WAR CABINET.

DISCUSSIONS UNDER ARTICLE VII OF THE MUTUAL AID AGREEMENT.

REPORT FROM THE COMMITTEE ON EXTERNAL ECONOMIC POLICY.

1. At their meeting on the 11th February the War Cabinet agreed that a Committee comprising—
   The Chancellor of the Exchequer (Chairman),
   Minster of Production,
   Lord Privy Seal,
   President of the Board of Trade,
   Minister of State,
   Paymaster-General,

should be set up, "to determine, in the light of the discussion in the War Cabinet as summarised by the Prime Minister,* the attitude to be taken by United Kingdom officials in the forthcoming discussions with official representatives of the Dominions and India over the whole field of the Washington Conversations under Article VII."

We have held six meetings during the course of the week, and have examined the main issues likely to arise during the forthcoming discussions.

The following paragraphs represent the views of the Committee, other than the Lord Privy Seal, who has submitted a minority report:

The General Position.

2. The talks which have taken place, both in Washington with the United States representatives, and in London with the representatives of the Dominions and India, over the whole field covered by what are described as the "Article VII Discussions" have so far all been carried out at the official level. It has been made quite clear that Ministers are in no way committed to the schemes which have been the subject of these talks.

This position must still be maintained. If, in our view, there were no likelihood of ultimate acceptance of the schemes, we ought, of course, to say so at once. On the other hand, we are not called upon to pronounce in favour of them at this stage.

3. Our general recommendation is that discussion should proceed with Dominion representatives on the basis that, while no commitment will be entered into, our expectation is that at the appropriate time we shall find it to our advantage to participate in these schemes, with or without modification.

4. During the opening meetings of the discussions (which are due to start on Monday, the 21st February) the general attitude to be adopted by United Kingdom officials should, we think, be mainly explanatory. They should give a full exposition of the schemes which have emerged from the Washington discussions, explain the attitude of United States officials on the more important points.

* The Prime Minister's summing up was to the effect that the general view of the War Cabinet was in favour of proceeding with a policy generally on the lines discussed at Washington, although no doubt there would be a number of specific points which would require further examination (W.M. (44) 18th Conclusions, Minute 4).
and indicate any issues which, from the United Kingdom point of view, may require further elucidation or in regard to which further safeguards may be required to protect our interests. Above all, their object should be to elicit the views of the Dominion representatives.

5. This phase of exposition and preliminary exchange of views may well occupy no more than the first days of the discussions with the Dominion representatives. During that time certain specific issues of policy will almost certainly arise in which—unless the general guidance which we have set out in the Annex to this report proves adequate—it will be necessary for the United Kingdom officials to seek further guidance from Ministers. We propose that it should be an instruction to the United Kingdom officials in the discussions to report as soon as these issues emerge, in order that they may be given the necessary guidance. These questions should, we suggest, be considered in the first instance by this Committee, a report being made to the Cabinet as necessary.

6. So much for the general position. We add observations on the more important issues dealt with in our discussions.

**International Monetary Fund.**

7. The first is the International Monetary Fund. The Bank of England, whose views are important, as they would be intimately concerned with the Fund’s management, have misgivings on several features of the scheme.

8. In the first place doubts have arisen concerning what is termed the passivity of the Fund. The member countries are all to contribute to the Fund very substantial amounts of their own currencies, and this “mixed bag” of currencies will constitute the main asset of the Fund. The intention of the plan is that, in all circumstances, this Fund shall be passive, in the sense that the currency of a country will be transferred to another country only on the initiative of the country first named. The doubt is whether, notwithstanding the words in the plan which lay this down, the management, in the course of time, would begin to use the currencies in their possession to help to keep exchange rates reasonably stable by buying and selling. It may be the case that, if no further technical safeguard is practicable to secure the original object, at any rate clearer and more direct instructions to the management should be introduced.

9. Secondly, it is common ground that it should be our constant aim to preserve indefinitely the main features of the sterling area in full force in the form in which it has been known. Doubts have been expressed whether the plan is compatible with this object. In particular doubts have been cast upon the effect of paragraph 6 (i) of the Statement of Principles,* which relates to the power of the Fund in certain circumstances, when a member country is using its facilities, to require that country to exercise controls to prevent use of the resources of the Fund to meet a large or sustained outlay of capital. This may appropriately be the subject of further discussion, and elucidation with the Dominions.

10. Thirdly, and above all, there is the whole question of the arrangements to govern the transitional period. This question was left rather on one side at Washington. It is clear that we cannot expect to get through that period without more material financial assistance to take the place of the system of Lend-Lease. Any plan, however, is still to be worked out. We are of opinion that before committing ourselves to accept the monetary scheme we ought, in any event, to have sufficient assurances to satisfy us that we can see our way through the financial difficulties of the transaction. Further, while the scheme contemplates that a member country joining at the outset may contract out of convertibility for a period, the present drafting of paragraph 11 of the Statement of Principles suggests that this applies only during the early post-war transitional period. We doubt whether we can safely commit ourselves to enter the scheme unless the latitude in this regard runs until such time as we can be really satisfied that we can maintain convertibility indefinitely. For, once the obligation has been accepted, it cannot be abrogated except by withdrawal from the scheme.

**Imperial Preference.**

11. The next question concerns Imperial Preference. On this we suggest the following instructions should be given to United Kingdom officials: They

---

* The Statement of Principles is printed on pages 18 to 20 of W.P. (44) 81.
should not open up any prospect of the substantial elimination of Imperial Preference, but should guide discussion on the following lines:

The main objective is the reduction of tariff barriers, and the abolition of import restrictions over the widest possible area with a view to the maximum increase in the export trade of the United Kingdom and of the Dominions. Our principal aim should be to achieve a more severe reduction in high tariffs than in moderate tariffs. It follows that the question of Imperial Preference would arise in the discussion with Dominion officials in the form of considering what reductions of preferences it will be worth while for us and the Dominions to contribute to a comprehensive scheme providing for the expansion of our trade.

Our representatives should also refer the matter to Ministers for instructions if any substantial body of opinion should appear to be developing among the Dominion representatives in favour of a substantial elimination of Imperial Preference.

[The Lord Privy Seal's dissent from our conclusion on this whole matter is set out in the Minority Report.]

Subsidies for Home Production.

12. We deal next with the provisions of the proposed commercial union in regard to subsidies and their effect on our agricultural policy. On this point we are satisfied that we cannot accept in an international convention any limitation of our right to buy our home agricultural products at fixed prices, to buy food from abroad in bulk and to pay subsidies for home production. We believe that all these points are, in fact, secured in the version of the scheme prepared by our officials; and we must make sure that they are retained in the scheme as it finally emerges.

13. Provided these points are secured, we see nothing in the proposed scheme which is inconsistent with the Government's declared policy of maintaining after the war a healthy and well-balanced agriculture. It is to be noted, however, that the commercial union scheme, in its present form, imposes a limitation on the price, in relation to world prices, at which our products can be placed upon the home market. The contingent Exchequer liability might be a matter for grave concern.

14. The Lord Privy Seal's dissent from our views on this matter is set out in his Minority Report.

15. The detailed instructions to the delegates on particular issues as recommended by the Committee are set out in the Annex to this report.

(On behalf of the Committee):

J. A.

Treasury Chambers, S.W. 1,
18th February, 1944.
ANNEX.

INSTRUCTIONS TO UNITED KINGDOM OFFICIALS ON PARTICULAR ISSUES.

I.—International Monetary Fund.

(i) Attention should be directed at an early stage of the discussions to the importance which attaches, in the United Kingdom's view, to ensuring adequate arrangements during the transitional period. United Kingdom officials should indicate that a clear distinction should be drawn between the arrangements appropriate during the transitional period and the long-term arrangements when normality had been reached.

(ii) It should also be made clear that the United Kingdom officials attach great importance to the maintenance of the sterling area in something like its present form during the transitional period. It should, however, be an instruction to United Kingdom officials to avoid opening up discussion at this stage on the question of Dominion (and Indian) sterling balances. [See, however, (v) below.]

(iii) Turning to the long-term scheme, it would be appropriate that the United Kingdom officials should elicit the opinion of the Dominion representatives on the reactions of the International Monetary Fund on the continuance of the essential features of the peace-time sterling area when normality had been reached. In particular, reference should be made to the provision in paragraph 6 of the Statement of Principles which enables the Fund to require a member country to exercise controls to prevent the use of the resources of the Fund to meet large and sustained outflow of capital. It would be relevant to consider whether this provision might, in certain circumstances, necessitate the establishment of an exchange control between separate units of the sterling area.

(iv) Again, reference might be made to the questions which had been raised as to the passivity of the Fund. The doubts on this matter should be explained, together with the grounds for holding that the matter is sufficiently safeguarded; and the views of the Dominion representatives elicited.

Instructions on the Use of Sterling Balances in the Transitional Period.

(v) Notwithstanding (ii) above, the United Kingdom officials, if seriously pressed to make a statement on the use of sterling balances during the transitional period, should begin by saying that the nearer we are to the war period, the more nearly should we hope the sterling area arrangements to remain on the war basis. As time goes on, existing restrictions would no doubt be relaxed to the extent that resources permit. We should hope, however, that throughout the transitional period the sterling area arrangements, as they now exist, will broadly be continued, particularly as regards the maintenance of exchange controls, which would prevent movements of capital outward from the area. As regards the use of exchange controls in respect of current, as distinct from capital transactions, we ourselves will have to exercise great restraint in importation, especially from outside the sterling area, and we hope that the other members will be prepared to exercise similar restraint.

If necessary, the officials are authorised to add a statement as follows:

What can appropriately be allowed is a matter for later arrangement with each sterling area country according to the circumstances and any generalisation must for the time being be subject to great reserve. Subject to that we do not expect to be in a position to enable any part of the sterling area to import on a scale which is not closely related to its current earning power. We should not, of course, expect members of the sterling area to continue in effect to make large loans to the United Kingdom as they have been prepared to do for war purposes. The least that we should expect to do would be to enable them to import from outside the sterling area to the full extent of their earnings outside the area, and to import from within the sterling area to the full extent of their earnings within the sterling area. We should do our utmost to facilitate a freer policy than this on the part of the exchange controls of other members.
II.—Commercial Policy.

(vi) Tariffs and Preferences.—The prospect of the substantial elimination of Imperial Preference should not be opened up by the United Kingdom officials, who should guide discussion on the following lines:

The main objective is the reduction of tariff barriers, and the abolition of import restrictions over the widest possible area with a view to the maximum increase in the export trade of the United Kingdom and of the Dominions. Our principal aim should be to achieve a more severe reduction in high tariffs than in moderate tariffs. It follows that the question of Imperial Preference would arise in the discussion with Dominions officials in the form of considering what reductions of preferences it will be worth while for us and the Dominions to contribute to a comprehensive scheme for providing for the expansion of our trade.

If any substantial body of opinion should appear to be developing among the Dominion representatives in favour of a substantial elimination of Imperial Preference, the matter should be referred to Ministers for instructions.

United Kingdom officials should be careful to bear in mind the position of the Colonies in connection with any discussion of Preferences which may thus arise.

(vii) Subsidies for Home Production.—United Kingdom officials should continue to maintain, as at Washington, that we cannot accept any limitation in an international convention on our right to subsidise home production. Thus, the United Kingdom Government would be free to pay whatever price they chose for home-grown agricultural produce for home consumption. But it should be noted that, under the proposed arrangements for limiting the height of protective tariffs, when the price paid to the home grower exceeds the price paid for imports of the same commodity plus the margin of protection agreed upon internationally, the excess would have to be found by the Treasury and not by the consumer.

(ix) Export Subsidies.—The practicability of the proposal for stopping the sale of goods in foreign markets at prices lower than those in the home market should be further explored.

(x) Quantitative Restriction.—It should be made clear that, so long as our balance of payments (including unavoidable capital exports) remains unfavourable, as judged by the appropriate objective criteria, we must retain freedom to impose restrictions on imports without reference to the amounts imported in previous years.

III.—Commodity Plan.

(x) Discussions should continue on the scheme for an International Commodity Organisation on the basis of the proposals outlined in Annex “C” of the Minister of State’s memorandum (W.P. (44) 81). The general line of approach should be that the general objective set out in the scheme is acceptable. It is for discussion, however, whether the scheme as now set out constitutes a sound mechanism in respect, particularly, of the linkage of the Buffer Stocks aspects of the scheme with the provisions for restriction of production in certain circumstances.

IV.—Cartels; Employment Policy; International Investment.

(xi) On all these three matters, the impressions formed by the United Kingdom officials of the attitude of the American representatives at the Washington Conversations should be reported to the Dominion representatives, whose comments should be invited.

MINORITY REPORT BY THE LORD PRIVY SEAL.

I dissent from the “general recommendations” contained in the Report of the Committee on External Economic Policy (paragraph 3).

I recommend that discussions should go on at once in Ministerial circles in order to produce an alternative to the Washington schemes. The Ministers to be consulted should, in my view, include the Secretary of State for Scotland, the Secretary of State for Dominions and the Minister of Agriculture, along with representatives of the Bank of England.
The new plan should embrace the Sterling Area and the Economic Empire, with adequate protection for agriculture at home.

I deplore the instruction given to United Kingdom officials in paragraph (vi) of the Annex to the Report. This involves a consideration of what reductions in Imperial Preference will be "worth while." It is my belief that we should approach this problem from the point of view of what reduction may be necessary. The instruction will inevitably encourage a canvassing of opinions among the Dominions for the purpose of enlisting support for reduced preferences. But Imperial Preference is the policy of Britain laid down at Ottawa in agreement with the Dominions. It is not for Britain, therefore, to take even the shortest step either towards promoting an attack upon Imperial Preference or towards a weakening of the Dominions' adherence to that principle of Empire.

In dissenting from the majority report of the Committee, I wish to record the following opinions on the general character of the scheme which emerged from the Washington Conversations on Article VII:

1. The Financial Plan restores the Gold Standard in the form of a "Gold Fund." To this project the Bank of England is opposed. The whole suggestion of the fund, in the view of the Deputy-Governor, is that gold-convertible currencies are better than other currencies. If we accept the "Gold Fund" we lay ourselves down to die. (See note from the Bank of England, attached.)

2. The Commercial Plan in its present form is intended to destroy Imperial Preference and re-ruin the agricultural industry of Britain. It is impossible to defend agriculture by subsidy unless quota is also introduced.

3. The Commodity Plan has been launched on many occasions in the past. It always ends either in financial disaster or restriction of production; the second is as bad for us as the first.*

The Canadian Government pool in wheat is an example. After eight years, in 1939, 1,000 million bushels of wheat were in storage. The money value was more than the total assets of the Bank of Montreal. Storage was a major problem. Bankruptcy was in sight. Then came the war, saving Canada from financial ruin.

18th February, 1944.

Note handed in by Representatives of the Bank of England, at a Meeting of the Committee held on 15th February, 1944.

[See Minority Report by Lord Privy Seal.]

The Bank's first objective must be to maintain and develop the acceptability and purchasing power of sterling. This policy is entirely consistent with the general objectives of the Fund: stability, avoidance of unruly capital movements and of speculation in currencies or competitive manipulation of exchange rates, and easy settlement of current account transactions.

But quite apart from the questions whether or when we shall be able to afford to accept the obligations of convertibility and fixed parities, the mechanism proposed by the scheme is inconsistent with our first objective in two respects:

1. The Fund as drafted is basically a gold fund—the whole suggestion is that gold-convertible currencies are better than other currencies. This in terms of international currencies means that the Fund will like dollars and encourage their use, but will look askance at sterling.

2. The Fund as drafted contemplates settlement of international trade payments in the currency of each country and not in international currencies.

Therefore, if we accept the mechanism in principle, even if we defer its operation, we say publicly that we are working towards a system where sterling will be less useful. This can only make our transitional arrangements, where we are largely dependent on the credit of sterling, more difficult.

*B The Minister of Production associates himself with the views expressed in these two sentences.