CABINET.

THE BALANCE OF INTERNATIONAL PAYMENTS.


(Circulated by direction of the Prime Minister.)

2, Whitehall Gardens, S.W. 1,
September 25, 1931.
ECONOMIC ADVISORY COUNCIL.

COMMITTEE ON ECONOMIC INFORMATION.

First Report.

The Balance of International Payments.

2, Whitehall Gardens, S.W. 1,
September 25, 1931.
COMMITTEE ON ECONOMIC INFORMATION.

COMPOSITION AND TERMS OF REFERENCE.

The Committee is constituted as follows:

Sir Josiah Stamp, G.B.E., Chairman.
Mr. W. M. Citrine.
Mr. G. D. H. Cole.
Mr. J. M. Keynes, C.B.
Sir Alfred Lewis, K.B.E.

Mr. H. D. Henderson, Joint Secretary, Economic Advisory Council.
Mr. A. F. Hemming, C.B.E., Joint Secretary, Economic Advisory Council.

Joint Secretaries to the Committee.

The Committee's terms of reference are as follows:

To supervise the preparation of monthly reports to the Economic Advisory Council on the economic situation and to advise as to the continuous study of economic development.
FIRST REPORT.

THE BALANCE OF INTERNATIONAL PAYMENTS.

I.—INTRODUCTORY.

1. On the 14th September, 1931, we were instructed by the Prime Minister to prepare a report on the balance of international payments. For the purpose of carrying out these instructions, we have prepared for our own guidance the following terms of reference:

(a) To prepare an estimate under the ordinary headings of the change in the balance of international payments for the year 1931, in order to obtain a view of the current and anticipated strain upon the exchanges.

(b) To enumerate the factors at home and abroad affecting each item and to attempt to estimate the probable rate of deterioration.

(c) To prepare a broad statement of possible remedies.

2. We have been greatly assisted in our inquiry by the Board of Trade, and, in particular, by Mr. A. W. Flux, C.B., and Mr. H. Leak of that Department, who have attended each of our meetings when this question has been under consideration. Our Chairman has also received in confidence from the Chairmen of a number of important Companies trading abroad information regarding the change in earnings in 1931, the broad effect of which is to confirm the estimates put before us by the Board of Trade.

II.—ESTIMATED BALANCE OF INTERNATIONAL PAYMENTS.

3. The latest published official estimate of the balance of trade is that which appeared in the Board of Trade Journal in February last. On that occasion the Board of Trade gave the following estimate for the years 1928, 1929 and 1930:

Table I.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>1928</th>
<th>1929</th>
<th>1930</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess of imports of merchandise and bullion</td>
<td>...</td>
<td>338</td>
<td>300</td>
</tr>
<tr>
<td>Estimated excess of Government receipts from overseas</td>
<td>...</td>
<td>15</td>
<td>24</td>
</tr>
<tr>
<td>Estimated net national shipping income</td>
<td>...</td>
<td>120</td>
<td>133</td>
</tr>
<tr>
<td>Estimated net income from overseas investments</td>
<td>...</td>
<td>270</td>
<td>273</td>
</tr>
<tr>
<td>Estimated receipts from short interest and commissions</td>
<td>...</td>
<td>65</td>
<td>65</td>
</tr>
<tr>
<td>Estimated receipts from other sources</td>
<td>...</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td>...</td>
<td>465</td>
<td>504</td>
</tr>
</tbody>
</table>

Estimated total credit balance on items specified above... | ... | 127 | 133 | 39

* Including some incomes on loan accounts.
| Including disbursements by foreign ships in British ports.
4. In the following paragraphs we examine the Board of Trade estimate under each of the headings indicated above and give an estimate for the year 1981. It is important to observe that these estimates were prepared prior to the suspension of gold payments which took place during our inquiry, and that no allowance has been made in them for the effect of the depreciation of sterling, which we deal with separately in Section III.

(a) Excess of Imports of Merchandise.

5. The excess of imports over exports of merchandise for the first eight months of this year was practically the same (£246 million) as in the corresponding period of last year. The average monthly excess of imports over exports of merchandise is normally rather greater in the latter part of the year than in January-August, owing mainly to the seasonal increase in the quantity of grain imported in the autumn. The price of wheat and other grain is, however, this year very much lower than it was a year ago, and has decreased more than import prices generally. If this low price continues, it will improve the prospect of having a smaller visible adverse trade balance than last year.

6. If, as may be assumed, the excess of imports over exports is not greater this year than it was last year, i.e., £386 million, it should be noted that owing to price changes the excess of imports will represent a larger volume of goods in 1931 than it did in 1930.

7. Since the first half of 1930 the fall in the average value of goods imported into and exported from the United Kingdom has been 20.6 and 11.4 per cent, respectively. Thus, if this country had imported and exported the same quantity of goods this year as last, the excess of imports over exports in 1931 would have been £216 million instead of the £386 million referred to above. (We have assumed that the price changes of the first half-year apply to the whole year.) For the first six months of this year as compared with 1930 there was a reduction of 25 per cent. in the aggregate quantity of goods exported and a small reduction in the aggregate quantity of goods imported. For some purposes, however, an aggregate figure of imports is misleading. In the following table we give index numbers of the volume of imports in the first half of this year and of the two preceding years, based on the corresponding period of the year 1924:

<table>
<thead>
<tr>
<th></th>
<th>January—June</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Food, drink, and tobacco</td>
<td>Raw materials and articles mainly unmanufactured</td>
<td>Articles wholly or mainly manufactured</td>
<td>Total</td>
</tr>
<tr>
<td>1929</td>
<td>194.2</td>
<td>114.4</td>
<td>138.4</td>
<td>115.4</td>
</tr>
<tr>
<td>1930</td>
<td>192.9</td>
<td>106.0</td>
<td>144.1</td>
<td>113.5</td>
</tr>
<tr>
<td>1931</td>
<td>198.9</td>
<td>95.4</td>
<td>133.7</td>
<td>119.2</td>
</tr>
</tbody>
</table>

It will be seen from the above figures that, in spite of a reduction this year in the aggregate quantity of imports as compared with 1929, there has actually been an increase in the quantity of food, drink and tobacco imported. This increase would be still greater if tobacco were excluded. Imports of raw materials have naturally declined with the decline of the export trade. Excluding goods required as raw material for manufactures exported, the total volume of goods imported is probably greater in the current year than in 1930.
8. Last year Government receipts from Overseas exceeded expenditure by about £21 million. This year these receipts have been substantially affected by the Hoover plan, but only a part of the burden of that plan, which amounts to £11 million, will come into the calendar year of 1931. Of the deficit on this account, it is estimated that £6 million will come into the calendar year, leaving £5 million as a deficit in respect of payments in the first quarter of 1932. It would, in our view, be reasonable to estimate an excess of Government receipts from Overseas as a whole at about £15 million for the year 1931. Of these receipts, £10 million may be put for the first half year and £5 million for the second.

(c) Estimated Net National Shipping Income.

9. Freight rates have not shown any substantial change since the beginning of 1930, the average for the first eight months of this year exceeding that for the corresponding period of last year by less than 5 per cent. Time charter rates have declined to a considerable extent, and there has also been a substantial reduction in the amount of shipping in employment. Further, passenger traffic has fallen off greatly this year, and passengers' fares have been reduced.

10. As will be seen from the table in paragraph 9 above, the Board of Trade estimated the net national shipping income for 1930 at £165 million. On the assumption that there is no substantial change in freight rates during the remainder of the year and no material change in the number of vessels in employment, the national shipping income for 1931 may be estimated at about £85 million. It is possible that the national income from this source may be slightly smaller in the second half of this year than it was in the first owing to the decrease in the number of vessels in employment. We estimate the figures for the first and second half of the year at £44 million and £41 million respectively.

(d) Estimated Net Income from Overseas Investments.

11. As will be seen from the table given in paragraph 9 above, the net income from overseas investments, i.e., the gross receipts in this country from investments abroad less payments to persons resident outside the United Kingdom in respect of investments in the United Kingdom, was estimated by the Board of Trade as £270 million for the year 1929. The Board of Trade arrived at this figure by working up a pre-war estimate of the amount of British capital invested abroad. It is mid-way between the figures arrived at by recent investigations carried out by Sir Robert Kindersley for the year 1927 (£285 million) and by the "Economist" for the year 1928 (£255 million). Sir Robert Kindersley has recently made a further estimate for the year 1929, the previous estimate having admittedly been made on an imperfect basis. It is necessary, therefore, to revise the published Board of Trade estimate of receipts from overseas investments in the year 1929.

12. Sir Robert Kindersley estimates the income received from British overseas investments in 1929 at £281 million. From this must be deducted a sum of about £15 million, representing payments made to non-residents in respect of investments in the United Kingdom. In the case of companies registered in this country and operating abroad, Sir Robert Kindersley's estimate only includes the dividends distributed. From the national point of view it is the gross receipts of the companies from abroad that have to be taken into account and it is necessary, therefore, to raise Sir Robert Kindersley’s estimate by £15 million, representing payments made to non-residents in respect of investments in the United Kingdom.
Kindersley's estimate in order to arrive at the total receipts remitted to this country. The gross receipts include head office expenses in this country and any sums that may have been added to the reserves in this country. The information available in regard to these points is by no means complete, but from inquiries which have been made it would appear that a sum of approximately £35 million should be added to the estimate for the year 1929 on this account. After account has been taken of a possibly inadequate allowance made by Sir Robert Kindersley for the income received in the United Kingdom in respect of investments not quoted in the official Stock Exchange list, the estimate for the year 1929 is raised to £230–£260 million. The reason that we have adopted a range is that there are a number of factors about which there is insufficient information to justify our making a firm estimate. The calculations would seem to indicate a figure rather towards the lower limit of the range, through other considerations would lend support to a somewhat higher figure.

13. As the result of the foregoing revision of the figure for 1929, it is necessary to reduce the Board of Trade figure of £235 million for 1930 to £210–£230 million.

14. For the year 1931, we have endeavoured to estimate (a) the income received in the first half of the year, and (b) the income likely to be received in the second half-year, of which there was no serious default in respect of the foreign and Dominion Government and Corporation stocks. Dividends from railways were substantially reduced, and dividends from mines, rubber, oil, tea, &c, were all less than in the previous year. In the case of rubber there was a substantial net loss.

15. In the case of British companies, it is, of course, remitted earnings from abroad and not dividends paid during the year which have to be brought into account, but the dividends paid assist in making an estimate as to the probable amount of the remitted earnings. Actual losses, if covered from reserves in this country, have also to be taken into account.

16. The bulk of the loan capital consists of Foreign and Dominion Government and Corporation stocks and some reduction in the receipts of interest on this account may be expected for the second half as compared with the first half of this year. So far, however, as can at present be estimated, this reduction is not likely to be very large. There is, however, the probability, if world conditions do not improve, of an increasing default in respect of these fixed interest securities next year.

17. We have made a number of inquiries in regard to the most substantial blocks of capital invested abroad, and we estimate that the net income from overseas investments for the first half of the year was probably about £90–£100 million, and that for the second half of the year it is likely to lie within the range £55–£75 million. For the calendar year 1931 we estimate the net income from overseas investments at between £175 million and £175 million. Taking the middle figures, this means a reduction of about £60 million as compared with 1930.

18. It is important to observe that the decline in our receipts from overseas investments generally would almost certainly be further accentuated if there were a complete suspension of fresh loans from London. It is probable, for example, that the payment of dividends due this year on Indian Government stocks was only made possible by the raising of some £15 million by loans in the London market this spring.

(e) Estimated Net Receipts from Short Interest and Commissions.

19. The Board of Trade estimate (see table in paragraph 3 above) of receipts in 1930 in respect of short interest and commissions was £55 million. It is extremely difficult to frame exact estimates of the changes in these receipts, but from such indications as are available in regard to the volume of trade this year as compared with last and in regard to the rates for short loans and acceptances in this country,
we consider that, subject to the qualification in the following paragraph, the receipts under this heading may amount in 1931 to nearly £40 million. In view of the increased payments in respect of borrowings this autumn, the net receipts from the second half of the year may be expected to be about £5 million less than those in the first six months.

20. Actual receipts from acceptances may be expected this year to be about the same as in 1930. We have been responsibly informed that up to date this year there have been approximately £6 million of defaults in respect of acceptances. The general practice of financial houses is to set any such losses against the income received from acceptances, and if these losses are charged against income for the purposes of the balance of trade, the above estimate would require to be reduced by at least £6 million, and, possibly, by as much as £10 million, if allowance is made for further defaults during the remainder of this year. The date when the default occurs is, however, not the date when the balance of trade is affected by the loss, since the money is remitted abroad immediately following the acceptance. On the whole, we consider that these losses should be included in the revenue account, and we therefore estimate the net receipts in 1931 from short interest and commissions at about £30 million.

(f) Estimated Net Receipts from Other Sources.

21. In this category are included a number of miscellaneous payments and receipts, such as receipts from the sale of second-hand ships, tourists' expenditure, emigrants' remittances, savings of returned migrants, and expenditure by foreign Governments on their Diplomatic and Consular Services in this country.

22. Receipts from the sale of second-hand ships were estimated some years since at about £4 million per annum, but this year the receipts on this account will be negligible. The expenditure of tourists in Great Britain is likely this year to show a large decline. The expenditure of British tourists abroad is not likely to have been affected to nearly the same extent. This year there has been a considerable increase in the number of migrants returning to this country, and a very large reduction in the number of emigrants.

23. For a number of years past the estimate for these miscellaneous items has been placed on a conservative basis at £15 million per annum. In the circumstances, we consider that some reduction may be expected this year and we are disposed to estimate receipts under this head for 1931 at £10 million.

(g) Summary.

24. In the following table we give a revised estimate of receipts and payments on revenue account for the year 1930, together with our estimates divided into half-yearly periods for the year 1931. In this table we have omitted the £5 million excess of imports over exports of bullion and specie in 1930, as movements of gold should be regarded as a balancing factor rather than as an item on revenue account.
TABLE III.

Estimated Balance of Income and Expenditure in the Transactions (other than the Lending and Repayment of Capital) between the United Kingdom and All Other Countries 1930 and 1931.

(In million £'s.)

<table>
<thead>
<tr>
<th></th>
<th>1930</th>
<th>Jan.-June 1931</th>
<th>July-Dec. 1931</th>
<th>Jan.-Dec. 1931</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess of imports over exports of merchandise</td>
<td>386</td>
<td>183</td>
<td>203</td>
<td>386</td>
</tr>
<tr>
<td>Estimated excess of Government receipts from overseas</td>
<td>21</td>
<td>10</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td>Estimated non-natural shipping income</td>
<td>105</td>
<td>44</td>
<td>41</td>
<td>85</td>
</tr>
<tr>
<td>Estimated net income from overseas investments</td>
<td>210-230</td>
<td>90-100</td>
<td>55-75</td>
<td>145-175</td>
</tr>
<tr>
<td>Estimated net receipts from short interest and commissions</td>
<td>55</td>
<td>18</td>
<td>12</td>
<td>30</td>
</tr>
<tr>
<td>Estimated net receipts from other sources</td>
<td>15</td>
<td>5</td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>406-426</strong></td>
<td><strong>197-177</strong></td>
<td><strong>118-138</strong></td>
<td><strong>285-315</strong></td>
</tr>
<tr>
<td>Estimated total credit or debit balance on items specified above</td>
<td>+20 to +40</td>
<td>-6 to -16</td>
<td>-65 to -85</td>
<td>-71 to -101</td>
</tr>
</tbody>
</table>

* Estimate revised in accordance with paragraphs 12 and 13.

25. We have included in our estimates nothing in respect of sums received from sinking funds and maturity payments of overseas loans held in this country. Sir Robert Kindersley estimated that for the year 1929 these receipts amounted to £48-5 million. It is probable that in the current year they will be substantially less. These sinking fund payments are, of course, not a receipt on revenue account, but a capital item; and against them it is necessary for us to make fresh loans on a fairly substantial scale as a condition of continuing to receive the interest on many of our investments. We think it better therefore to leave these sinking fund payments out of our calculations.

26. The estimated debit balance of international payments for the second half of this year is much larger than that for the first half. This is due in part to the normal increase in the excess of imports over exports of merchandise in the latter part of the year, but is mainly caused by the loss in income from our overseas investments. It is possible that the Board of Trade figures both in this and in preceding years may have erred on the side of caution and have omitted some favourable items, but even after making allowance for this possibility, it would seem that the net debit against this country is now running at a rate of not less than £2 million a week.

27. It is worth emphasising that the deterioration in our trade balance is mainly due to the falling off in our income from overseas investments, which is occasioned by international causes, and very little to the worsening of the visible balance of trade. It is, of course, evident that over the last few weeks the exceptional pressure on the exchanges has been due to capital transactions. The unfavourable balance of trade, though it mounts up heavily in course of time, cannot be responsible over a short period (except indirectly in so far as it affects confidence and foreign sentiment) for the heavy drain of recent weeks.

† This, of course, is not a constant rate since the income from overseas investments is received at irregular intervals.
III.—EFFECTS OF THE DEPRECIATION OF THE POUND.

28. The estimates given in the previous Section are those which we should have made prior to the depreciation of the sterling exchange. They relate, however, to the year 1931, three-quarters of which has already passed, so that, in view of the various time-lags involved, the effect of the new factors on them cannot be very material. If we look further forward and consider the probable outcome of the year commencing October 1931, there are two important disturbing factors which have to be considered. The first of these is the risk that our invisible income from overseas investments may be still further diminished; and the second is the net result on our trade balance of the change in the gold value of sterling.

29. As regards the first of these factors, our income in 1930 from fixed-interest investments overseas has been estimated at about £150 million and the income from the variable investments at about £130 million. The latter sum has already been greatly reduced: but, so far, the reduction of the former has been quite small, so slight that in compiling our estimates we have reduced it by £5 million for the current year, and we believe that even this modest reduction is on the safe side. Looking further forward, we believe that these receipts must be regarded as in the highest degree precarious unless there is a great change in the international position. The depreciation of sterling, however, in itself represents an important favourable influence in the right direction. For if sterling is depreciated by 25 per cent., this means that it is that much easier for the debtor countries to meet their sterling obligations. It is even possible that in the coming year our receipts in respect of these loans in terms of depreciated sterling may amount to more, when they are reconverted into gold at the lower exchange, than they would have been if we had attempted, with imperfect success, to exact payment at the former gold parity. Whether this mitigation of the problem of the debtor countries will be sufficient without a rise in gold prices must be uncertain. The change of gold parity by ourselves, and by the other countries which are likely to follow our example at an early date, will indeed lead to a rise in prices in terms of the currencies thus affected, which should prove stimulating to trade. But it may well be necessary that gold prices should rise, before normal prosperity returns or debtor countries are able to meet their liabilities in a normal way.

30. As regards the effect of the fall in the sterling exchange on the other items of our international Balance Sheet, it is extremely difficult to make even an approximate estimate, especially at a time when the degree of the gold depreciation of sterling and the action of other countries in relation to their own currencies are still matters of conjecture. As regards imports and exports, a depreciation of (say) from 20 to 30 per cent. in the gold value of sterling must necessarily have a strong tendency to restrict the volume of imports and to increase the volume of exports, since its influence on imports is equivalent to that of a tariff, and its influence on exports, so long as sterling costs of production are unchanged, to that of export bounties. The restriction of imports will help at once to reduce the aggregate value of our imports as measured in gold. Indeed, the effect on imports may be more drastic at the outset than it will be later on. The bounty on exports, on the other hand, will serve to reduce the gold prices at which our exports are sold, so that until the volume of our exports is increased proportionately, the net effect will be to increase the aggregate gold value of our exports. It may, therefore, be a considerable time before the balance of payments in respect of imports and exports is materially improved by the depreciation of the pound. Moreover, the instability of the exchange which must be expected for some time will introduce a factor of uncertainty which will tend to delay the increase in the volume of exports. Ultimately, however, the depreciation of the pound will improve substantially the balance of payments in respect of imports and exports; but the extent of the improvement from this cause will depend, in part, on the policy pursued by other countries in respect of their own currencies.
31. As regards Government receipts and payments, there will be some increase reckoned in sterling, but a reduction reckoned in gold, in the overseas expenditure of the defence services (the total being £7 million in a full year), of the diplomatic services, &c.

32. The effect of our national shipping income will be similar to the effect on our exports, i.e., it is likely to be favourable in the long run by improving the power of our shippers to meet foreign competition.

33. As regards our income from overseas investments, we have already expressed the view that the diminution in the real burden to debtor countries of sterling loans may actually serve to maintain our receipts from such loans, as measured in gold, at possibly even a higher level than would otherwise have been the case. As regards variable interest overseas investments, the effect on our receipts is likely to be favourable in so far as debtor countries allow their currencies to move with sterling. Nevertheless, even if there are no further defaults there will be a reduction of £25 million (assuming a depreciation of 25 per cent.) in the gold value (though not in the sterling value) of our receipts.

34. The value of our receipts from "short interest and commissions" is likely to be reduced, at any rate for the time being, by a diminished use of the sterling bill, which must be expected to result from the instability of sterling.

35. The main effect of the depreciation of the pound on the balance of payments will be that on merchandise imports and exports. Whatever uncertainty there may be regarding the net balance of the initial effects, ultimately the balance of payments should be materially improved. The extent of this improvement will, of course, depend on the eventual level at which sterling settles, and on the course pursued by other countries, as well as on many other factors at present unknown.

IV.—THE QUESTION OF REMEDIAL ACTION.

36. We conclude that it is in any case vital for the solvency of our trade balance that sterling should remain for the time being substantially below gold parity, and we are of the opinion that in existing circumstances a decline in the gold value of sterling by 25 per cent. would not be by any means excessive. At any rate it would, we think, be unwise from the point of view of the balance of trade to make artificial efforts to maintain the value of sterling except in the event of a serious further slump.

37. Our examination of the figures leads us to the conclusion that, even after allowing for all likely assistance from exchange depreciation, whether or not accompanied by a tariff, the problem still remains difficult of complete solution unless there is a recovery in world prices and a general revival of world trade. It is important, therefore, that we should not allow our minds to be occupied too exclusively by our domestic problems, but that we should be thinking out a comprehensive international policy.

38. Until lately our power of international initiative was paralysed by our anxiety to prevent, or provide for, foreign withdrawals of balances. But now that we have recovered greater freedom of action, we should consider most carefully how best to use it. Plans for useful international action are more possible to-day than they were a short time ago. It is probable that many other countries will be constrained to follow our example, whilst those countries which remain on the existing gold parity will bear the whole brunt of the competition of those countries which depart from it. France and the United States are likely to find themselves at no distant date with their export trade cut to pieces and their banking systems seriously impaired. These factors might tend to make them more reasonable in their discussion of international remedies.
Y.—SUMMARY OF CONCLUSIONS.

39. We summarise our conclusions as follows:

(a) During the past year there has been a marked adverse change in the balance of international payments, with the result that there is a large and growing debit balance which we estimate is now running at a rate of not less than £2 million in a week.

(b) The adverse change in the balance of payments is mainly attributable to a large decline in our receipts from overseas investments. Up to the present this decline has not spread to any considerable extent to our fixed-interest investments. A large part of the income from these investments must be regarded, however, as in a high degree precarious, unless there is a great change in the international position.

(c) The outlook for the balance of payments has been materially altered by the depreciation of sterling, which will principally affect merchandise imports and exports. Whatever uncertainty there may be regarding the net balance of the initial effects, ultimately the balance of payments should be materially improved. The extent of this improvement will, of course, depend on the eventual level at which sterling settles, and on the course pursued by other countries, as well as on many other factors at present unknown.

(d) Even after allowing for all likely assistance from exchange depreciation, whether or not accompanied by a tariff, the problem still remains difficult of complete solution unless there is a recovery in world prices and a general revival of world trade. Plans for useful international action are more possible to-day than they were a short time ago. We should not allow our minds to be occupied too exclusively by our domestic problems, but should be thinking out a comprehensive international policy.

(Signed) J. C. STAMP, Chairman.
WALTER M. CITRINE.
G. D. H. COLE.
J. M. KEYNES.
ALFRED E. LEWIS.

(Signed) H. D. HENDERSON Joint Secretaries
A. F. HEMMING to the Committee.

2, Whitehall Gardens, S.W. 1,
September 23, 1931.