CABINET.

THE AMERICAN SITUATION AND THE MONETARY AND ECONOMIC CONFERENCE.

SEVENTH REPORT OF COMMITTEE ON ECONOMIC INFORMATION OF THE ECONOMIC ADVISORY COUNCIL.

Note by the Secretary.

The attached seventh Report of the Committee on Economic Information of the Economic Advisory Council is circulated for the information of the Cabinet, by direction of the Prime Minister.

(Signed) M. P. A. HANKEY.

2, Whitehall Gardens, S.W.1.
18th May, 1933.
SECRET.


TO BE KEPT UNDER LOCK AND KEY.

It is requested that special care may be taken to ensure the secrecy of this document.

ECONOMIC ADVISORY COUNCIL.

COMMITTEE ON ECONOMIC INFORMATION.

SEVENTH REPORT.

SURVEY OF THE ECONOMIC SITUATION, MAY 1933.

The American situation and the World Economic Conference.

2, Whitehall Gardens, S.W. 1,
May 10, 1933.
COMMITTEE ON ECONOMIC INFORMATION.

Composition and terms of reference.

ON the 14th July, 1931, the Prime Minister appointed a standing committee of the Economic Advisory Council with the following terms of reference:—

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

2. The committee is now constituted as follows:—

Sir Josiah Stamp, G.B.E., Chairman.
Mr. G. D. H. Cole.
Mr. J. M. Keynes, C.B.
Sir Alfred Lewis, K.B.E.
Sir Arthur Salter, K.C.B.
Sir Ernest Simon.

With—


Mr. H. D. Henderson, Joint Secretary, Economic Advisory Council.

Mr. Francis Hemming, C.B.E., Joint Secretary, Economic Advisory Council.
SEVENTH REPORT.

Survey of the economic situation, May 1933.

The American situation and the World Economic Conference.

BY our terms of reference we are directed to supervise the preparation of periodical reports on the economic situation; and in accordance with these instructions we* now submit the seventh of these periodical reports.

2. In the circumstances of the moment, we have not followed in our present report our usual practice of surveying the general economic situation and summarising the recent trend of economic statistics; for, in the light of the American developments, these statistics necessarily lose their normal significance as a guide to the future. We have therefore confined ourselves to a discussion of the American situation and of the problems which it opens up for the World Economic Conference.

Signed on behalf of the committee.

J. C. STAMP, Chairman.

2, Whitehall Gardens, S.W. 1.
May 16, 1933.

* These references do not include Sir Arthur Salter, who is abroad. Nor was Sir Frederick Leith-Ross, who normally attends our meetings, able to be present while this report was in preparation.
THE AMERICAN SITUATION AND THE WORLD ECONOMIC CONFERENCE.

From the economic standpoint, the outstanding developments of recent months are those which have occurred in the United States. The American departure from the gold standard is likely to prove, for better or worse, the dominating influence on the course of trade in the near future. It raises, moreover, important issues of policy for Great Britain and for the world at large.

2. A year ago, in our third report, dated May 1932 (Council Paper E.A.C. (S.C.) 3), we thought it worth while to discuss seriously, and at considerable length, the then remote possibility that the dollar might be driven off gold. We expressed scepticism as to whether the "reflationary" measures of open-market purchases and Reconstruction Finance Corporation loans would "succeed in turning round the tide of trade and prices," and suggested that the American authorities might be "confronted with the dilemma that any action which they take which is sufficiently moderate not to cause alarm as to the dollar will be inadequate to affect trade and prices, while action powerful enough to raise prices would first entail general alarm as to the dollar." We reproduce the conclusion of our argument in extenso:

"22. If at any time a serious flight from the dollar were to begin, it is probable that the Federal Reserve authorities, in an endeavour to restore confidence, would reverse their present policy of credit expansion. If they were supported in this course by the administration and by public opinion, and were to succeed thereby in checking the flight, the position would then be that the policy of organised refation would have been abandoned as a failure, and the American people would have no prospect before them but that of an indefinite continuance of progressive deterioration.

"23. It may be doubted, however, whether the American people would for long tolerate a prospect so unilluminated by hope; and in these circumstances an early reaction to extreme and desperate measures of public expenditure would be by no means unlikely. It is necessary, therefore, to contemplate the possibility, although it seems at present remote, that a flight from the dollar may acquire such momentum as to become uncontrollable, with the result of driving the dollar off gold despite the strong gold position of the United States. In this event serious issues will be opened up for Great Britain. We have already referred to the likelihood of exchange depreciations in central and south-eastern Europe. Such depreciations will deprive our industries of part of the relative advantage which they have gained in world markets from the fall of the pound. Indeed, if the process of devaluation extends to Germany, the position of our industries vis-à-vis German competition will be materially worse than it was last summer, inasmuch as Germany has effected drastic reductions in her costs of production in the meantime. If, in addition to central and south-eastern Europe, the United States should devalue her currency, the consequences would be still more far-reaching. The sequel to such a development would probably be a period of extreme exchange confusion, in which the whole of our present competitive advantage might disappear, and which would probably accentuate the growing paralysis of the processes of international trade."

3. It is instructive, we think, to observe the respects in which the actual course of events has conformed to this forecast, and those in which it has diverged from it. The reflationary measures failed, as we feared they would, to reverse the downward course of trade. There was a considerable distrust of the dollar, taking the form of the internal hoarding of gold and to some extent of the acquisition of foreign currencies, movements which received a marked impetus at the time of the crisis which culminated in the closing of the banks at the beginning of March. The first reaction of the authorities to this distrust was to combat it by measures designed to restore financial confidence. Internal gold
hoarding and the export of capital were alike checked by emergency measures, while licences were granted for the export of gold where necessary for the maintenance of exchange parity. The success of these measures within these limited objectives was temporarily complete; and for a time neither the power, nor the will, of the new administration to maintain the dollar appeared to be in doubt. There quickly followed, however, a refusal of the American people, as represented by the new Congress and the President, to "tolerate a prospect so unilluminated by hope," as was implied in the continued pursuit of orthodox financial policies; and the abandonment of the gold standard on the 19th April was mainly attributable to this refusal.

4. The rapidity of the dénouement, however, and the form which it actually assumed, were such as we should hardly a year ago have thought possible. We thought it not unlikely that the advocates of heterodox financial policies would gain such influence as to cause an uncontrollable flight from the dollar. But it did not occur to us that the export of gold might be suspended by the administration as a deliberate act of policy, before any serious difficulty in maintaining the dollar had been experienced. The American action is, indeed, the first instance of a spontaneous departure from the gold standard in monetary history; and that such a course should have been followed in the United States, where the prevalence of the "gold clause" in debt contracts presents a peculiar complication, indicates the extraordinary fluidity of all ideas, even those which seem the most firmly rooted, under the pressure of three years of unparalleled depression. This fluidity of ideas adds greatly to the uncertainties of the economic outlook, for the course of events may at any time be deflected by unforeseeable vagaries of policy.

5. Before discussing the probable consequences of the American action, it is desirable, in order to prevent any possible confusion, to make certain distinctions and definitions. It is desirable to distinguish clearly between (a) a fall in the exchange value of the dollar relatively to other currencies (which we shall call "exchange depreciation"), and (b) a depreciation in terms of gold (which we shall call "gold depreciation"). It is further desirable to distinguish between (c) a condition of gold depreciation in which there is no definite link between the currency and gold, as is the case at present with both the dollar and the pound, and (d) devaluation, which would place the currency again on a gold basis at a new and lower parity. Devaluation, again, may be either (e) provisional in character, like the stabilisation of the French franc between 1926 and 1928 (which we may call _de facto_ devaluation), or (f) final and formal, entailing the restoration of the full trappings of the gold standard (_de jure_ devaluation).

6. It is of the essence of devaluation, whether _de facto_ or _de jure_, that the Central Bank of the country concerned is prepared to buy (or to sell) unlimited quantities of gold at a fixed price corresponding to the new parity. So long as this arrangement holds, an inward movement of funds, however large, cannot force up the gold value of the currency; it can only lead to an inflow of gold; and no country has ever yet been forced to raise its gold parity by any difficulty in absorbing gold imports. There is, therefore, no limit to the power of any country to secure as large a degree of gold depreciation as it wishes by means of devaluation.

7. It is the possibility of devaluation in the United States that at present governs the exchange value of the dollar. But for this possibility, it is improbable that the embargo on gold payments would have been followed by any considerable exchange depreciation. American money costs of production have been cut drastically in the last two years. Even on the basis of gold parity the United States has maintained a favourable balance of trade, and she has in addition a strong creditor position. It follows that substantial adverse capital movements are required to weaken the exchange value of the dollar or indeed to keep it weak; and, apart from the possibility of devaluation, it is probable that an exchange depreciation of the dollar by as much as 10 per cent. would suffice to set the tide of capital movements strongly towards the United States. But President Roosevelt has been equipped by Congress with authority to devalue the dollar at his discretion down to 50 per cent. of its gold value; and behind the grant of this authority lies a strong opinion in favour of devaluation as a means of raising
commodity prices. The possibility of a large eventual devaluation involves a substantial gold depreciation of the dollar in the meantime; and, so long as the gold values of other currencies remain unaltered, this involves a proportionate exchange depreciation.

8. This exchange depreciation of the dollar must be expected to have a disturbing influence on the international situation analogous to that which was exerted in 1931 by the fall of the pound. In so far as the United States benefits from an improvement in the competitive position of her producers, both industrial and agricultural, in world markets, this implies a corresponding worsening of the competitive position of rival producers in the outside world. In many countries, unlike the United States, the maintenance of a balance of trade adequate to the discharge of their external obligations, is a problem of great difficulty; and the fall of the dollar may thus lead to an accentuation of international financial instability and to a tightening of the network of restrictions upon international trade. Moreover, the American departure from gold necessarily leaves great uncertainty attaching to the stability of other currencies which are now linked to gold. No one can feel much confidence that we may not be about to enter on a period of extreme exchange confusion; and this lack of confidence is necessarily prejudicial to the recovery of international trade.

9. Despite these considerations, there is a widespread feeling of optimism in the United States, which is shared in a lesser degree in Great Britain, that the preponderant effects of the American action on the world situation are likely to be beneficial, as the result of the impulse which will be supplied by the immense improvement which is hoped for in American economic life. For this view to be justified, a small or fleeting recovery in the United States, such as Great Britain secured after the fall of the pound in 1931, would clearly not suffice. What grounds, then, are there for expecting an improvement in the United States on a scale sufficient to reverse the normally deleterious effects on world trade of the depreciation of an important currency?

10. The optimistic view is based upon two broad arguments: the first, that the embargo on gold payments must be viewed not in isolation, but as part of a systematic policy of reflation and expansion which will be actively pursued; the second, that the United States has been the real centre of the world depression throughout all its phases, and that an American recovery is thus an essential condition of recovery elsewhere.

11. As regards the first of these arguments, there is unquestionably a striking contrast between the present attitude of the American administration, and the attitude of the British authorities in the autumn of 1931. British policy after the fall of the pound was concentrated on the objectives of limiting the extent of the fall, of maintaining budgetary equilibrium, of improving the balance of trade, and of safeguarding against the possible development of a "spiral process" of rising prices and wages. Accordingly in the sphere of finance, a policy of economy was pursued, in the fiscal sphere a policy of tariffs and import restrictions, while in the monetary sphere Bank Rate was kept high and credit conditions were kept tight for a considerable time. In every one of these respects, the American administration seems likely to follow an opposite course. Its governing object is to secure as large a rise of prices as possible, up to the limit of the price-level of 1929, by means of various forms of intensified "reflation."

12. It is, indeed, mainly upon the prospect of a resolute pursuit of policies of internal expansion that intelligent American business circles base their optimism. The departure from the gold standard is envisaged rather as the removal of an obstacle which might otherwise have rendered these policies futile, or limited their application, than as a measure of positive significance. So long as the dollar had a fixed gold parity, it is felt, the most liberal monetary expansion and governmental expenditure might fail to bring about a rise in prices, unless prices also rose in the outside world. But now that the link with gold is severed, this difficulty no longer remains, and the road is clear for expansionist policies to produce their natural results. This desire for an effective sovereignty over the internal price-level has contributed to the growth of the opinion which has led to the departure from gold far more than a desire to improve the competitive position of the United States against other countries.
13. It is by no means clear, however, that the fixed parity of the dollar has really been the obstacle which has prevented American prices from rising. The suggestion is difficult to reconcile with the other contention which we shall consider presently, that the internal difficulties of the United States have been the main cause of the severity of the world depression. The sharp rise in commodity prices which has already occurred will only be maintained if consumers increase their purchases substantially; and so far as the domestic market is concerned, this will require an increase in the volume of business, as distinct from speculative activity. That there will be some improvement in the volume of business is reasonably certain. But it remains to be seen whether it will prove large enough to justify the optimistic expectations that are now entertained. Foreign consumers of American products are not likely to increase their purchases, unless American goods become relatively cheaper, i.e., unless the exchange value of the dollar falls more than American prices rise. So far, therefore, as concerns commodities sold in world markets, the rise in prices which is likely to be sustained, in the absence of a business improvement in the outside world, is limited by the extent of the exchange depreciation of the dollar.

14. We turn to the second main argument on which the case for optimism rests. There is no doubt that the depression has been more severe in the United States than in most other countries; and the economic importance of the United States is so great that, in the absence of an American recovery, it is difficult to imagine the possibility of any general world recovery. There is accordingly, in our judgment, considerable force in the view that the world stands to gain from any development which is calculated to bring about a large improvement in the United States, even though its direct effects may be prejudicial to the interests of other countries. But the proviso that the improvement in the United States must be a large one is crucial to the argument. Moreover, there is another factor in the world problem of which it is necessary to take account. One of the outstanding causes of the world depression is the difficulty which the rest of the world has experienced, since the cessation of American foreign lending on a large scale, in adjusting its balance of payments with the United States. From this standpoint, the heavy decline in American exports in recent years may be regarded as the only means of balancing accounts, which the United States, with its high tariff, its creditor claims and its extreme reaction against foreign lending, has left open. The depreciation of the dollar will tend to improve the American balance of trade and to impair that of other countries. There is, therefore, a real danger that it may tend to aggravate one of the main factors of fundamental disequilibrium that lies behind the present slump. Something would be done to diminish this danger if the Administration were to secure a substantial lowering of the American tariff. The cancellation or drastic writing-down of war-debt claims, and American participation in schemes of international financial reconstruction, would provide more immediately effective safeguards. These are desiderata which the World Economic Conference may help to secure. We refer to them in the present connection in order to emphasise that the exchange depreciation of the dollar greatly increases their importance.

15. Subject to these international questions, we think that there is sufficient truth in the view which regards impulses from the United States as the dominating influence on the course of trade throughout the world to ensure that, if the American recovery is substantial and sustained, the resultant effects on the world at large will be beneficial. It is as yet, however, impossible to gauge the probable extent of the American recovery. The increase in the figures of steel production is promising; but a considerable part of this increase represents a normal seasonal improvement. Small reliance can be placed on the boomlets which have taken place on the commodity markets and the stock markets. There have been many similar boomlets during the course of the depression, which have faded away in renewed disillusionment. The optimism which produces a speculative outburst is a different thing from, and sometimes inimical to, the steady confidence which is requisite for a business revival. From the American standpoint, perhaps the strongest reason for taking a hopeful view is the determination which now evidently inspires the Administration to use any and every means to secure a substantial rise of commodity prices; for it would be difficult to maintain that the price-level is in the last resort beyond human control, and there can be no question, in view of the huge internal debt structure of the United States, that
a rise in the price-level is an indispensable condition of recovery. But from the world standpoint vital importance attaches to the question of the means which may be employed in the United States before a real recovery is secured.

16. We may assume that President Roosevelt will not use his authority to devalue the dollar, until after the opening of the World Economic Conference. If, however, recovery does not proceed far in the United States in the next few months, and if in the meantime the World Conference should have ended without any definite agreement upon monetary policy, the question of devaluation will assume a pressing importance. We must remember that the personal credit of President Roosevelt, and the credit of his administration are now staked irretrievably upon securing a substantial rise of prices and a real business recovery. If their first attempts appear to fail, they will be compelled to try any expedient for which it can plausibly be claimed that it is likely to be helpful to their purpose. In these circumstances, it would not be unlikely that the advocates of a large immediate devaluation would carry the day; and that the world would be confronted with the *fait accompli* of a dollar devalued in terms of gold by substantially more than the extent of its present depreciation.

17. This would create an international situation of extreme confusion and difficulty. The devaluation of the dollar would almost certainly be followed by a large movement of balances into the United States. For with the removal of the expectation that the dollar might fall further in terms of gold, Americans who had previously been putting their money abroad would begin at once to repatriate it. Simultaneously, distrust of the stability of other currencies would be greatly accentuated. Faced both with large adverse capital movements, and with the prospect of a serious injury to their exporting industries if gold parity were retained, it is highly probable that those countries which still retain an effective gold standard would quickly abandon it, allowing their currencies to undergo a substantial gold depreciation. Countries like Germany which at present maintain a pseudo-gold standard by means of drastic exchange restrictions would be faced with an embarrassing problem, which they would probably solve, though not without some increase of internal distrust, by depreciating their nominal gold parities. Great Britain would be subjected to the conflicting pressures of a large inflow of balances to the United States, and a large outflow of balances from other countries, and the course of the sterling exchanges, in the absence of a definite policy, would probably be erratic in the extreme.

18. Yet it would be extraordinarily difficult in the circumstances we are supposing to know what exchange policy it would be wise to pursue. By returning to gold ourselves at a new parity, we could indeed obtain a fixed parity for sterling in terms of the dollar. But we have hitherto thought it unsafe to take this step, and the risks attaching to it would be greatly increased by the developments which we are now discussing. It is unlikely that our resumption of a gold basis would suffice to check a large return of balances to the United States, and the movement of balances might easily attain dimensions which would drive us off gold once more. This danger would be especially great, if the gold parity which we selected was one which gave sterling a considerably higher exchange value relatively to the dollar and other currencies than has prevailed since September 1931; for in that event the competitive power of our exporting industries would be prejudiced, and distrust of our ability to maintain the new established parity would naturally arise.

19. If, on the other hand, we chose a low parity, there would be dangers of an opposite character. While it is, we think, true that the motive of securing a competitive advantage by means of exchange depreciation has not played an important part in the movement of American opinion responsible for the departure from the gold standard, the desire for an exchange depreciation is by no means absent in the United States, and is very likely to grow in strength. If we suppose that the prevailing level of the sterling-dollar exchange in the next few months is in the neighbourhood of $4, that the United States then devalues and that we subsequently return to gold at a parity entailing an exchange-rate in the neighbourhood of $3.40, we must expect a considerable outcry from the American interests which have felt the benefits of exchange depreciation in the meantime. In the circumstances we are supposing, namely, a
setback to American trade and an absence of international co-operation, the possibility cannot be dismissed that the United States might treat our devaluation as an act of economic hostility, and retaliate by a further devaluation of the dollar in terms of gold. We should then find ourselves plunged in a warfare of competitive exchange depreciation, fatal to the hopes of the restoration of orderly conditions for international trade.

20. These dangers would not be appreciably diminished if we were to have recourse to *de facto* instead of to *de jure* devaluation. If we refrained from the attempt to establish any particular parity, but endeavoured by means of the Exchange Equalisation Fund to keep the movements of the exchanges within reasonable bounds, we should find ourselves faced in the circumstances we are supposing with a task of extraordinary difficulty. Speculative movements in the exchanges might assume dimensions far greater than any that we have yet experienced, and call for correspondingly large operations on the part of the Exchange Equalisation Fund if any degree of exchange stability were to be maintained. At the same time the risk of eventual loss attaching to these operations would be greatly increased. Indeed, a not unlikely outcome of the situation we are envisaging would be that we should be driven, as the only feasible means of maintaining essential stability, to introduce ourselves a system of restrictions on exchange dealings on the Continental model.

21. Such, we believe, are the formidable possibilities latent in the present situation, in the event of a failure to reach a monetary agreement at the World Economic Conference. But while the American departure from gold adds greatly to the dangers of the international position, it also lends a new feasibility to the possibility of constructive international agreement. We turn, therefore, to the question, which has now assumed a vital urgency, of international monetary policy, as affected by the developments in the United States.

22. We take the view that the most satisfactory sequel to the American departure from gold would be all-round devaluation of currencies, though at first on a *de facto*, rather than a *de jure*, basis, which would leave their relative exchange parities very much as they have been in the past year. We therefore suggest that an attempt should be made at the World Conference to secure a general agreement for such an all-round devaluation. The suggestion is not one to which the American Government is likely to be averse. Real though the danger is that American opinion may shortly come to attach value to exchange depreciation as such, that is not at present an important motive of American policy. President Roosevelt in his utterances has laid stress on the importance to the United States of "a return to prosperity all over the world," and has expressly mentioned the "stabilisation of currencies" as one of the conditions of recovery. If he could claim that he had secured an agreement at the World Economic Conference which reconciled a devaluation of the dollar with the avoidance of a chaotic disturbance of the foreign exchanges, and which proceeded for a return of Great Britain to a gold basis, the requirements of the American political situation would be fully met. So far, indeed, from a proposal for all-round devaluation being likely to encounter American opposition, it is probable that she would co-operate gladly in a joint Anglo-American initiative along these lines.

23. From the British standpoint, the proposal would entail a *de facto* return to the gold standard at a lower parity, a step which we have hitherto been unwilling to take. We do not claim that this course would be free from dangers and possible disadvantages. There is, in particular, the risk that the stability of the new parity might be subjected to serious strain at any time as the result of large-scale capital withdrawals, a development which might be stimulated by the repatriation of American balances, which we must in any case expect. For this reason as well as for others which we develop later, we think it important that the stabilisation should be *de facto* in character. But the risk of large capital movements, which is inherent in a return to a gold basis, would be greatly diminished if our return to gold took place as part of an amicable international agreement, based on all-round devaluation. In the first place, such an agreement would have a tranquillising influence on the international financial atmosphere and make large capital movements less likely. Secondly, we should presumably be able to obtain general acquiescence for a parity for sterling low enough to avoid serious damage to our balance of trade. This certainly should
be an essential condition of our willingness to adhere to a scheme for all-round
devolution; and as all countries would have a common interest in avoiding a
repetition of the experience of September 1931, it is unlikely that any great
difficulty would arise over the point, though we might do wisely to accept exchange
parities slightly higher than those of the past year. Thirdly, the common interest
which all countries would have in maintaining the stability of the new inter-
national system should make it possible to secure arrangements providing for
the mutual support of each other's currencies by the principal financial countries.
It might be agreed, for example, that in the event of a large-scale movement of
funds from London to New York, the American authorities would buy sterling,
and *vice versa*. If the general principle of an agreement for all-round
devolution were accepted, it is reasonable to assume that there would be a
general willingness to explore the possibility of such arrangements.

24. It could not be expected that a proposal for all-round devaluation
would at first commend itself to France and other countries at present on an
effective gold standard. France, in particular, having passed through a period
of inflation, is the more deeply wedded in consequence to conservative financial
traditions, and having a price-level which in francs is still much higher than
pre-war, is less responsive than Anglo-Saxon peoples to arguments about
the necessity for raising prices. She will enter the conference resentful of what
seems to her the irresponsible frivolity of President Roosevelt in suspending
gold payments, and prejudiced against proposals which seem to be inspired by the
same state of mind. In these circumstances, we must expect that the first
reaction of France to a proposal for general devaluation would be to denounce
it as fundamentally unsound. It by no means follows, however, that this would
be her last word, if the proposal were seriously pressed by the joint persuasions
of Great Britain and the United States. For, after all, the step which France
would be asked to take is one which, if she refuses to take it, is likely to be forced
upon her in effect by the development of events. It is most improbable, as we
have already pointed out, that France and the other gold standard countries
would be able, or would long attempt, to maintain their present gold parities, if
the United States were to devalue the dollar by a large percentage. With the
warning conveyed by the authority conferred on the American President to
decree a large devaluation at any time, the French financial authorities cannot
have failed to envisage this situation, and must already be fully conscious of the
difficulties which would confront them. The chance is, therefore, considerable,
we believe, that, after preliminary protests, the French would acquiesce in an
Anglo-American proposal for all-round devaluation, as the best means of
safeguarding their position. If France were to agree, there would be no difficulty
with the other gold-standard countries.

25. From the general world standpoint, an agreement for all-round
devolution would have a more positive value than that of a safeguard against
foreign exchange chaos. We cannot, indeed, assume that the writing-down of
the gold values of the different currencies on a plan which would leave their
relative exchange rates unaffected would serve directly to raise commodity prices.
But it would increase the value of the gold reserves of every Central Bank, in terms
both of its own currency and of the currencies of other countries, by an amount
corresponding to the percentage of the devaluation. It would thus equip every
country, in proportion to its gold reserves, with increased means of meeting
external obligations. It would thus meet, in some degree, the vital need of
increasing the supply of international purchasing power, for meeting which we
suggested in a previous Report the creation of an international note-issue. This
increased international purchasing power would accrue preponderantly, it is
ture, to the stronger financial countries, but, even so, it would do something to
ease the international financial tension. It might prove practicable, moreover, to
supplement an all-round devaluation agreement with a scheme for organised
international assistance to the weaker countries. It might be arranged, for
example, that the stronger financial countries should pool part of the increased
financial resources which devaluation would give them with the Bank for
International Settlements as a basis for advances to debtor countries, possibly in
proportion to the decline in their gold reserves during the years of the present
crisis. Such assistance might appropriately be made subject to suitable
modifications in the system of exchange restrictions. Finally, it would be
reasonable, as a general rule, to provide that the financial gain of the increase in the value of the gold reserves should accrue to the Governments rather than to the Central Banks, as would indeed happen automatically in some cases. The windfall which Governments would thus secure would be of great value at a time of general embarrassment in public finances.

26. There is, indeed, all the difference in the world between a disorderly process of gold depreciation, in which first one country and then another is forced by circumstances off its gold parity or chooses impulsively to abandon it, and an agreed international devaluation. If it had been possible early in 1931, before the financial crisis arose, to have secured an agreement for an all-round devaluation of currencies by, say, 30 per cent., the resources of every country subjected to an external drain would have been proportionately strengthened, the resources available in every country for assisting its neighbours in difficulties would have been correspondingly strengthened. With these aids, it is not inconceivable that the whole international crisis might have been averted; it is almost certain that its area would have been more circumscribed. As events are moving, it is not out of the question that something very like an all-round 30 per cent. devaluation may be brought about by a piecemeal process. But, as the experience of the past two years clearly shows, the piecemeal process entails an immense injury to international economic life. As each fresh gold depreciation occurs, there is a disturbance of the foreign exchanges, a multiplication of trade obstacles, and an increase of financial tension. The world is now confronted with a grave danger of an intensified phase of the piecemeal process with a corresponding accentuation of its attendant consequences. The moral is clear that we should provide by an orderly devaluation, based on appropriate exchange parities, for the depreciations which we must in any case expect; and we may turn what threatens to be a source of serious aggravation of the world’s difficulties into a means of escape from them.

27. As we have already indicated, however, we think it important that the devaluations should, in the first instance at least, be de facto rather than de jure. The uncertainties which must necessarily attach to the working of the new international system make it desirable and appropriate to retain the possibility of subsequent modification. It is not impossible, for example, that the reflationary efforts which the United States is vigorously making, however unsuccessful at first, may eventually lead to a tremendous rise in the American price-level. In view of the widespread acceptance of the formula that the objective should be to restore prices to the level prevailing before the slump, no steps might be taken to check the rise until it had reached this level, and the rise of prices might go considerably beyond it before any check became effective. But a return of dollar prices to their pre-slump level would mean a rise of sterling prices far above their pre-slump level, owing to the exchange depreciation which sterling has undergone in the meantime. In such an eventuality an increase in the gold parity of sterling would be a preferable alternative. This is only one of many possible developments which make it desirable to retain some possibility of modifying the new parities which are established.

28. At the same time, it would be unsatisfactory if extensive modifications of the de facto parities were to prove necessary. For this and other reasons, it is desirable that a scheme of devaluation should be accompanied by an agreement for co-operation among central banks, in association with the Bank for International Settlements, in regard to the future working of the gold standard system.

29. We have indicated in the course of our argument certain of the conditions which would be essential and the supplementary features which it would be desirable to attach to an agreement for all-round devaluation. We may summarise them as follows:

1. The gold parities should be such as would roughly maintain the foreign exchanges at the rates prevailing before April, though we might accept for sterling a somewhat higher rate than 3·45 dollars.

2. These parities should at first be of a de facto, rather than a de jure, character.

3. There should be arrangements between the chief financial countries for the mutual support of each other’s currencies in case of emergency.
(4) The financial windfall represented by the increased value of gold reserves should accrue as a general rule to Governments rather than central banks.

(5) The devaluation agreement should be supplemented, if possible, by a scheme of organised international credits for financially embarrassed countries, subject to the condition of the relaxation of restrictions on exchange dealings, and by an agreement between central banks in regard to the future working of the gold standard system.

30. We conclude by repeating that, as we see the situation, the American departure from gold, while it confronts us with new dangers, opens up new opportunities as well; and it should be for British policy to see that these opportunities are grasped at the World Economic Conference. The case for pursuing the course we have indicated is further strengthened by a consideration of high policy. It is of the utmost importance, with regard to every phase of world affairs, to develop the cordial co-operation of Great Britain and the United States. President Roosevelt has staked large hopes on the success of the World Economic Conference. He has declared that it "must succeed," for "the future of the world demands it." Notoriously it is through co-operation with Great Britain that he sees the best chance of securing a satisfactory result. Hitherto he appears to have been looking primarily to co-operation in the sphere of the reduction of tariffs and the removal of trade barriers. So far as we can judge, however, the prospects of a real accord between the two countries in this sphere are extremely slight. There is indeed a manifest danger that the attempt to reach an accord may end in severe disillusionment and mutual recrimination.

31. It is all the more important, therefore, to find a major project for which Great Britain and the United States can work cordially together at the Conference. A proposal for all-round devaluation would form such a project. As we have argued above, the proposal is one which is likely to be welcomed by the United States. It is from the Continental countries like France that opposition is to be expected. We have given above our reasons for hoping that this opposition might be overcome by Anglo-American persuasion. But, even if our hopes under this head should be disappointed, and it proves impossible to secure an international agreement, much good would still have been done by the demonstration of Anglo-American harmony upon this matter. Failing a general agreement, indeed, we might still reach an agreement with the United States for the simultaneous devaluation of the pound sterling and the dollar which would safeguard effectively against the dangers which we have discussed at length in this report.

2, Whitehall Gardens, S.W. 1.
May 16, 1933.