.

Italy (sterling area deficit 1947, £12.9 million): We may be able to avoid paying gold or dollars, but unless we cut down imports (especially of fresh fruit) Italy will certainly accumulate substantial amounts of sterling which will either be a charge upon our exports later or be used by Italy in a manner which indirectly costs us dollars or gold.

Spain (sterling area deficit 1947, £9.4 million): We are likely to have a considerable deficit in 1948; this will not cost us gold or dollars, but rather similar considerations apply as in Italy, except that our import programme from Spain is more essential than that from Italy.

Russia (and Danubian countries): We shall be bargaining directly for supplies; if we were willing to pay gold or dollars, a very large liability could arise. In any case, we shall almost certainly have to export "dollar equivalent" manufactured goods.

20. We recommend that the Overseas Negotiations Committee and the Exchange Requirements Committee should base their detailed recommendations for negotiations with those countries on the lines set out above.

21. With the rest of the countries, the sterling area is likely to have a surplus—Holland, Norway, Egypt are the chief examples. In these cases, it is proposed that our import policy be liberal, taking some less essentials where they satisfy a general consumption demand.

22. We propose that there should not be a definite currency ceiling for these countries as a whole; arrangements will have to be made for carrying out the import policy appropriate to each country ad hoc.*

Import Programme: Sterling Area

23. The rest of the sterling area is clearly an "easy" source. Most imports from these countries are essential, and the range of non-essentials is not wide. A similar general policy can be followed to that outlined in paragraph 21 for the "easy" non-sterling countries. South Africa is an exception to this; purchases of the goods covered by the tied loan should not exceed the tied amount. In the case of India, Iraq and Palestine, we should not feel free to allow a large accumulation of sterling.

* In particular, this means that there would no longer be an overall financial limitation upon our total food purchases from non-dollar sources; in the countries to which there is a danger of our having to pay gold or dollars, we should buy as much food as we can without incurring direct or indirect gold or dollar liability; from other sources we should buy as much food as possible including less essential foods provided that the latter satisfy a general consumption demand. As pointed out in paragraph 6 above, some expansion may be possible in the programmes as they stand, but the success of this will depend upon the negotiations with the various countries concerned.
24. There is a further consideration of the dollar earnings of sterling area countries. We should not take imports into United Kingdom which could, with greater advantage for our balance of payments, be sold for dollars, nor should we encourage sterling area countries to build up markets here for such supplies. In the field of "essentials" it is probable that there are cases in which it would be advantageous in the common interest if we purchased less, freeing supplies for dollar-exports. It is proposed that our import programme from the sterling area countries should be examined in detail with this purpose.

Non-Discrimination

25. The proposed import policy from the sterling area and the easy sources raises important non-discrimination issues. It will be entirely impossible to carry out this policy unless it is politically possible to maintain these discriminations. For example, we cannot accept fruit and vegetables fairly freely from Holland if we have to accept more than taken quantities from Belgium. A much more restrictive policy would be needed if a "quota m.f.n." were developed, or also if countries in the "easy" group were able to buy from the more dangerous group for sterling. It is an essential condition of this whole lay-out that we should from the start be determined to resist political pressure on this point.

26. The development of this policy would involve us in increasing difficulties with Article IX of the United States Loan Agreement, for however liberally the obscure clauses are interpreted much that we do will be inconsistent with it. We are glad to understand that attention is being given to this in another context.

Particular difficulties, even in the early stages, will be encountered in regard to citrus, dried and canned fruit, &c.

Conclusions

27. We ask for approval for the following recommendations, and authority for Overseas Negotiations Committee and European Reconstruction Committee to proceed with negotiations and import programme determination accordingly:

(i) Objectives (paragraph 4).
(ii) Unrequited exports (paragraph 9).
(iii) Direction of exports (paragraph 11).
(iv) Development of long-term import programme (paragraph 12).
(v) Less essential imports (paragraph 13).
(vi) Sterling area co-ordination (paragraph 16).
(vii) Policy to be followed with countries to which we may lose gold or dollars (paragraph 20).
(viii) Policy to be followed with countries to which we are unlikely to lose gold or dollars (paragraphs 21 and 22).
(ix) Sterling area import programme (paragraphs 23 and 24).
(x) Political pressure and non-discrimination (paragraph 25).