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CABINET

**THE "COLLECTIVE APPROACH TO CONVERTIBILITY"**

MEMORANDUM BY THE PAYMASTER-GENERAL

I have set out in P.E.C. (52) 31 and 44 reasons why I think we should not proceed with the "collective approach to convertibility." In this paper I summarise my views for the convenience of my colleagues.

2. In February, and again in June, we were threatened with dire consequences unless we at once made the pound convertible and let the rate of exchange float. This is the central theme of the proposals we are now asked to put before the Commonwealth Conference.

3. The main argument is the same. If we give up supporting the pound and let it float, we shall, so we are told, "mobilise the price mechanism in support of policy." This is perhaps a more euphemistic variant of the usual phrase that it will "take the strain off the reserves and put it on to the rate of exchange." But in plain English both versions mean the same, namely curing a trade deficit by letting the value of the pound fall and therefore the price of imports rise, until food becomes so dear and raw materials so expensive that the people have to eat less and factories have to lay off workers. Thus, through high prices and unemployment, the demand for imports is to be reduced, the policy often ascribed to Conservatives by Socialists and as often repudiated by us.

4. But even this unpleasant process is likely to be self-defeating since the fall in the pound, save in very special circumstances, will reduce the foreign exchange earned by our exports. The trade gap will then be increased, causing a further fall in the rate of exchange and thus a further widening of the gap and so on. Speculation against the pound, and a wage-price spiral, will add fuel to the flames.

5. Convertibility of the pound, moreover, will be a serious blow to our export trade. Not only will it remove the effective incentive to foreign holders of inconvertible sterling to buy sterling goods; it will offer foreigners an alluring prospect of earning dollars by cutting their imports of British goods; and in a dollar-hungry world the temptation will be irresistible, whatever safeguards we may try to erect.

6. These objections have never been effectively answered. Nevertheless, it is proposed to press this policy first on the Commonwealth, then on Europe, then on the United States. But the recent meeting of Commonwealth officials showed that the Dominions find serious difficulties in the plan. Most of them object strongly to the floating rate. Many object strongly to convertibility; for this is to be given only to foreigners, not to residents of the sterling area; indeed the latter, as they justly complain, will have to put up with more severe restrictions so that foreigners can be allowed to change their pounds into dollars. As one of them remarked, this gives members a positive incentive to leave the sterling area.

7. Recent discussions in the Organisation for European Economic Co-operation have shown that the Europeans, likewise, are opposed to convertibility and the floating rate. They fear that the latter might "bring in its train political and social consequences which Governments could not contemplate"; and they would object strongly to the break-up of the European Payments Union which the Treasury proposals would entail.

8. As for the Americans, the proposal is to ask them to recognise openly the right of all other countries to go on discriminating against them and the right of Commonwealth countries to intensify Imperial Preference. The floating rate would strike at the very heart of the philosophy implanted by the United States in the I.M.F.; and a depreciating pound would lay us open to charges of unfair competition against dollar goods. Having created this agreeable atmosphere we are then, apparently, to ask the Americans for \$5 billion for an "exchange support fund" or a correspondingly increased subscription to the I.M.F. At best it is hardly conceivable that such support would be forthcoming without conditions; and these are likely to be politically most embarrassing.

9. It may well be, in view of these objections, that the scheme will emerge in an almost unrecognisable form after negotiations with the Commonwealth, with Europe and with the United States. But the final form is almost certain to be more dangerous and disadvantageous to us, not less. For in the effort to get the floating rate and convertibility accepted, concession after concession will be made and the essential safeguards will tend to be whittled away. Already the Chancellor proposes to relax restrictions on dollar purchases. What shall we be faced with in six or nine months' time when, according to the latest forecasts, our balance of payments will be taking a serious turn for the worse? Either we shall have to back out ignominiously or we shall have to accept conditions dangerous to Britain and quite possibly unacceptable to Parliament.

10. I therefore believe that we should decide definitely not to press the Commonwealth to adopt convertibility and a floating rate until our economic position is much stronger. While urging continued restraint in the internal policies of all sterling area countries, we should push ahead with plans for sound economic development of the Commonwealth, for freer trade and greater production in Europe, for reducing instability in trade in primary commodities and for increasing international reserves through freer use of the International Monetary Fund or in other ways. We should work in close co-operation with the United States and press on them the need for "good creditor" policies.

11. No one can really claim that an effective programme on these lines would mean "standing still." On the contrary, it would represent a most successful outcome of the forthcoming Conference. For reasons I have given in P.E.C. (52) 44 I believe it would be welcome to most members of the Commonwealth and acceptable to all. Recent reports from Europe suggest that it is also very much in line with the views of O.E.E.C. countries.

12. As for the Americans, I feel sure they could be convinced that this is the right policy. It is true that they aim, as we do, at one multilateral world with convertibility and non-discrimination as the ultimate objective. But it cannot really be United States policy to enforce this whatever the cost.

13. I should have thought that the present over-riding objective of all the free world—not least America—was to win the cold war and to disprove the Russian belief that the Western world can be forced into bankruptcy and political disunity. If so, the major theme of any approach to the Americans should not be how we can achieve "convertibility," but how we can all maintain our European defences and yet get through the next couple of years without an economic crash, the spread of Communism on the Continent and the growth of anti-American feeling in Britain.

14. For reasons I have described in P.E.C. (52) 31 I fear that the "collective approach to convertibility" might end in a serious set-back in the cold war. It might well lead to the worst financial crisis in our history. The need to maintain convertibility would almost certainly require much more severe internal measures than we endure to-day; it would almost certainly mean considerably more unemployment and a further severe cut in the defence programme. It would play into the hands of those with anti-American views, who would argue that we were trying to borrow more billions of dollars from the United States, not to buy food as in 1946, but to finance a "bankers' ramp"; and in return, they would say, we were prepared to give Wall Street the right to dictate our internal policy.



15. For the first time since the war, production in Western Europe and the United Kingdom has ceased to rise and has, indeed, started to fall. Yet without more production either our defences, our social services or our standard of life must fall. Are we now to substitute for the goal of higher production the goal of convertibility? For, in present circumstances, the two are inconsistent, since convertibility without special restrictions, which it is intended to remove, can only be maintained if European Governments are prepared to depress production and incomes, and so the demand for imports, to the extent necessary to balance their dollar trade.

16. I feel sure that, if we explain all this frankly to the Americans, they will not press us to adopt convertibility *coute que coute*. Convertibility and non-discrimination are very important objectives; but they are means to an end, not an end in themselves. The almost theological fervour with which they were advocated at the end of the war by some people in the United States has now, it seems, largely evaporated. The Marshall Plan ran completely counter to those ideas, and showed that the Americans now regard the cold war as of far more importance.

17. We should certainly tell them that we have no intention of trying to build up a non-dollar world; we adhere more firmly than ever to the objective of one world and intend to achieve it as soon as is humanly possible. But we are very much afraid that an attempt to plunge into it before we are strong enough might end in failure with disastrous economic and political consequences; it would mean a reversion to Schachtian policies and the end of all hope of ever achieving multilateralism.

18. I therefore hope that we shall put before the Commonwealth Prime Ministers a constructive programme for economic expansion such as I have outlined in paragraph 10, and that we shall drop, for the time being, the idea of convertibility and a floating rate which would almost certainly result in economic contraction and unemployment. We are not yet strong enough for these financial experiments, nor, I believe, are the people ready to accept the entirely new political philosophy they involve. In view of the criticisms expressed at the Commonwealth officials' meeting we can certainly pursue this course without losing face, provided we take a definite decision now; but it may well be our last chance. Once negotiations begin in earnest and Ministers become involved in defending the plan, it will become more and more difficult to take a clear view and we may find ourselves committed to a course that is full of dangers and from which it will be exceedingly difficult to extricate ourselves.

C.

*Paymaster-General's Office, S.W. 1,  
31st October, 1952.*