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FOREWORD

THE greater part of this book consists, in revised form, of part of a doctoral thesis entitled 'The Dollar Pooling Arrangements of the Sterling Area', accepted by the University of Cambridge in 1953. The work on this thesis was carried out under the supervision of Professor Sir Dennis Robertson of Cambridge and Professor Wilfred Prest of the University of Melbourne. I am very conscious of my debt to both for their help and encouragement. And I owe it to the Ritchie Research Fund of the University of Melbourne that it was possible for me to carry out a year of this work in Australia.

The latter part of the book — and the revision of the whole of it — consists almost entirely of work done while holding a Research Fellowship at the Australian National University. During my time at Canberra I have benefited greatly from the helpful comments and encouragement of members of the staff of the Australian National University, especially of Mr L. G. Melville, the Vice-Chancellor, of Professor T. W. Swan, Professor of Economics, and of Mr Leicester Webb, Reader in Political Science.

I wish also to acknowledge my indebtedness to many public servants and central bank economists — especially in Australia, New Zealand and Ceylon — whose positions make it impossible for me to mention them by name. And there are academic economists far too numerous to mention from whom I have derived many ideas (consciously or otherwise) in the course of discussions with them; if any of them find such ideas expressed here without acknowledgment at the appropriate place, I trust they will pardon the oversight. Of these academic economists I would especially mention my Ph.D. examiners, Professor R. F. Kahn and Professor B. Tew, who have both made very helpful comments, as has Mr W. B. Reddaway.

Finally, I would express my debt to Mr Norman Macrae of *The Economist* and *The Banker*; I find it impossible to assess exactly how much I gained from discussions with him over the ten months during which we shared the same office, but I am certain that my debt to him is very considerable.

I have naturally put my own construction upon the comments and suggestions that have been made to me by all of these. For this, of course, and for the conclusions I have drawn from their remarks, I accept full responsibility.

J. O. N. PERKINS

November, 1955

CONTENTS

INTRODUCTION

THE years following World War II saw various attempts to work towards the restoration of world-wide multilateralism of trade and payments, notably in the establishment of the International Monetary Fund and through the negotiations under the General Agreement on Tariffs and Trade, and also towards the formation of an International Trade Organization — which never came to fruition. But the limited success of these approaches to the freeing of world trade and payments throws into stronger relief the success that is generally considered to have been achieved over a more restricted area by the sterling system and the European Payments Union. But did the very success of these institutions prejudice the success of the efforts of larger groups of countries to free trade and payments over a wider area? And, if it did so, would the economic welfare of the participating countries, or of the world as a whole, have been greater if the energy that had been devoted to making the sterling and EPU systems work had gone into the efforts to free trade and payments on a world-wide plane?

Any answers to such questions must be purely speculative; for one can only guess at the nature and probable degree of success of any alternative system of world-wide multilateral payments that might have been erected. But such questions may be usefully kept in mind while attempting to assess the worth of regional payments institutions; and the question of the contribution that the latter made to the wider objective is clearly important if one is attempting to draw from the experience of the sterling area and the EPU lessons that might usefully be applied to the more general problem of world payments.

An appraisal of these two regional[1] payments systems has, then, two main purposes: the first, historical, to assess whether (and if so in what ways) they contributed to re-building the trade and to raising the real income of the countries concerned and of the trading world as a whole; the second, prescriptive, is to consider whether such institutions may have a part to play in the future — in particular, in a world of more freely convertible currencies than

[1] 'Regional' is used in this connection to mean 'less than world-wide'.

that which was the setting for these payments systems. Even if by the time these words are read the degree of convertibility of currencies is such as to make the past operations of the sterling area and the EPU seem of little practical relevance, there are still useful conclusions of a very general importance to be drawn from their history; and, moreover, it is important to consider how such institutions should be modified if in future it becomes necessary to retreat somewhat from a world-wide multilateralism towards a greater degree of regionalism (even if the 'region' be that of the whole non-dollar world) in the face of an intensification of the dollar problem of the non-dollar world.

This work places the main emphasis upon the discussion of certain aspects of the sterling area that are most directly relevant to these objectives. The European Payments Union is discussed more summarily, and with three main purposes: first, to draw comparisons between its main features and those of the sterling area; second, to analyse the indirect effects of the sterling system through its payments nexus with the EPU and the other monetary areas attached to it, which together covered a very important part of the whole trading world; and third, because any extension of the principles embodied in the sterling system to a wider group of countries would be possible only if proper application were made of the lessons to be drawn from the experience of the EPU — relating as it did to a group of countries not pooling their reserves, and politically less closely akin to each other than were the members of the sterling area. It is, however, true that the European countries that were the full members of EPU are more similar to one another in their economic structure than are the countries in the sterling group.[2] In these and other respects the experience of the two systems is complementary; and any consideration of world monetary problems should hold in a proper balance the lessons that may be drawn from the history of both.

At the time of writing, the intention of the member governments of the Organization for European Economic Co-operation seems to be that the European Payments Union shall be brought to an

[2] In that the United Kingdom's economy is far more dissimilar from the economies of the other sterling countries than is that of any one Western European country from its fellow members of the Organization for European Economic Co-operation (OEEC).

end by June 1956. One factor leading to this decision is that the United Kingdom and certain other European countries have expressed the intention of making their currencies fully convertible into dollars as soon as possible. For the United Kingdom, at least, this means that their currencies when held by non-residents will no longer be subject to limitations upon their convertibility (especially into dollars — the only limitation now remaining) such as have prevailed in recent years. One may well doubt the desirability — and perhaps the practicability — of retaining, at any rate permanently, appreciable dollar import restrictions upon goods imported into the sterling area when non-sterling countries receive the right to use their sterling to buy dollar goods without any limitation. It may therefore be argued that this virtually means that the sterling area system of dollar import controls as it has operated in the post-war period is intended to come to an end. That is to say, it is apparently intended that the limitations upon the use of sterling, by countries inside as well as outside the area, shall be removed in the reasonably near future.

This, therefore, seems an appropriate juncture to look back upon the main aspects of the sterling area since 1945 and of the European Payments Union; to assess their contribution to the rebuilding of international trade and to consider how the lessons that can be learned from them might be applied in the future. These two payments systems have both financial and commercial aspects; and the two aspects are very closely intertwined. It is primarily as international monetary institutions that they will be considered here. The commercial policies that accompanied the international monetary co-operation of countries belonging to the two groups will be referred to mainly in order to illustrate the implications of the financial arrangements in the field of trade policy. The justification for this approach is that these are the aspects of commercial policy most directly relevant to a discussion of what sort of payments 'clubs' (if any) might be found desirable in conceivable future situations and what form they should take. It does not deny the importance of co-operation in matters of commercial policy as a subject in itself; but an adequate treatment of the commercial policies of the sterling countries and of the Western European countries would demand a separate book. It is, then, primarily as monetary institutions that the sterling area and the EPU are examined in what follows; trading arrangements are discussed only in so far as they throw light upon the working of these payments systems as such, or in so far as they sprang directly from the payments arrangements themselves.

The Genesis of the Payments Systems

In the 1930's each of the main European (and other) currencies, including sterling, was convertible into the other main currencies, including dollars. Before the abandonment of the gold standard they were convertible at a fixed and stable rate; after each of them left the gold standard they were convertible at the day-to-day rate prevailing in the foreign exchange market (in which, of course, official dealings played their part by affording some support mainly in order to reduce the instability of the international value of most countries' currencies). Although payments and trade restrictions became increasingly widespread, the Commonwealth countries constituted an area of relatively stable trade, and the sterling group — of varying membership and consisting of countries with varying degrees of attachment to sterling — formed a bloc of relatively stable currencies and of relatively free payments.

After the outbreak of war in 1939, the extent of the convertibility of the main currencies was gradually, but strictly, limited; the general adoption of exchange control made it possible to prevent acquisition of foreign currencies by a private citizen except for approved purposes; and the use to be made of scarce currencies — especially dollars, the currency of the richest non-belligerent in the early days of the war — had to be strictly controlled in order to ensure the most efficient prosecution of the war, despite the assistance afforded by Lend-Lease when it began.

The rights of non-residents to acquire a country's currency were also closely controlled, but as various non-belligerent countries were able to insist on payment in dollars or gold the importance of conserving dollars was scarcely less after the United States entered the war, although dollar payments no longer had to be made to that country. To this end, and in order to make the best use of available shipping, the sterling countries pursued a fairly closely concerted dollar import policy; in short, they accepted some *de facto* limitation upon the purposes for which the monetary authorities of the various sterling countries converted their sterling into dollars.

The end of hostilities brought payments problems that were hardly less serious; indeed, the cutting off of Lend-Lease (or 'Mutual Aid' as it came to be called) presented new and severe difficulties of dollar payments. Both the sterling area, as it had operated in recent years, and the European Payments Union were products of the disruption of world trade and payments arising out of the war — though it is true that the war had accentuated underlying maladjustments present even before 1939. It is not intended here to add to the many excellent analyses[3] of the dollar problem for the sterling area and the non-dollar world in the years after 1945. In the present context, the important and inevitable conclusion from any such analysis is that it was essential for the non-dollar world (in particular, the sterling area and Western Europe) to reduce its dependence upon supplies from the Western hemisphere and to expand its dollar earnings; for the non-dollar world's holdings of dollars had been severely reduced by the war (especially in terms of what they would buy), and the production of many commodities essential to the non-dollar world was now heavily concentrated in the Americas. Accordingly, the non-dollar countries continued to limit severely the rights of their residents to spend dollars — the sterling countries, at least, continuing the use of the exchange control machinery they had developed during the war. The purchase of dollar goods was generally subject to a strict licensing procedure, and the payment of dollars for services was also strictly controlled, whilst capital transactions that might involve the loss of dollars were almost invariably prohibited. At the same time, the rights of other countries to turn their holdings of the main non-dollar currencies into dollars were severely limited.

Within the sterling area (and the group of countries most closely linked to it), countries accepted payment from each other in sterling; between most other countries (and between them and the sterling area), the extent to which settlement was made in gold or

[3] For example, *The Sterling Area*, by A. R. Conan (MacMillan, 1952); *The Sterling Area — an American Analysis*, by the E.C.A.; 'Imbalance of International Payments', by R. F. Harrod (*I.M.F. Staff Papers*, April, 1953).

dollars depended upon payments agreements between the pairs or groups of countries concerned: and a network of such agreements sprang up in the immediate post-war years. The dollar-pooling arrangements of the sterling area were devised to regularize the principles upon which members drew on the central reserves of gold and dollars, which were held in London. The European Payments Union was devised to economize in gold by reducing the extent to which it had to be used in settlements among the Western European countries (and their oversea monetary areas), and to stimulate their mutual trade (and so the extent to which they might produce dollar-saving goods for each other) — which was in danger of stifling in the strait-jacket imposed upon it by the network of bilateral payments agreements[4] and by the only slightly less unsatisfactory Intra-European Payments Agreements. Both payments systems, then, evolved in directions that could be expected to relieve in some degree the shortage of gold and dollars from which member countries were suffering; a main objective of both was to put the available supplies of dollars to the best use; both, accordingly, limited (whether *de jure* or *de facto*) the extent to which members could convert their credits with other members (or with the world as a whole — in the case the sterling countries[5]) into dollars. And both were characterized also by the efforts of their members to see that their trade amongst themselves did not suffer more than necessary from the relative lack of gold and dollars.

The intention of the present work is, first, to examine the nature and effects of the dollar-pooling arrangements of the sterling countries — which limited, in effect, the extent to which their sterling was converted into dollars — and secondly, to consider the payments arrangements of the sterling area with non-sterling countries. (These arrangements limited the degree to which non-residents, that is, residents of non-sterling countries, could convert sterling held by them into gold or dollars or into other currencies.) Thirdly, there will be some discussion of the main lessons that may

[4] These were based on a bilateral balance of imports and exports between pairs of countries, and so greatly reduced the volume of intra-European trade compared with what a multilateral payments system would have made possible.

[5] For a credit earned anywhere by a sterling country almost invariably resulted in a rise in its sterling balances — and so in its right to draw upon the central reserves.

be drawn from the operation of the European Payments Union from the viewpoint of international monetary co-operation. The final chapters are concerned with the possible future role of payments systems of these or similar types in a world of more fully convertible currencies; and, in particular, with the ways in which the EPU and sterling systems might be modified to make them more effective means of international economic co-operation.

I

PRINCIPLES OF OPERATION OF THE DOLLAR POOL

THE pooling of the dollar earnings of the sterling countries arose naturally from their practice of holding their unspent oversea earnings in the form of sterling balances in London. So long as sterling remained convertible into all other currencies, this did not involve any conscious surrendering of dollars which these countries would have preferred to spend. During the 1939-45 war, however, it was clearly impossible to leave all the sterling countries completely free in practice to exercise all the claims upon the restricted supply of dollars that they were likely to wish to make. It therefore became necessary to establish a system to ensure that those dollars which were available should be surrendered to the central pool and then used in the ways that would do most to further the common purpose of winning the war.[1]

In the post-war period a similar problem existed. It was intensified by the large accumulation of sterling balances during the war, by the relative plenty of essential goods in dollar countries, and by the cutting off of Lend-Lease. Moreover, the problem of allocating the available dollars was inevitably more difficult in time of peace, when the supreme common objective of winning the war was replaced by more diverse — and less easily concerted — economic objectives.

The crux of the administrative problem of allocating the available dollars was how far this should be done by the United Kingdom acting through the Bank of England and how far by the individual members, limited only by broad agreements about their common policies. The exact extent of the control exercised by the United Kingdom the unofficial observer can only surmise: in fact, it would almost certainly be incorrect to say that Britain exercised 'control' at all over the white Dominions in this field: and it is reasonable

[1] Preliminary arrangements for this were made shortly before the outbreak of war.

to suppose that such influence as Britain did exert was greater during the war than in the post-war period. So far as possible the allocation of definite sums of dollars to individual countries (either gross or net of their dollar receipts) seems to have been avoided, though such a form of allocation is found in the agreements with some Eastern sterling countries during certain post-war years.[2] The advantages of avoiding such rigid methods of allocation are clear. It is not easy to estimate in advance a country's requirements of dollars — whether its dollar expenditure or its likely dollar earnings (if it is its *net* drawings upon the pool that are to be stipulated). And the reaching of decisions upon such matters by mere bargaining-power would hardly be likely to result in the furtherance of the best interests of the countries concerned. Moreover, any rigid form of allocation would make countries inclined to over-estimate their probable requirements (if only in the fear that their quota of dollars might be reduced in the course of negotiation), and then to ensure that they did not underspend their allocations for fear that if they did so underspend them, they might receive a smaller quota in the next period. Limits for dollar expenditure were, however, agreed upon at various times, especially during the war.

It was, therefore, clearly preferable to reach agreement upon the principles according to which the available dollars should be spent. But this did not necessarily involve decisions to import only specified types of dollar goods into all sterling countries: members' needs (both their tastes and the availability to them of domestic or other substitutes for dollar goods) varied greatly, as did the transport costs (especially in war-time) of importing dollar goods into different sterling countries. But some co-ordination of dollar import programmes seems to have occurred both in war and peace, at least to the extent of informing other members of what sterling supplies were available to act as substitutes for dollar imports. And consultation about dollar import policies certainly went further than

[2] See note at the end of this chapter. According to A. R. Conan, ('Changes in the Dollar Pool', *Canadian Journal of Economics and Political Science,* February, 1950), an important reason for ceasing to limit India's net drawings by agreement was the incentive it gave her to increase her gross dollar earnings by exporting to the dollar area commodities urgently needed within the area. Another was the resumption of the practice of selling tea through London.

this, for the central banks and treasuries overseas were always in close consultation with the monetary authorities in the United Kingdom. Indeed, Mr Wightman has suggested that the Bank of England exercised a degree of control far greater than is generally known,[3] and that the dollar import programmes of the outer sterling area were virtually submitted for its approval.[4] He understandably suggests that, if true, this would have been concealed from electorates in the Dominions, who might well have resented it. He has argued that any more flexible procedure would have been impossible, as any one member would not then have known whether his fellow-members were obtaining more than their fair share of dollars by applying laxer dollar import policies than his own. But this view would seem to under-estimate the high degree of mutual confidence existing among members: there were very frequent interchanges of information on such matters between member countries through their central banks and treasuries, as well as the general supervision and advice given to all members by the Bank of England, which might, admittedly in the last resort, have exercised certain sanctions (for instance, by granting less favourable treatment over the release of sterling balances to 'offenders') if cases arose of habitual refusal to conform to the mutually agreed principles. It is difficult to see how such a procedure as Mr Wightman indicates could for long have been concealed from the electorates of the Dominions; their political leaders would certainly have been aware of any such system, and, even if they could be supposed to have accepted such a derogation from their independence whilst in office, it seems likely that either they or their successors would have used the existence of the practice as a strong political point when a change of government occurred. In fact, various pronouncements by the governments of outer sterling area countries make it clear that they reserved and exercised the right to determine both their total dollar expenditure and the commodities upon which it should be spent.[5]

[3] 'The Sterling Area', *Quarterly Review of the Banco Nazionale del Lavoro* (July-September, 1951).

[4] See A. R. Conan, *The Sterling Area*, pp. 153-4, however, for a statement of the position, which seems likely to be nearer the truth. It is there made clear that the practical difficulties involved in such a degree of control would have been prohibitive.

[5] See, for example, the statement to the Australian House of Repre-

The basic principles upon which dollar import policies were framed were agreed upon by consultation amongst the members. During the war — and indeed after it — it was not possible merely to agree that each country should try to minimize its dollar deficits (or maximize its surpluses), for some had conflicting obligations (especially Australia and New Zealand) for the supply of food to the United Kingdom: if given a free hand they could have sold some at least of this food in dollar markets and considerably increased their dollar earnings. This example illustrates that there were objectives with a higher priority than the earning of dollars. The alternative for each sterling country of endeavouring to maximize its *gross* dollar receipts (so far as this was consistent with its other obligations) seems to have been preferred as a guiding principle rather than that of minimizing dollar deficits or of maximizing dollar surpluses. This is as near as it seems practicable to go in putting into words the flexible and, in general, unpublicized objectives that were formulated. The high degree of mutual confidence and the conscientiousness with which the agreed policies concerning dollar imports were implemented by individual members seems to have made it possible to follow this policy without an undue degree of centralization of decision. Not only would the administrative difficulties of referring each individual decision to London have been great, but such a method would also have been inefficient because individual countries were usually in the most favourable position to decide how they could best save dollars at the least real cost of their own economies.[6]

The concept of pooling came to imply the obligation to impose a certain degree of restriction upon members' dollar imports. (In pre-war days dollars were in fact 'pooled' in London, but dollar

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sentatives by the Prime Minister, the Rt. Hon. J. B. Chifley, 4th December, 1947 (*White Paper,* especially paragraphs 40, 44 and 47-49). This statement makes it clear that Australia reserved the right to decide what her dollar spending should be, that she would not absolutely guarantee to keep her dollar spending within her dollar income, and that she would decide for herself where the cuts should be made.

[6] I am indebted to Mr Leicester Webb, Reader in Political Science at the Australian National University and former New Zealand Director of Stabilization, for valuable information about how these objectives were formulated in the war and immediate post-war years. He is not to be held responsible, however, for the construction I have placed on his words in the above paragraph.

import restrictions were not applied, and so the phrase 'dollar pooling' was not used.) This being so, members naturally insisted on knowing the principles upon which other members based their decisions about how to spend the dollars drawn from the pool. Largely, the members framed their dollar import policies in the post-war period upon the criterion of 'relative essentiality'. They undertook to import only those dollar goods which were roughly as essential to their economies as those imported by other members were to theirs. There seem also to have been certain flexible and general rules of thumb whereby certain dollar goods would be imported only if their prices were lower by at least an agreed minimum percentage (or the delivery dates correspondingly sooner) than those of similar goods coming from soft currency sources. The actual degree of 'essentiality' that was applied at any one time varied according to the state of the central reserves: when these fell, the marginal advantage of adding a dollar to them (compared with that of using the same dollar to purchase an additional dollar's worth of goods) naturally rose: in such circumstances dollar import restrictions were intensified all round, as in the crises of 1947, 1949 and 1951-2. In the opposite situation, when the dollar position improved, as in 1950 and 1953-4, there were relaxations, varying somewhat in extent and in timing from country to country. The United Kingdom did not disapprove of them (at any rate, not openly); indeed, she followed a similar policy.

There was never a pronouncement, either by the United Kingdom or by the sterling countries acting in concert, to the effect that the reserves had risen to a 'safe' level, but in the Commonwealth talks in September, 1950, some relaxations were apparently agreed upon. Such changes of policy imply that the sterling area governments had in mind a concept of 'degrees of safety' in the level of the reserves; that is, the application of something akin to the marginal principle just suggested.[7]

[7] For some details of how dollar import restrictions were relaxed during the period of higher reserves in 1951, and an indication of the diversity of the degrees and methods of relaxation applied by different sterling countries, see *I.M.F. First Annual Report on Exchange Restrictions,* pp. 61-2. In the light of later events the advisability of having made these relaxations can be doubted (see U.N., *Economic Survey of Europe in 1951,* pp. 18-20). In any event, the experience of the second half of 1951 showed the difficulty (under the existing arrangements) of arresting a tendency towards relaxation, once it had started, even when events took an unfavourable turn.

An exception to the usual principles upon which dollar import policies were based is to be found in the agreement at the 1949 Finance Ministers' Conference that each member would cut dollar imports by twenty-five per cent of their level in the previous year. This may well have been justifiable as a temporary crisis measure, especially as, in the event, the subsequent devaluation of almost all the sterling currencies was responsible for effecting the desired reduction in dollar imports at least as much as were the import cuts — which to a large extent therefore really only anticipated its effects. The disadvantages of adopting percentage cuts (or increases) in the value of dollar imports in a base year as the general principle for allocating the available dollars are clear. To do so would penalize those countries which had already, in the base year, exercised the greatest economy in their dollar spending. Moreover, even if hitherto all members had been importing dollar goods of the same degree of 'essentiality' to their economies (if this could ever be defined or established), percentage cuts from this level would be a greater hardship for some than for others, because for some sterling countries non-dollar substitutes for those categories of dollar goods which were next on their list for exclusion would be more readily available than they would be for others.

At the Conference in the 1947 crisis, some attempt seems to have been made to induce outer sterling area countries to undertake to live within their dollar income. Had it been carried out as a principle of policy, this would clearly have involved an undesirable degree of bilateralism in each member's dollar trade; in any event, it was clearly impossible for any member with a fluctuating dollar income to give such a rigid undertaking.[8] The injunction to each member of the outer sterling area to live within his dollar income was no more than a hastily adopted rule of thumb urged upon members in a crisis; there is no evidence that it was ever an important principle upon which each member's dollar spending was in fact based.

The other exception to the usual methods of determining the dollar expenditure of members relates to the agreements with certain Eastern members in some of the post-war years, which limited their dollar expenditure, either net or gross.[9] By 1949 the necessity

[8] See J. B. Chifley's statement (n. 5 above), pars. 37-40.

[9] There were such agreements with Egypt and Iraq from 1945 to 1947,

for such agreements had apparently ceased, partly because Egypt no longer belonged to the sterling area, but mainly because the sterling balances of India, Pakistan, Ceylon, and Iraq had declined to a level where agreements about the rate of their release, together with the co-operation of India, Pakistan, and Ceylon, in formulating sterling-area policy at Finance Ministers' Conferences from 1949 onwards, were expected to be sufficient to restrain their drawings upon the central reserves within the appropriate limits. From 1948 onwards, Ceylon seems to have been granted a considerable degree of freedom to dispose of her dollar earnings as she saw fit.[10]

The application of dollar import restrictions by the sterling countries in 1954 and 1955 showed certain new features, though there was at no time an avowed change from previous policy in the way the dollar pool was operated. The recovery of the reserves during 1954 led to a marked reduction of dollar import restrictions by the sterling countries, as well as by many other countries of the non-dollar world. At the same time, the extent of the dollar import restrictions of the sterling countries was still such that dollar goods were now much less readily importable into the sterling area than they were into, say, Western Europe. Moreover, the wide transferability of sterling, the possibility of purchasing certain dollar commodities for sterling in Britain's commodity markets and, above all, the convertibility of sterling into dollars through the New York and other markets at not far below the official rate (from early 1955 onwards, when the Bank of England announced its intention of intervening in these markets, where necessary, to support the rate at a level that would make 'commodity shunting' unprofitable) all greatly facilitated the wider use of sterling held by non-residents.

In view of the considerable degree of 'convertibility' thus made possible for non-resident holders of sterling by 1955, it is scarcely surprising that a wholesale return to tight dollar import restrictions by the sterling countries could not readily be resorted to when the reserves started to fall again in late 1954 and in 1955. Sterling countries were already accepting a greater *de facto* limitation on

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and with India, Pakistan, Ceylon, Burma, and Iraq from 1947 to 1949. An informal agreement with Eire limited that country's drawings.

[10] See A. R. Conan, *The Sterling Area*, pp. 154-5.

the convertibility of their sterling into dollars than was imposed upon non-residents; and in view of the especially high degree of liberalization of dollar imports by Britain (notably of primary commodities, which competed with similar exports from outer sterling-area countries), the remaining sterling countries could not reasonably have been expected to impose a higher degree of discrimination against manufactured dollar goods than those already imposed. Nor, indeed, would it have been at all readily practicable to tighten dollar import restrictions considerably,[11] since dollar goods might then have been imported by other non-dollar countries and re-exported to the sterling countries, at a premium, for sterling — which could then have been converted into dollars on the transferable market at not very far below the official rate.

It may well be that more general considerations were primarily responsible for the fact that the sterling countries did not tighten their dollar import restrictions during 1955 — for instance, after the Finance Ministers of most of them had attended a conference on the occasion of the I.M.F. meeting in Istanbul in September. The intention to move towards 'convertibility' in all its various senses, and the predilection of the governments in power, notably that of the United Kingdom, for restoring external balance by general monetary and fiscal measures rather than import controls (a policy that the British Chancellor reaffirmed and stressed at the I.M.F. meeting) would have probably precluded any move towards generally tighter dollar import restrictions in the sterling area — the policy that might have been expected in the light of the reactions to previous declines in the reserves.

In any event, the strain that the reserves were undergoing in this period was due virtually entirely to the deterioration in the accounts of three members — Britain, Australia and New Zealand. The deficits incurred by these countries had in any case to be brought under control in their own interests; and as this was done the strain on the central reserves was likely to be reduced, though it is true that only an indirectly favourable effect upon the reserves

[11] That is, without a wholesale tightening of exchange and trade controls throughout the sterling area to a degree that would have been unacceptable and probably unfeasible.

was brought about by the improvement of that part of the accounts of each of them that covered trade with other sterling countries. Even if these three countries had seen fit to increase the extent of their discrimination against dollar imports — and in fact they did not — it would have been difficult or impossible to persuade other sterling countries to do so, since they were not responsible for the strain the reserves were undergoing. It is true that Pakistan's accounts were in an unhealthy state during this period, but receipts of dollar aid by that country had enabled it virtually to remove discrimination from its import restrictions by 1955, and since the receipt of this dollar aid was conditional on its expenditure, no benefit to the pool would have resulted from a different policy.

By late 1955, therefore, the customary post-war policy of relying mainly upon concerted dollar import restrictions by all members of the dollar pool to arrest a fall in the reserves seems to have been abandoned, partly from choice and partly from necessity. Certainly, if all members had been exercising a serious strain on the reserves, and if other non-dollar countries had also been in serious dollar deficit and consequently applying severe dollar import restrictions also, greater discrimination against dollar goods might have been employed as the main method of restoring equilibrium. But the fact remains that for the first time since the war a serious decline in the reserves was being met by general monetary and fiscal measures rather than by an intensification of dollar import restrictions. This was partly a reflection of the 'hardening' of the European Payments Union, which meant that the much higher imports of the sterling countries from Western Europe during 1955 had to be paid for, to a far greater extent than before, in gold or dollars. But the fact that payments to Europe and elsewhere had now to be made in hard currencies to a much greater extent than hitherto would not in itself have made dollar import restrictions undesirable or indefensible from the viewpoint of the sterling countries; the new situation merely meant that the argument for discrimination against dollar goods was to that extent the less strong, and the amount of discrimination against dollar goods (compared with those from Western Europe) appropriate to a given state of the reserves was less than when payments to non-dollar countries were more readily made in sterling or 'soft' currencies.

But the new reliance upon global measures — tighter credit policy and sterner budgets — to correct members' balance of payments brought with it serious problems that had to be solved. For one thing these measures, involving as they usually do higher taxes and higher interest rates, have a degree of political unpopularity that is not shared by import controls, and governments are therefore less ready to implement them — especially if this might seriously impair their electoral prospects. Moreover, they are usually applicable only after a delay, and take longer to have their effect. Nor are they so readily agreed upon and implemented by conferences of finance ministers. It is, moreover, more difficult, if not impossible, to slant them in directions that will do most to improve member countries' accounts with those areas from which dollars may be earned (or to which payments have to be made in dollars). The probability that members in overall deficit will have to take measures on their own account that will incidentally improve the state of the reserves does not, therefore, make it by any means certain that measures will be taken to check a fall in the reserves in the shortest possible time. And, especially if a serious fall is likely to cause a flight from sterling, it may well be of crucial importance that a fall in the reserves should be checked as soon as possible.

This seems to be the main problem that has now to be faced in the operation of the dollar pool. So long as some currencies remain 'harder' than others — or even so long as they merely remain likely at some future date to be much 'harder' than others — it is impossible to ignore the necessity to pay special attention to member countries' accounts with hard currency areas if they are to avoid running a serious risk of a dangerous decline in the reserves. If it is considered undesirable or impracticable to rely on the concerting of dollar import restrictions to safeguard the central reserves of the sterling area, the inevitable corollary is that a much closer liaison among member governments is essential in all those fields of economic policy — quota and tariff policy, monetary and fiscal policy, investment and development policy and so on — that have important effects upon the reserves.[12] And whatever the

[12] It is, as already suggested, much more difficult than it is with dollar import controls to adopt policies in these fields that will directly affect the level of the gold and dollar reserves (by influencing mainly the sterling countries' balance with hard currency areas). But capital issues controls,

measures that are to be relied upon to check a decline in the reserves, it is also essential that they be speedily brought into play by as many member countries as possible, and that they should not have to wait upon full-dress conferences of leading ministers before they are introduced. The precise administrative arrangements among member countries needed to facilitate this can be adequately discussed only by those in close touch with the working of existing organs — notably that of the Commonwealth Liaison Committee. But the economic problems posed by the new conditions are many, and there should be no delay before they are fully ventilated and agreement sought and reached about how to safeguard the reserves when dollar import restrictions are no longer available as the main line of defence.

Summary of the Principles of Operation

(1) Each member's dollar import programme was geared primarily to the prevailing state of the sterling area's central reserves rather than to the state of its own dollar accounts.[13]

(2) Members' restrictions upon dollar imports were relaxed or tightened in such a way as to admit goods of a similar degree of 'essentiality' to all members at any one time; that is, the 'most essential' requirements of each member for dollar goods were to be met first, the intention being that as the reserves rose each member would be able to import dollar goods that were slightly lower on his scale of priorities.

(3) Responsibility for implementing these mutually agreed principles was decentralized, but very close liaison was maintained among members through the Bank of England.

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credit controls and tax structures may often be applied in ways that will favour dollar exports or discourage dollar imports.

[13] The word 'primarily' is inserted partly because a member's own efforts to save dollars did not, in many cases, have a negligible effect upon the area's reserves, and so upon the main factor determining how freely he was able to import dollar goods; but partly, also, because it would be unrealistic to suppose that a country's own current dollar position had no influence at all upon its willingness to grant import licences — even if this were an almost unconscious psychological effect. Moreover, a country making a substantial net contribution to the dollar pool was inevitably in a relatively strong bargaining position at the next conference, and if it chose to import dollar goods rather more freely than other members, it would clearly be difficult to insist that it should not do so. Ceylon, as stated in the text, is the case where this seems most definitely to have occurred.

(4) Obligations on the dollar import side being thus determined, each member endeavoured to maximize his dollar exports (so far as this did not conflict with his other obligations) as his contribution to improving the dollar position of the whole sterling area.

Note on agreements with certain sterling countries about their dollar expenditure

The dollar expenditure of certain sterling countries was limited by agreements between the years 1945 and 1949.

The agreements with Iraq and Egypt between 1945 and 1947 enabled them to draw hard currencies from the central pool up to agreed limits; that is, they limited their gross drawings. Similar agreements in 1947 limited the net drawings of India and Pakistan from the pool and allowed them to keep control of their hard currency earnings.[14] In 1948 Ceylon and Burma gave similar undertakings to limit their hard-currency expenditure. But from 1949 onwards, although the limitation of the rate of release of sterling balances continued to be an important feature of the financial agreements made by the United Kingdom with India and Pakistan, no specific reference was made to the amount of dollars they might spend during the period of the agreements; thereafter India and Pakistan were therefore members of the dollar pool in the full sense. Iraq was given full membership of the dollar pool, in this sense, in February 1951.

A noteworthy feature of these agreements is that some of them limited *gross* dollar expenditure and some *net* dollar expenditure out of the pool. The majority were of the second type, the limitation upon gross dollar expenditure being confined to the agreements with Egypt, Iraq, and Ceylon. The explanation would seem to be that Ceylon, at any rate, was likely to make some net contribution to the pool; the limitation of her gross dollar expenditure ensured that any dollar receipts above this figure would accrue to the central reserves, whilst any falling short of her dollar earnings below the agreed figure would not prevent her from buying dollar goods up to the agreed amount. The possibility that Iraq was (or might have become) a net dollar earner in the years in question seems the most likely explanation of the limiting of her dollar expenditure in a similar way: the difficulties involved in estimating the *net* dollar contribution to the dollar pool of the oil industry may also have contributed to the decision to limit Iraq's *gross* dollar expenditure upon imports for domestic use.

[14] See A. R. Conan, 'Changes in the Dollar Pool', *Canadian Journal of Economics and Political Science*, February, 1950, p. 72.

II

THE DOLLAR POOL AND VARIOUS ALTERNATIVES — A COMPARISON

THE purpose of this chapter is to appraise the advantages of the pooling arrangements outlined in the last chapter from the point of view of their effects upon the sterling countries, and upon world trade as a whole. This may best be done by comparing the actual system with the most reasonable alternatives that might be proposed.

For this discussion two basic criteria should be borne in mind: (1) how far the system under consideration promoted the raising or maintaining of the standard of living of the sterling countries and of the world as a whole; and (2) how far it led to the improvement of the dollar accounts of the sterling area.

To a considerable extent, from the viewpoint of the sterling countries, these criteria, or objectives of policy, are conflicting: so far as progress was made in reducing the sterling area's dollar deficit, the resulting reduction in the supply of goods within the sterling area would represent some reduction in the standard of living of the sterling countries. Nevertheless, in the long run the fall of the reserves owing to continued deficits would have been bound to make necessary heavy reductions in imports and thus in living standards. The conflict is, therefore, a short-term one, and amounts to the problem of how to improve the area's dollar position to the desired extent without the sterling countries having to suffer an undue fall in their living standards in the process of doing so; dollar balance could, after all, have been restored at any time if a sufficiently drastic cut in dollar imports had been made, and if the price in the form of the resulting disruption of production (or even starvation or unemployment) had been acceptable. In the immediate post-war years it is understandable that the improvement of the area's dollar position was considered a less important objective than that of safeguarding the standard of living of the sterling countries and enabling them to restore their productive potential — even if this meant a heavy drain upon the reserves. It was reasonable to hope that, with the restoration of the productive potential of the non-dollar world and the rise in living standards in the sterling countries, it would be possible subsequently to shift the balance of emphasis towards building up the reserves.

Dollar-Pooling Arrangements Compared with the Holding of Separate Reserves

The most immediately obvious alternative to the dollar-pooling system is one in which each member holds separate reserves in gold and hard currencies and tries to build them up to a level sufficient to meet his foreseeable needs. The important question, both in its implication for the economic welfare of the sterling countries and for world trade as a whole, is whether this alternative would have necessitated the holding idle of more or fewer dollars, in the form of reserves, in order to provide the sterling countries with a given degree of security in the event of a fall in their dollar income. Or, to look at the same question from another viewpoint, if the sterling countries had held separate reserves, would they have had to impose sterner restrictions on balance (taking the whole group of countries together) against dollar imports in order to build up their reserves to the level that would give them the desired degree of security?

It would seem that the dollar-pooling system has acted somewhat as an insurance fund,[1] membership of which has enabled any one country to offset its risks of running a dangerous dollar deficit against similar risks to other members. The validity of this point is not destroyed by the fact that virtually all sterling countries were likely to have serious dollar deficits at the same time (at any rate, so far as the deficits were due to a recession in the United States), for even a recession would not affect them all equally, those exporting industrial raw materials to the American market probably standing to lose most.

In any event, the primary-exporting sterling countries had various risks to 'insure against' that did not affect them all: even where the risks of different members were similar in their nature they

[1] Since the above was written I have found that the same analogy has been used by F. V. Meyer in *Great Britain, The Sterling Area and Europe* (Bowes & Bowes, 1952), p. 64, and also by A. C. L. Day in *The Future of Sterling* (Oxford University Press, 1954), p. 84.

were not dependent upon the same factors in each case, for in the matter of dollar earnings the eggs of the sterling countries were in a number of different baskets — even if the baskets were not as numerous or as varied as was desirable in the interests of their economic security and stability. One risk on the supply side was that of crop failure, which might considerably reduce dollar receipts of one country (unless dollar demand for that country's products was inelastic), whilst the dollar receipts of other sterling countries remained high. The most important example is cocoa, where the threats from swollen shoot disease, as well as that from the growth of competing sources of supply,[2] constituted a possible long-term danger. It does not seem sufficient to point to the high proportion of world cocoa exports produced by West Africa and to assume that dollar demand for her exports would consequently prove inelastic as a result; a considerable rise in the price of cocoa resulting from a fall in its supply would certainly lead to a great diversion of demand towards other forms of confectionery and to other substitutes such as peanuts (in American markets); and, what is more, such a market, once lost, might not be easily recovered: the choice of confectionery upon which the American child spends his pocket-money depends largely upon the whim of fashion, and a fashion once changed is not always so easily restored.[3]

Other important dollar-earning primary exports of the outer sterling area countries were open to considerable threats from the development of substitutes: natural rubber was immediately threatened by the rapid development of the synthetic commodity; the wool industry feared that similar developments in the production of synthetic wool might threaten its market in the future; whilst jute experienced close competition from paper bags, the growing use of other fibres, and the growth of the bulk transportation of certain commodities which had previously relied upon jute

[2] See *Coffee, Tea and Cocoa,* Stanford Food Research Institute, 1951, pp. 366 ff.

[3] See *Coffee, Tea and Cocoa,* p. 274; 'The number of products competing with chocolate [in the United States] is much greater [than in Europe]'. Not only sweets (whose relative prices depend largely upon the price of sugar), peanuts and ice-cream are relevant in this context, but also less obvious substitutes such as entertainments and children's comics. See also in this connection *United Africa Company Bulletin,* No. 2, p. 26.

bags. Apart from these long-term threats, there were fluctuations in the demand for important dollar-earning commodities resulting from cyclical and political factors: the market for strategically essential commodities could quickly be made and broken by decisions of the major importing countries to stock-pile or re-arm and then to hold off the market or to slow down their defence programme, as the events of 1950 and 1951 showed.

These various threats to individual members' dollar earnings would clearly affect different members in different degrees and at different times. In return for the right to draw upon the pool when their export earnings were adversely affected, it would seem justifiable that members should pay a premium in the form of high contributions to the pool (or in some other way) when their dollar earnings were especially high. A country would have most to gain from effecting this 'insurance' (that is, from belonging to the dollar pool) when its main dollar exports were subject to the sort of risks outlined above, especially if they constituted a particularly high proportion of its total export earnings or of its national income. The alternative — that each member should build up a large enough reserve to safeguard himself against all the risks to which his exports were exposed — would clearly permit no such offsetting of different countries' risks against one another, and would therefore require larger total reserves (taking all the sterling countries together) to afford a given degree of security to members than if the reserves were centralized in the dollar pool. This advantage of pooled reserves does not lie in the fact that some members were exposed to greater risks than others, but in the fact that the commodities on which they relied for their dollar earnings would not all be equally hard hit by any single likely turn of events. Professor Giblin once described Australia as 'a nation of eight million people clinging to the back of a large and woolly sheep bestriding a bottomless pit': in such a predicament it is not unreasonable to suppose that those concerned would feel happier for the placing of a few layers of tin, jute, and rubber across the chasm — even if any one of these commodities taken alone were no more reliable than the others.

But it is clear that certain sterling countries constituted, from this point of view, particularly bad risks. Where this can be shown, there would seem to be good reason why such countries should contribute especially highly to the dollar pool when circumstances were favourable to them. The worst risks could reasonably be expected to pay the highest premiums.

The insurance principle, then, indicates one important advantage of pooled reserves over the holding of small separate amounts of gold and dollars by individual sterling countries. Its second advantage over that alternative is that the holding of small separate dollar reserves by each country would undoubtedly result in each member trying to effect a bilateral balancing of his accounts with dollar countries, or, rather, to obtain a dollar surplus in order to build up his separate reserves to a safe level. But such bilateral balancing would clearly not promote an optimum world division of labour, for many sterling countries (to judge by their experience before and since the war) clearly tend naturally to have a pattern of trade that involves a deficit with dollar countries and a surplus with others. Whether they normally had dollar surpluses or not, the holding of separate reserves would encourage all of them to maximize their net dollar earnings by imposing heavy restrictions upon dollar imports and also upon imports from those sterling and other non-dollar countries that were net dollar earners: and dollar settlements would almost certainly have been insisted on to a considerable extent within the sterling area, with the result that the limited gold and dollar reserves would have had to be drawn upon for the settlement of some balances between sterling countries. This would have removed one of the main advantages of the dollar-pooling system, namely that gold reserves did not have to be kept for the purpose of settling (or as a reserve against the possibility of having to settle in future) debts arising between different sterling countries. All these consequences of the holding of separate reserves would certainly have militated against multilateralism of payments and against the reduction of trade restrictions within the sterling area, as well as between sterling countries and the rest of the non-dollar world. Its effect upon real income and trade of both sterling and other countries would, therefore, probably have been adverse compared with the situation that resulted from the pooling of dollars.[4]

[4] Strictly speaking, it is possible to say this only if the distribution of the

It is probable that the holding of separate reserves would have led sterling countries to pay greater attention to the elimination of their dollar deficits; this is partly because they would then have needed to build up larger reserves (in total) to afford them a given degree of security, but partly also because their hard currency reserves would then have been more obviously their own responsibility, since it would no longer be possible to draw upon a central reserve which (it was possible for each of them to hope) was being kept at an adequate level through the efforts of other members. On our second criterion (the incentive it provided for members to improve their dollar accounts), then, the holding of separate reserves has something to be said for it. But it would work towards the closing of the dollar gap by restrictionist means; and it would have been likely to reduce the total of exports from dollar countries to the non-dollar world because more dollars would have had to be held idle. It would, in short, encourage the solving of a problem which it had itself made much worse; the net result would not be one that could be viewed favourably, either by the sterling countries or dollar exporters, or for its effects upon world trade in general.

The pooling of dollar reserves would seem, then, to have promoted both international specialization generally and also the gains from trade of the sterling countries. It probably did make members less concerned with closing the dollar gap than if they had held separate reserves: but the economies derived from the pooling of reserves certainly imply that if members had held their own reserves the area's dollar problem would have been intensified and efforts to solve it far more restrictive than, in fact, they were.

Dollar-Pooling Arrangements Compared with Partial Pooling of Reserves

It is possible that some means might have been devised whereby members would have been permitted to hold some gold or dollars themselves whilst still pooling the majority of their dollar earnings. If a scheme could be devised that would do more than the actual pooling system did to promote an efficient distribution of the

real income of different countries and people is not adversely affected. As a practical guide to policy it seems permissible to let the above statement stand, provided distributional considerations are not forgotten where they can be shown to be of importance.

resources of the sterling countries and to encourage the closing of their dollar gap, these advantages might outweigh the disadvantages implied by the loss of some of the economies obtainable from the pooling of reserves.

Any such scheme would be essentially the same as one permitting some or all members to apply very different dollar import policies from those of other members; that is, to allow each of them complete freedom of choice about how they should spend a certain amount of dollars — the amount varying from country to country according to some criterion or other. With separate reserves they would be permitted to hold or spend these dollars; under this further alternative they would have been allowed only to spend them.

Consideration of these alternatives, then, resolves into a discussion of whether it would have been desirable to allow members to earn (or to draw from the pool) certain sums of dollars to which their obligations as members of the dollar pool (as these were generally understood) would not apply. The case for any such arrangement depends upon whether it would have been likely to promote a more efficient distribution of sterling (or world) resources and whether it would have been likely to encourage members to reduce the sterling area's dollar gap, assuming for the moment that the loss of the economies of pooled reserves would have a negligible effect in intensifying the area's dollar problem.

The simplest way in which something of this sort might be done would be by a bonus in dollars to be paid to a member who earned a dollar surplus, or to one who improved his dollar balance compared with a base year, much as certain non-sterling countries have rewarded individual exporters for increasing their sales to dollar markets by giving them a free allocation of dollars to spend or sell as they wished. The advantage would lie in a more direct incentive for members to reduce their dollar deficits than existed under the dollar-pooling arrangement: the lack of such an incentive was, indeed, one of the main defects of the actual arrangements, as Professor Smithies has pointed out.[5] But the difficulties in the way of applying such a scheme would be immense. If the aim is to reward policies likely to improve the dollar balance there would

[5] *Quarterly Journal of Economics,* May 1950, p. 172.

be no point in rewarding purely fortuitous increases in a member's dollar earnings; such a system would be likely to constitute an improvement only so far as it rewarded improvements in a member country's dollar balance that were the intended consequences of policy decisions made by the government of that country; and the impossibility of assessing how much of any given improvement was due to his efforts is evident. Moreover, the improvement would have to be judged by comparison with a base year (or period), any choice for which would invariably give cause for dissatisfaction to some members; and such choice would reward most highly the efforts of those members who had been least economical in their spending or least energetic in promoting dollar exports in the base year chosen.

There is, moreover, the difficulty that too much or too little inducement to close the sterling area's dollar gap would almost inevitably be given by any such scheme, and that the inducement provided would vary greatly between different members. It would be desirable to ensure that the gain to the reserves from the operation of the scheme was not greatly exceeded by the subtraction from them due to the freer dollar spending by some members: but some net loss might be thought worthwhile if a better distribution of world trade and reserves resulted. However, to offset against the loss of the economies of pooled reserves there would be an advantage from the holding of separate reserves: some policy decisions might then be taken by member governments to improve their dollar accounts — decisions that were not in fact taken when they were members of the dollar pool.

Dollar Capital Goods and Inflation in the Sterling Area

A further criticism that has been made of the dollar-pooling arrangements of the sterling area is that of Mr Zupnick, who comments adversely upon them, not because they involved a centralization of reserves — he would presumably acknowledge that this effected a considerable economy of dollars compared with the holding of separate reserves by each member — but because of the way in which they were operated.[6] Moreover, his main points

[6] E. Zupnick, 'The Sterling Area's Central Pooling System Re-examined', *Quarterly Journal of Economics,* February, 1955, p. 71.

do not relate to the frequently heard contention that as a result of the way the pool operated consumer goods were purchased by some sterling countries from the dollar area on a larger scale than was justified; they depend on the argument that the total level of dollar capital-goods imports into the outer sterling area, as well as its distribution among members and over time, was not what a rationally-operated, centrally-organized system would have made it.

Mr Zupnick does not discuss other considerations that such a centrally-organized arrangement could not have ignored — notably political necessity and equity — though in practice the distribution of dollars from the pool could not have been determined merely upon the criterion of the contribution to improving the dollar balance made by the goods bought with them; the importance of this criterion, however, if applied in a long-term sense, is great enough to warrant a good deal of Mr Zupnick's concentration upon it. But it was politically necessary, for example, that the Eastern members of the sterling area should have had a large measure of freedom over the spending of their sterling balances; and there was also a strong case in equity, as well as from the viewpoint of probable effects upon productivity, for allowing poorer members of the sterling area to import fairly freely both consumer goods and capital goods.

There can be no doubt that if a centrally-organized system for allocating the dollars had been feasible, and if other objections to it are for the moment waived, it might have had more success than was achieved by the actual mechanism adopted in distributing the dollars in those directions where the goods they could buy would do most to check inflation in the sterling area and to improve the sterling area's dollar balance of payments. There are, however, several points at which Mr Zupnick's argument may be questioned.

In the first place, it scarcely seems permissible to relate by a sort of 'multiplier'[7] the increase in a country's imports of dollar goods to the corresponding increase in its national income in a situation where all dollar imports were strictly controlled. This seems to assume, what Mr Zupnick in effect argues subsequently, that the dollar imports actually made possible (that is, were an

[7] *Loc. cit.*, p. 81.

inevitable concomitant of) the level of national income to which they were related. But, in fact, so long as a system of import controls existed, a given level of dollar imports could be associated with an almost infinite number of different levels of national income, though one of the factors affecting national income (given all the other relevant determinants) would certainly be the level of dollar imports, together with the availability or otherwise of substitutes from non-dollar countries.

This is not merely a theoretical point, for Mr Zupnick argues that the high rate of dollar capital-goods imports into a given sterling country often led to a level of investment and a degree of inflation higher than that which would otherwise have occurred. But it is difficult to accept Mr Zupnick's contention that a reduction in the level of sterling countries' imports of dollar capital goods would actually have caused them to reduce the total scale of their investment programmes and, accordingly, to demand also fewer complementary capital goods from non-dollar countries. Certainly, a given project might have had to be seriously modified or even abandoned if the dollar equipment on which it depended had not been available, but, surely, in the vast majority of cases, so long as the sterling countries concerned had high sterling balances they would have bid high prices for the nearest available substitutes from elsewhere; if these were not at the moment available at all, then this insistent demand for them would have made it worthwhile for the United Kingdom and other non-dollar industrialized countries to turn over to their production. This would have been both wasteful and time consuming, for such countries would probably have produced the goods at higher costs and with longer delivery dates than dollar exporters could quote, and the delay before they were obtained would have postponed the increase in production in the sterling countries that they made possible, and thereby the growth of dollar-earning and dollar-saving production which were essential for the restoration of equilibrium in the accounts of the non-dollar world, and which did much to reduce inflation in the sterling area and to improve its balance of payments.

If, on the other hand, an outer sterling area country with high sterling balances had decided not to proceed with a given project

— or another one of lower priority but requiring at least as great an outlay — because it had been unable to obtain the necessary dollar capital goods or any soft-currency substitute, it seems certain that in the vast majority of cases, if it had resigned itself to the idea that it could not persuade non-dollar producers to increase their output of the equipment it needed, it would then have spent upon consumption goods the sterling balances so released. Had it done so, this would have attracted further resources in the sterling area away from the more essential task of rebuilding capital after the war. Moreover, it would probably have encouraged the non-dollar industrialized countries to devote even more of their resources to producing consumer goods, in which they were generally less fitted to compete with the excluded dollar substitutes, and less to the production of capital goods, in which they were probably better able to produce substitutes for dollar products at nearer the cost of similar goods. At least, the greater severity of the restrictions against dollar consumer goods than against dollar producer goods, imposed by the non-dollar world, raises the presumption that consumer-goods industries in the non-dollar world were already receiving in this form more protection than was desirable, as compared with that afforded to capital-goods industries in non-dollar countries.

In short, it may be true that individual specific investment projects in sterling countries might have been rendered impossible if the dollar capital-goods on which they depended had not been available. But Mr Zupnick has still to show that the consequent increase in alternative investment projects necessitating the import of non-dollar substitutes — however indirect — or of consumer goods in the event of capital goods being unprocurable, would not have had adverse effects upon the pattern of trade and production of the sterling area, and the whole non-dollar world, sufficient to offset any specific saving there might have been from the curtailment of a given investment project whose execution depended on the import of dollar capital goods. The presumption is, surely, that there would not have been any net reduction in inflation had the dollar capital goods not been bought — and probably the reverse would have been true in the light of their undoubted contribution to raising productivity.

On the particular argument that the United Kingdom and other non-dollar industrial countries were discouraged from developing dollar markets by the high rate of development in the outer sterling area, one must agree that had that rate been lower they would have had much more incentive to develop dollar markets. But whilst their markets in Canada might profitably have been expanded, it is doubtful whether the risks and the considerable costs involved in expanding their sales to the United States market (notably the erection of sales organizations and uncertainty about future United States production and future tariff policy) would have justified even greater efforts in this direction than those that in fact were made — efforts that made possible the considerable increase in Western Europe's dollar exports that in fact occurred. In the light of these considerations, the extent to which sterling and other countries united to Western Europe concentrated on the rebuilding of production, especially that of dollar-earning and dollar-saving commodities, seems far more defensible. For such concentration to be possible these countries had to import capital goods from European exporters on a large scale: and if capital goods had not been available from dollar sources, the extent to which European exporters would have had to meet the need for them would have been even greater. Lower imports of dollar capital goods into outer sterling area countries would have thus discouraged Western Europe from developing its dollar markets even more than actually occurred. This argument would seem, therefore, to suggest a conclusion completely contrary to what Mr Zupnick takes to be the effect of admitting dollar capital goods to the outer sterling area.

There remain Mr Zupnick's criticisms of the way in which drawings from the dollar pool (especially for the finance of capital goods) were distributed amongst different countries and over time. One may at once agree that the somewhat haphazard pattern of drawings that resulted from the way the system worked could hardly, except by the merest chance, have corresponded with a theoretical ideal that a rational system of central allocation would have tried to attain. It is doubtful, however, whether the tables he gives for the level of capital-goods imports from dollar and non-dollar sources throw much light on the matter. Where there have been large increases compared with the annual rate of import before the war, this can easily be justified in the light of the growth of population of the outer sterling area countries over the intervening period and the need to make up for the inadequate maintenance of capital during the war period, as well as the need to provide for a much higher level of economic activity than in the depressed conditions of the 1930's. It is roughly true to make the generalization that, compared with pre-war, the Eastern members of the sterling area increased their demands for dollar capital goods most, and the Colonies least, with Australia and New Zealand somewhere in between.[8] But this does not of itself prove anything about the mis-allocation of dollars — even from the viewpoint of the single criterion of the comparative marginal productivity of dollar investment goods in the different countries. In countries with a low standard of living — notably the Eastern countries — much of the dollar spending, even on consumption goods, may well have had a favourable effect upon productivity; wherever such infusions of capital and other goods can be used to good effect, there is a strong case for allowing them on a scale that will enable the poorer under-developed countries to raise their productivity swiftly enough to keep pace (at least) with the rise in population. It is still, of course, an open question whether the particular capital projects were those best calculated to raise productivity in these countries. At the other extreme, in the case of the Colonies there is no reason to suppose that the import of dollar capital equipment was not permitted where there were good grounds for believing that its import would contribute to the development of dollar-earning and dollar-saving production; and, in fact, the growth of such production has been a powerful contributory factor to the improvement of the sterling area's balance of payments in recent years. One may, of course, still discuss whether more of certain types of imports could not have been profitably used by the Colonies, but there is no reason to suppose that the high rate of import of dollar capital goods into other sterling countries was allowed to prevent the Colonies from getting the capital goods they needed to increase their production of important commodities. As

[8] South Africa, not being a full member of the pool, is here excluded from consideration.

to the import of capital goods by Australia and New Zealand, this equipment was undoubtedly used largely — perhaps principally — to rebuild primary industries (and the services upon which their expansion depended), and most of these primary industries were either dollar-earning or dollar-saving — at least in the immediate post-war period.

It is difficult, therefore, to agree with Mr Zupnick that the development programmes of individual sterling countries were seriously prejudiced because other sterling countries had an unfairly high rate of import of dollar capital goods. It is far more arguable that all the sterling countries devoted too much of their available international reserves (as well as their domestic resources) to consumption goods and too little to capital goods; if so, it is misleading to argue that those countries that were nearer to importing the optimum amount of dollar capital goods were doing so at the expense of those that were farthest from doing so; on the contrary, over-consumption was a far more likely culprit, and what was really needed was more capital goods, from whatever source they were available.

Mr Zupnick is, however, quite justified in arguing that the distribution of dollar imports over time left much to be desired. The relaxing and tightening of dollar import restrictions did proceed by a series of gigantic hiccups. When the reserves were rising, all members imported dollar goods more freely while the going was good, but when the situation deteriorated they did not draw in their horns as quickly as one would have expected under a rational, centrally-administered system. There may, indeed, have been, as Mr Zupnick says, consequent wastage of some dollar equipment — though the losses on this account must have been slight; even if projects may have been held up, they were not permanently abandoned. Dollar equipment was probably diverted in some cases where the original project was held up, and non-dollar substitutes became more readily available as time went on.

One may argue that in theory an adequately informed central organization might have distributed the dollars better over time and amongst different members. But it would have had to weigh a multitude of different projects against one another and judge them on a number of different political and economic criteria. And the consequent delay, rigidity, and political strains in the system would have to be weighed against any probable improvement in the efficiency of distribution. Certainly the system was not ideal, and some means might well be sought to encourage members to take greater account of the effects of their policies upon the central reserves; but it was the high level of the sterling balances, not the dollar-pooling arrangements, that imparted inflationary bias to the system. The spending of dollars was — at any rate on balance — a disinflationary force, at least when the alternative was the purchase of less satisfactory equipment elsewhere at higher costs and with longer delivery dates. Admittedly, any investment is inflationary in a sense — until the fruits of it appear: but the purchase of dollar capital goods, where these were permitted, promised the best hopes of swift increases in production of commodities that were considered vital to the sterling countries' balance of payments. A centrally-organized system — if we may abstract from all the difficulties and disadvantages of such a device — might ideally have adopted a different policy about the distribution of dollars; but if it, like Mr Zupnick, were concerned primarily with improving productivity in the sterling area and its balance of payments, it should, logically, have diverted dollars from consumption goods to capital goods, and not from the purchase of capital goods to the building up of idle reserves or to the purchase of consumption goods — which could do less to raise output in the sterling area.

In short, neither the pooling of dollars nor the decentralization of detailed decisions about how the dollars should be spent seems in itself to be open to serious criticism. Such mistakes as were made were due to the member countries' natural preference (which would have existed under any system) for maintaining or raising their living standards now, rather than for spending their available dollars to an even greater extent upon capital goods — which would be likely to improve their dollar earnings, their reserves, and their standard of living in the more or less distant future. Though the arrangements adopted were often operated in ways that can be criticized, there is no reason to believe that either the dispersion of the gold reserves or the centralization of detailed decisions about the spending of dollars would have been more in the interests of the sterling countries, or of world trade as a whole, than was the system that in fact existed.

III

GOLD PRODUCTION AND DOLLAR LOANS

THERE are two types of hard currency resources whose relationship to the dollar pool requires separate discussion, namely (1) the proceeds of gold production in the sterling countries; and (2) the proceeds of dollar loans raised by individual sterling countries, together with the obligations that such loans involve.

It would at first sight seem clear that if an economy of reserves was achieved from the pooling of dollars earned from exports, this could not be any less true of those dollars acquired either by selling gold or by borrowing on the credit of any one member government. Are there any reasons why dollars acquired in these ways should be treated differently from the proceeds of dollar exports?

The Proceeds of Gold Production

In general, the gold-producing members of the dollar pool seem to have sold their output to the United Kingdom for the central reserves. Since the resumption of gold sales to the Bank of England after the war (in July, 1947[1]), it appears that this gold was retained in Australia but earmarked as belonging to the Bank of England. But at the beginning of 1951 Australia began to retain part or all of her gold output in her possession. The first rise in the official published figures of Australia's own gold holdings since 1947 took place in January, 1951,[2] and these holdings rose considerably during that year and fairly steadily thereafter. A main motive for this seems to have been the desire to strengthen Australia's credit standing in the United States capital market, but there seems also to have been a feeling that these separate reserves might at some future date be used to settle a dollar deficit — presumably in

[1] *Bank of England Report for 1947.*
[2] *I.M.F. Financial Statistics.*

circumstances in which drawing on the central reserves might be difficult. The following statement by Sir Arthur Fadden (the Australian Federal Treasurer) on 9th October, 1951, mentions both these underlying motives:

> . . . During the period of acute shortage of dollars and other hard currency, when Australia was drawing heavily on the sterling area dollar pool, Australian gold production was acquired by the Commonwealth Bank and sold to the Bank of England. Nearly a year ago sales of currently produced gold to the Bank of England were suspended, and the new production has been going into the Australian gold reserve which is required to underpin the Commonwealth's[3] credit in hard currency countries and to provide a reserve against any emergency demand for hard currency . . . .

A similar dispersion of part of the area's reserves has been due to the granting of permission to certain members who have recently acquired their own central banks to hold small amounts of gold themselves. This was to put them on a footing similar to those of Australia, India, and New Zealand, which also held small amounts of gold, dollars, or both. Ceylon was granted this right in 1950, and Pakistan in 1951. A similar agreement with Iraq was reached in 1955. Is there any reason to view with disfavour this fragmentation of the reserves?

If the dispersion of the reserves is purely geographical, the dollar-pooling arrangements are clearly not affected in principle; the question would arise only if one or more sterling area governments were likely to adopt a different sort of dollar import policy as a result of this dispersion of reserves. One would suppose that the countries holding such reserves would use them only in an emergency; that is, that they would draw upon the dollar pool for all their ordinary needs. But it cannot be denied that the main motive for wishing to hold them — apart from considerations of prestige — seems likely to be the desire to have some hard currency reserves which could, at need, be used without reference to the policies agreed upon with the other members of the pool.

Such fragmentation may bring several disadvantages, if carried out on any but a negligible scale. First, if *all* sterling countries (including those holding the small separate reserves) continue to

[3] i.e., the Commonwealth of Australia.

base their dollar import policies solely upon the size of the centrally-held reserves, their dollar imports will be more restricted than if the fragments had continued to form part of the central reserve. Secondly, world confidence in sterling is almost certainly affected mainly by changes in the size of the central reserves. It is therefore clear that the dispersion of part of the reserves to outer sterling area countries may have an adverse effect on world confidence in sterling that is not justified by the total gold and dollar holdings of the sterling countries. Thirdly, if those sterling countries holding separate reserves of gold or dollars base their import policies to some extent upon the fact that they have these holdings, a purely arbitrary departure from the mutually agreed sterling area policy would occur according to the size and location of these different holdings and the extent to which (at any given time) the government concerned was disposed to regard its separate gold holding as justifying freer dollar expenditure than would be justified by its obligations as a member of the dollar pool — if it had to finance its dollar expenditure entirely by drawing upon the pool. If, on the other hand, it did not spend these dollars at all in normal times (keeping them as an ultimate reserve), the fact that the sterling area's dollar expenditure depends normally upon the height of the central reserves would cause the total dollar imports of the area to be lower than if the reserves had not been fragmented in this way; though, of course, some allowance might be made for these separate reserves when dollar import policy was being decided.

It would seem, therefore, that, if either (a) these separate holdings are disregarded when sterling countries are deciding whether the hard currency reserves justify freer dollar imports; or (b) some members regard them as justifying freer dollar imports merely because they hold them within their borders, the sterling group would not succeed in maximizing the amount of dollar imports and minimizing the amount of gold or dollars held idle to provide a given degree of security. From the general sterling area point of view the ideal course is for these separate reserves to be regarded, dollar for dollar, in exactly the same way as the centrally-held reserves when dollar import policies are being framed. And, in order to engender as much confidence in sterling as members' actual hard currency resources justify, these dispersed reserves should not be omitted when the size of the central reserves is announced. This would clearly become of more importance the lower the reserves were to fall and the greater the size and number of the fragmented portions.

It is therefore suggested:

(i) That the area's published reserves should include all gold and dollars held by sterling countries — not only those held by the United Kingdom. This would probably involve some change in the banker-customer relationship, unless the gold were held in the other countries and earmarked as owned by the Bank of England (as in Australia up to 1951).

(ii) That the sterling countries should agree and state publicly that, when deciding upon their import policies, they will bear in mind these total reserves, which are to be regarded as available to meet any of the obligations of all of them.

If this were done, and provided that the implementation of agreed sterling-area policy would not become any more difficult for individual member governments when their electors were aware that their countries had gold or dollars within their borders, one might (viewing the matter from the point of view of the totality of the sterling countries) favour some dispersion of the gold reserves. Economies of transport might arise from the possibility of settling gold debts from the nearest part of the reserves to the country to which payment had to be made, and there is little point in transporting gold from, say, Australia, where it has been produced, to the United Kingdom if it is shortly to be sent to the United States.[4] There might also be strategic advantages in such a dispersal of the reserves. Willingness to accept the Bank of England's ruling (or that of any subsequent central controlling body for the pool) about which holding of gold should be drawn upon to finance any given sterling area payment would, incidentally, constitute a useful indication of whether members were in fact regarding the reserves in their keeping as belonging to the whole sterling area — or as in any sense owned by them individually. It seems doubtful whether similar advantages could be claimed from the dispersal of *dollar* reserves among different members — at any rate beyond the very

[4] Unless, of course, it would in any event have been sent through London as the cheapest route. And even then, it would be preferable to avoid unloading and re-shipping the gold in London.

small holdings of dollar balances in American banks that most members hold at present as a matter of convenience.

Proceeds and Repayment of Dollar Loans

If the pooling of dollar earnings and the framing of dollar import policies in accordance with the state of the central reserves bring the advantages already outlined, is there any reason for believing that the proceeds of a dollar loan raised by one sterling country should be spent more freely upon dollar goods by that country than should any other form of increment to the area's dollar resources?

This would clearly be permissible and desirable when the dollar loan had been raised for the express purpose of development that could not take place without it.[5] Even so, if it is believed that the principles of dollar import policy that have been agreed upon amongst members will lead to the optimal use of the area's dollar resources, the object should be to cause as small a diversion from this agreed policy as possible. This might well involve some reduction in the dollar expenditure of the country raising the loan other than expenditure expressly provided for in the loan arrangements; for it is reasonable to suppose that, in fact, some part of the development programme financed by the dollar loan would have taken place in any event, or, alternatively, that some other development programme (using the same factors of production) likewise also involving some expenditure of dollars would have been substituted. It would therefore seem reasonable to suggest that the borrowing country should not increase its total dollar expenditure by the whole amount of the dollar loan. On the other hand, the improved dollar position of the whole sterling area would justify a greater degree of freedom of dollar imports on the part of all members (or, at the least, it would tend to raise the reserves towards the point at which this would become possible). This would certainly be true of grants of dollars; but in the case of a dollar loan, the future obligations to repay interest and principal in dollars must be set upon the other side of the account; if dollars are likely to be 'hard' and the

[5] Cf. Professor R. F. Kahn, *District Bank Review,* December, 1951, p. 16, where it is pointed out that outer sterling area countries' restraint on their development is not so necessary where it is financed by dollar aid that would not otherwise be available.

dollar pool still in existence when these repayments fall due, the raising of such a loan becomes the concern of all members.

Is a member country likely to raise such a loan in circumstances when it would be against the interest of other members that it should do so? If the country raising the loan is not likely to be a net drawer upon the dollar pool in future years, it is unlikely that the other sterling countries would feel able to influence its decision. At the other extreme, if the country is at all likely to have to default on its loan obligations, they would wish to dissuade it from raising the loan, if only because of the effect that such a default would be likely to have upon the credit standing of other sterling countries.

The interesting and important position in which most sterling countries are likely to find themselves is intermediate between these two extremes. A country wishing to borrow dollars presumably believes that the loan will result in such an increase in its productivity that its export potential will be raised sufficiently to repay interest and principal, and that it will still find itself with a higher standard of living than it would otherwise have had. We may assume that the borrowing country honestly believes that it will obtain a net benefit from the loan in this way. But it may well be that the future dollar incubus would burden all the sterling countries, while almost all the benefits accrue to the borrowing country.

It is true that if the loan is raised at a time when the area's reserves are dangerously low, some future costs might justifiably be incurred as the price to be paid for the time gained during which it might be hoped that the dollar position of the sterling countries would (for other reasons) improve. Even a net loss of real income[6] over the whole period of the loan might be worthwhile if the real incomes of those paying the dollars due for the servicing of the debt had (for other reasons) risen sufficiently between the time the loan was spent and the dates at which it was repaid.

But, apart from this complication, any rise in the real income and productivity of the borrowing country that is directly attributable to the loan may or may not bring to the other members

[6] That is, if the rise in real income due to the higher productivity made possible by the loan is less than the real cost of repaying the interest and amortization.

benefits that outweigh the future dollar incubus they will be helping to shoulder. The country raising the loan will pay most attention to whether it is likely to raise its export earnings enough (through the rise in productivity occasioned by the loan) to be able to afford to draw upon its sterling balances and exchange them into dollars to pay off the obligations when they fall due. But the rest of the members will be most interested in whether they will receive any benefit to compensate them for having to find the extra dollars at a later date if the member who has borrowed the dollars proves, when the time comes to repay, to have increased his earnings of softer currencies only — with the result that the dollars he needs will have to be supplied out of the central reserves (that is, the dollar earnings, past or present, of other members). Other members will wish, therefore, to compare the cost of raising the loan, not merely with the improvement in the total balance of payments of the borrowing country that it is expected to make possible but with that improvement (special weight being given to any dollar earning or dollar saving included in it) less an appropriate discount to allow for the fact that dollars are likely still to be 'hard' (in some sense) when the time comes for repayment. They will naturally wish for some form of compensation if, during the period when the debt repayments are being made, they will have to impose sterner dollar import restrictions than would otherwise have been necessary. One way in which they might receive this compensation from the borrowing country — which will have hitherto reaped all the advantages of the higher productivity due to the loan — would be by receiving from it the right to some goods or services for which they do not pay, or for which they pay less than the full price. They would be especially likely to view with favour a loan that was expected to raise the area's output of scarce foods or materials, and would probably be ready to shoulder in the future some of the risk of additional dollar burdens for repayments in return for some sort of guarantee of favourable consideration when the scarce exports were being sold.

It should be stressed that the relevant criterion from the point of view of the sterling area as a whole should be not merely whether the dollar loan will enable the borrowing country to earn (or save) more dollars than it will have to pay in the form of interest; it should be the effects of the loan upon the real income of the whole area — including its effects upon the area's ability to earn and save dollars.

Finally, from the point of view of the other sterling countries it is clearly not sufficient that the borrowing country should so increase its productivity, through the use of the dollar loan, that it *could* raise its real income (after allowing for the servicing of the debt) and still compensate them for the burden of converting its future surpluses with the sterling area (or other 'soft' currency countries) into dollars to repay the debt. They will wish for some provision to be made whereby they will *in fact* be compensated. The members of the dollar pool will suffer no less from the repayment of the loan if the country borrowing the dollars happens to run a dollar surplus in the years when repayment is being made, for, clearly, this would merely mean that owing to the servicing of the dollar loan its net contribution to the pool would be so much the smaller than it would otherwise have been. On the other hand, so far as the dollars obtained when the loan is raised are paid into the pool rather than used to finance dollar imports directly, the other members will gain an off-setting advantage: each of them will be able to import dollar goods more freely than if the loan had not been raised.[7]

In Chapter IX some suggestions will be made which might, if adopted, go some way towards ensuring that the country borrowing dollars took into account these effects upon other members; and that, conversely, the latter recompensed the borrowing country to the extent that it paid into the pool the dollars it had borrowed instead of using them to finance increased imports directly from dollar countries.

[7] Especially if the proceeds of the loan are used to finance purchases from other sterling countries, and are therefore not lost to the dollar pool.

IV

THE EFFECTS OF THE DOLLAR POOL UPON TRADE

IT IS, in the nature of things, impossible to adduce statistics to show diversions of trade (from the pattern that would otherwise have obtained) due to membership of the dollar pool. It is possible, however, to make certain generalizations about the sort of effects on the pattern of trade that probably resulted from the pooling arrangements. Where sudden changes in the pattern of sterling countries' trade followed a concerted decision to divert trade in that same direction, or where there were certain particularly pronounced changes from the pre-war pattern (when the dollar-pooling system as it operated in the post-war period did not exist), it may sometimes be a fair assumption that the changes that occurred were due to trade policies arising out of the dollar-pooling arrangements.

Any attempt to answer the hypothetical question, 'In what ways would the pattern of trade have been different if the dollar-pooling system had not existed?' must assume the existence of some alternative — presumably the holding of separate reserves of gold or dollars by each member. There is reason to believe (as argued above) that this would have meant that taking them all together the sterling countries would have had to impose more severe dollar import restrictions than they in fact did; moreover their standard of living (and that of the world as a whole) would probably have been lower, by reason of the bilateral balancing of dollar trade at which they would each have then aimed and because of the smaller amount of multilateral trade there would then have been amongst themselves. But this generalization conceals divergent effects upon the trade of different members: those who normally earned dollar surpluses would naturally have imported dollar goods more freely than they were able to do as members of the dollar pool; the countries with dollar deficits would have had to import dollar goods less freely than they in fact did.

In the conditions of very acute dollar shortage immediately after the war this would have necessitated an even greater reduction in the dollar imports of the countries with dollar deficits than in fact occurred; and the result would have been the diversion of resources towards a pattern of trade and production appropriate to the particularly severe dollar shortage experienced by many of those countries at that time. Whilst the probability of a serious long-run shortage of dollars might necessitate a considerable diversion of trade and production away from pre-war patterns, it may be doubted whether the ideal pattern would be that appropriate to the especially acute dollar famine of the immediate post-war years; ideally, it would seem preferable to adopt arrangements that facilitated the necessary long-term adjustments with a minimum of distortion of patterns of trade and production in response to purely temporary factors.

It can be argued that the pooling of dollars may well have worked towards this ideal far more than the alternative of the holding of separate reserves would have done, for the fact that the dollar deficit countries had the dollar pool to draw upon kept open (even though on a reduced scale) the channels of trade between the dollar and sterling areas that one would expect to become permanently re-established when the area's reserves had been built up sufficiently to relax or remove dollar import restrictions. The result was a sort of 'token imports' scheme on a large scale.[1] The importance of this consideration was the greater since the dollar surplus countries included those, such as Ceylon and certain colonies, where the standard of living was generally low, whilst the countries with dollar deficits were among the richer members. The fact that all the sterling countries continued to import some or most of the lines of goods they normally bought from dollar countries meant, therefore, that the complete cessation of sterling-dollar trade in those lines normally imported by the richer members was avoided. On the other hand, those members with dollar surpluses did not adapt

[1] The 'token imports' scheme was the name given to the arrangement whereby small quantities of American goods not otherwise imported were admitted to the United Kingdom and certain other countries in order to keep the manufacturers' names before consumers in the expectation that these 'normal' channels of trade would be more fully re-opened at some future date.

their economies to the import of dollar goods to an extent that they might have found unprofitable when a more normal pattern of trade was restored with the recovery of production in non-dollar countries.

If the dollar-pooling arrangements enabled dollar deficit members to avoid making those changes in their patterns of trade and production that were desirable in view of the long-term shortage of dollars, the system might well be criticized. If the dollar deficit countries had, in fact, made smaller relative reductions in their imports from dollar sources, compared with pre-war years, than had the dollar surplus countries, this would constitute strong *prima facie* evidence that something like this had happened. For, assuming that in future dollars were likely to be 'harder' than they were in the thirties, one would expect the equilibrium pattern of trade (when dollar import restrictions were ultimately removed) to involve smaller reductions in dollar imports, or even increases, compared with pre-war for those countries running dollar surpluses; similarly, one would expect the dollar deficit countries to show the largest reductions in their dollar imports. At the same time, these countries could expect, once a more 'normal' pattern of trade established itself, to be able to import more freely from dollar sources (paying for their imports with the surpluses they achieved with dollar surplus countries) than they had been able to during the period when they were forced to live within their own dollar income (plus what they were able to draw from the dollar pool).

To score most highly on these counts, then, the dollar-pooling arrangements would have had to operate in such a way that the largest cuts in dollar imports were made by the dollar deficit countries, yet so that these cuts were not as large as these countries would have had to make if forced to live on their own dollar income in the phase of exceptionally acute dollar shortage.

In the immediate post-war years all the sterling countries took a much higher percentage of their imports from dollar sources than before the war (as Table I shows). But after the cuts of 1947 and 1949, the only members of the dollar pool who had higher percentages of dollar imports than before the war (apart from the United Kingdom, Eire, and Iceland, who were able to finance considerable dollar imports out of Marshall Aid) were Malaya and

TABLE I

Percentage of Imports coming from Dollar Area in Certain Years for Different Sterling Countries

SOURCE: Official Trade Statistics, and *Direction of World Trade.*

	1937	1938	1947	1948	1949	1950	1951	1952	1953	1954
United Kingdom	20	21	34	22	22	18	20	21	19	18
Australia	23	22	32	14	14	11	10	18	16	15
Ceylon	2	2	19	9	10	5	6	11	4	5
India	7	8	34	22	18	21	27	38	19	16
New Zealand ..	21	21	28	16	13	10	12	13	9	10
Pakistan	—	—	—	8	11	10	8	7	5	8
S. Rhodesia	10	9	22	13	9	6	6	7	5	6*
East Africa	11	11	21	11	9	6	4	4	7	3
Malaya	3	4	12	13	7	4	5	6	6	5
N. Rhodesia	14	13	15	14	13	9	7	7	7	6*
West Africa	9	10	16	11	6	5	5	6	5	5
West Indies	34	34	58	40	31	30	34	31	30	30
South Africa ..	23	21	41	41	32	21	24	26	23	27
Burma	4	2	3	4	4	3	3	5	4	4
Eire	11	15	27	10	16	18	18	18	11	9
Iceland	2	1	23	19	19	22	15	22	30	21
Iraq	8	9	8	8	11	8	15	19	15	14

*This 1954 figure is for the Federation of Rhodesia and Nyasaland; statistics for the two Rhodesias separately have not been published after 1953.

Ceylon — both dollar surplus countries — and India; West and East Africa, however, both likewise dollar surplus countries, took a much smaller percentage of their imports from the dollar area than in pre-war years. In general, therefore, all shared in the cuts. Of the dollar deficit members, only India seems (on this rough reckoning) to have gained greatly, in this special sense, from the ability to draw on the dollar pool; whilst, of the dollar surplus members, the African Colonies presumably cut dollar imports more severely than they would have had to if they had not been members of the dollar pool, and, compared with their pre-war percentages, only Iraq, Iceland, Malaya, and Ceylon were able to maintain their dollar imports at a relatively high level. There is certainly no clear evidence that the dollar deficit countries as a group benefited unduly at the expense of the dollar surplus countries; but it is certainly true that the cuts were spread more thinly over a wider area than if they had had to be concentrated on the dollar deficit countries while others had imported dollar goods as freely as they liked.

There can therefore be no doubt that the existence of the dollar pool enabled the dollar deficit countries to maintain a pattern of trade more closely approximating to that which one would expect to see re-established when non-discrimination is restored; they did not have to curtail their dollar imports as drastically as the exceptionally acute dollar shortage of the immediate post-war years would otherwise have necessitated; and, in a world where non-dollar currencies were generally not convertible into dollars, they were enabled (indirectly, through drawing upon the pool) to continue to earn dollars in exchange for the sterling they earned from the dollar surplus members, in accordance with what seems to be the normal pattern of trade.

Whilst the dollar surplus countries would certainly have imported dollar goods more freely had they not been members of the dollar pool, there are several reasons for believing that their pattern of trade would not have been so very different if they had held their own reserves of gold and dollars and framed their own dollar import policies.

In the first place, they would have had to hold a considerable part of their net dollar earnings as a reserve to provide them with the same degree of security as was afforded by their membership of the dollar pool.[2] No dollar surplus sterling country was so secure against the possibility of serious falls in its dollar income that it could have afforded not to hold a substantial reserve; and the probability of its running a dollar deficit in some future year would, of course, have been all the greater if such a country had been importing dollar goods on the less restricted scale that would have been permitted by its release from its obligations as a member of the dollar pool.

A second reason to believe that dollar surplus countries would not, in the absence of the pooling arrangements, have imported very much more freely from dollar sources is that a large part of

[2] See the discussion in Chapter II of the economies provided by the pooling of the reserves.

their net dollar earnings would still have had to be used — as they were in fact used through the operation of the system of pooled reserves — to finance their deficits with sterling and other non-dollar countries; deprived of the contribution these dollar surplus countries made to the dollar pool, other sterling countries would have had to seek ways to earn the dollars they needed by running surpluses with these dollar surplus sterling countries. It is not likely that members of the sterling group hitherto accustomed to importing goods from sterling sources would readily switch over to the import of a wide range of goods from dollar countries, especially to many sorts of American equipment, which would have very different standards and specifications from those of the non-dollar capital goods hitherto installed: and most of the need to do so would probably have passed with the recovery of production in the non-dollar world. Ceylon is the example of a sterling country with complete political and financial autonomy that preferred (partly or mainly for such reasons as these) to continue to run a substantial deficit with the other sterling countries, using its dollar surplus to cover its sterling deficit and to contribute to the building up of the central reserves upon which it might need to draw in some future years; there is every reason to believe that the international trade position of the net dollar-earning colonial territories would be essentially similar to that of Ceylon (even though their dollar surpluses were relatively larger); indeed the greater reliance of each of them on a single dollar-earning export would probably have necessitated their building up an even stronger separate reserve than Ceylon would have had to do had she left the pool.

Moreover, a sterling country quitting the pool would lose the other advantages of membership of the sterling area, unless it paid for them in some other way, as South Africa did; and such a payment would presumably, as with that made by South Africa, involve a further reduction in the dollars available to it to spend freely in dollar countries. If it left the sterling area completely, its real income would probably be reduced owing to the greater limitation there would then be upon the transferability of its earnings and the restriction upon the flow of sterling capital to it that would follow its withdrawal, as well as by the likelihood that other sterling countries would discriminate against its exports in order to try to earn as much as possible of its dollar surplus, and that they would insist on payment being made to them in dollars instead of sterling.

It must be concluded that, had the dollar pool not existed, the pattern of trade of the dollar surplus members might not have been so very different (as would appear at first sight) from that which in fact existed. Certainly, to judge by pre-war experience also, they appear to be natural 'dollar surplus, sterling deficit' countries on current account. At the same time, it might be objected that the existence of a banker, the United Kingdom, holding the reserves for all the sterling countries, may have caused the sterling group as a whole to import dollar goods less freely than members could have done if acting independently; in other words, that the banker might have caused them to be over-cautious in building up reserves. A sufficient answer to this seems to be provided by the fact that only in one period — the post-Korea boom of 1950-1 — was it at all generally suggested that the area's reserves had been built up to a 'safe' level.[3] Even in this case, the events of the next six months showed the error of those who thought in this way.

On the export side, as Table II indicates, it does not appear that, because they had the dollar pool to draw upon, the dollar deficit countries lagged behind the dollar surplus members in making the diversion of exports to dollar markets that the greater shortage of dollars (as compared with pre-war) necessitated. Malaya, the biggest net dollar earner, sent a smaller proportion of her exports to dollar markets than in 1937 and 1938. Among the other net dollar earners who were members of the dollar pool, a noticeably greater proportion of exports going to dollar markets than in 1937 (1938 is a bad year to use for comparison because of the American recession in that year) is to be found only in West Africa and East Africa. Of the important dollar deficit countries only the United Kingdom (for whom the percentage of exports going to dollar

[3] Especially by certain hard currency countries (apparently with IMF support) at the Torquay conference on Tariffs and Trade at the end of 1950. An illuminating analysis of the errors of the outlook that led to the extensive relaxation of dollar import restrictions by the sterling countries in the year 1951 is given in the *Economic Survey of Europe in 1951*, pp. 18-20.

TABLE II

Percentage of Exports going to Dollar Countries in Certain Years for Different Sterling Countries

SOURCE: Official Trade Statistics and *Direction of World Trade.*

	1937	1938	1947	1948	1949	1950	1951	1952	1953	1954
United Kingdom	13	14	10	11	9	13	13	14	15	13
Australia	4	5	13	9	8	10	19	11	8	9
Ceylon	21	16	21	22	16	30	16	17	14	11
India	10	9	24	21	19	23	21	24	22	19
New Zealand ..	9	4	9	7	5	12	16	14	9	7
Pakistan	—	—	—	16	14	10	7	5	7	7
S. Rhodesia	13	8	7	5	5	5	6	5	8	11*
East Africa	8	9	10	11	9	12	13	12	11	15
Malaya	47	33	38	30	28	29	23	29	19	18
N. Rhodesia ..	1	1	0	7	15	22	10	6	20	11*
West Africa	16	9	30	23	16	22	21	18	18	13
West Indies† ..	29	30	24	23	28	30	26	22	20	23
South Africa ..	2	2	10	7	9	11	13	10	8	8
Burma	1	1	1	1	1	2	0	1	2	0
Eire	1	1	1	1	1	2	4	3	2	2
Iceland	8	9	5	7	6	13	19	25	16	18
Iraq	7	5	2	7	2	2	2	1	1	1

*This 1954 figure is for the Federation of Rhodesia and Nyasaland; statistics for the two Rhodesias separately have not been published after 1953.

†West Indies exports to Central American dollar countries are excluded.

markets had regained the pre-war figure by 1950), Southern Rhodesia, and Eire did not show a substantial increase in the proportion of their exports going to dollar markets as compared with pre-war. It is fair to note that such diversions of exports to dollar markets are largely dependent, for primary exporters at least, upon the state of American demand. Only in the case of the sort of goods exported by the United Kingdom could we expect to find considerable opportunities for affecting the value of a member's dollar exports through sales promotion, though the stimulation of output of dollar-earning primary commodities could clearly affect appreciably the dollar earnings of primary-exporting countries, at least in the longer run. In fact, the United Kingdom's dollar exports drive and the existence of such institutions as the Dollar Exports Board provide evidence that her efforts in the direction of sales promotion were certainly not surpassed (or, indeed, approached) by those of any other sterling country.

The argument may still be advanced, however, that the existence of the pooling arrangements made it possible for the United Kingdom to finance essential dollar imports (by way of the surpluses she derived from her trade with the net dollar earners of the sterling area) without making the efforts to sell in dollar markets that she would otherwise have been unable to avoid. The force of this argument rests, in the first place, on whether or not further dollar markets could in fact have been developed by her on a scale sufficient to outweigh the dollar costs of the necessary sales promotion. Secondly, its importance would depend upon the extent of the real long-run costs involved in a greater dependence of the United Kingdom's export industries upon the unstable American market.

It is, in any event, doubtful how far the dollar-pooling arrangements should be held responsible for the undoubted inducements that existed to United Kingdom exporters to sell in the relatively 'soft option' of the sterling markets. The chief factor here was undoubtedly the very high sterling balances built up during the war; and of these only a part were due to the dollar surpluses of the outer sterling area and still less to the dollar surpluses obtained by them in the post-war period: a large part of them arose from the debts incurred by the United Kingdom for goods and services imported directly from the outer sterling area countries during and since the war. And even the part of the post-war rise in the sterling balances that was due to the holding of these countries' dollar reserves in London might still have had a parallel if the pooling system had not existed, for it is probable that a considerable part of these dollars would then have been earned by the United Kingdom through current account surpluses with these same sterling countries. Thus the inducement to the United Kingdom to sell in these sterling markets rather than in the dollar markets would probably have remained, even if the dollar pool had not existed. Nevertheless, the fact that sterling countries could not use their sterling balances to buy dollar goods certainly afforded protection to the United Kingdom exporters in sterling markets.

The Main Dollar Import Cuts: Changes in the Pattern of Trade

The impact of the trade policies followed by members of the dollar pool as a result of their concerted efforts to save dollars is roughly indicated by the changes in their dollar trade after the crises of 1947, 1949, and 1951-2, when conferences of the Finance Ministers agreed to intensify import restrictions against dollar goods. However, the changes after 1949 were clearly due in large measure to devaluation. It would seem difficult to attribute to their membership of the dollar pool the decision of the outer sterling area countries to devalue; so far as concerns the independent members, the fact that Pakistan did not devalue (whilst many non-sterling countries did so) shows clearly, if illustration is necessary, that they were free to choose. Whether the net dollar-earning Colonies would have devalued if left to their own devices is a theoretical question it seems unprofitable to pursue:[4] certainly it is impossible to separate their membership of the dollar pool from all the other aspects of their membership of the sterling area or, indeed, from their whole financial and political relationship to the United Kingdom, which was such that devaluation by the latter almost inevitably entailed devaluation by the Colonies also.

The evidence provided by the cuts after the conferences of 1947 and 1949 (see Table I) indicates that, in general, and at least so far as concerns the independent members, cuts were generally made where they would probably in any event have had to be imposed by reason of the dollar deficits of the members concerned. Ceylon is one exception; for despite her dollar surplus, she cut her dollar imports at the same time as the other members and by similar percentages after the decisions of 1947, 1949 and 1952. It may be noted, however, that she relaxed her restrictions liberally as dollar receipts increased generally in 1950 and 1951. Pakistan, which did not devalue when the other members did so, took in 1950 only a slightly lower percentage of its imports from dollar countries than it had in 1949. The dollar surplus Colonies almost invariably cut their dollar imports by proportions similar to those of the other members. But an indication that devaluation was not alone respon-

[4] British Honduras protested against the decision to devalue and would undoubtedly have avoided doing so if it had been free to choose.

sible for the reductions may be seen in the fact that India actually took a higher percentage from dollar sources in 1950 than in 1949. Both Eire and Iceland (neither, incidentally, represented on the Commonwealth finance ministers' conference) also increased the share of their imports coming from dollar sources in 1950, despite devaluation, though the importance of ERP (i.e., Marshall Aid) receipts in determining their dollar expenditure must be borne in mind. There can be little doubt, however, that the net dollar-earning colonies would not, if given free choice, have made such large cuts in their dollar imports as they did. In this sense a given degree of discrimination against dollar imports by all the sterling countries may be held to represent a greater degree of sacrifice on the part of the dollar surplus members.

The effect that the dollar import cuts of 1947, 1949 (reinforced by devaluation) and 1952 had upon the distribution of sterling countries' imports shows clearly in Table I. The proportion of imports coming from dollar sources in the years 1948, 1950 and 1953 (when the cuts had had time to take effect) was, almost without exception, less than in the year immediately preceding each of these. Although South Africa was not a member of the dollar pool, it may be noted that her dollar imports followed a similar pattern, which may reasonably be judged, therefore, to have been a consequence of a deterioration in the sterling countries' dollar accounts, rather than of the way the dollar pool operated.

At the same time, the sterling countries belonging to the dollar pool tended to make their dollar import cuts well after the reserves had been suffering considerable strain, and the cuts had therefore to be more severe than if action had been taken earlier. It may well be that if each of them had held its own gold and dollar reserves they would have taken action to check the fall sooner than they did as members of the dollar pool. The dollar import restrictions had their main impact about a year after the periods of most serious strain on the reserves had been reached (that is the 'crisis' years, 1947, 1949, 1951-2), so that when the sterling area's balance of payments had recovered to its most favourable points, that is in 1950-1 and 1953-4, the effects of the preceding cuts were still in evidence. The considerable relaxations of the years 1953, 1954 and 1955 did not lead to such an increase in the proportion of dollar imports as one might have expected, since production and competitive power in non-dollar countries had by then recovered greatly, in contrast with the experience of 1951-2, when the relaxations following the recovery of the reserves in 1950-1 led to a considerable increase in dollar imports — and thereby did much to precipitate the 'crisis' of 1951-2.

Certain general conclusions may be drawn about the probable effects of the trade policies arising out of the dollar-pooling system upon the incidence and timing of the import cuts made by the sterling countries.

First, so far as concerns those colonies that had dollar surpluses, the degree of restriction against dollar imports was probably greater than if they had been responsible for framing their own dollar import policies.

Secondly, the tightening of dollar import restrictions, when it was made, was made simultaneously by a large number of countries. At the same time, there was a clear tendency to postpone such tightening of restrictions until a conference of the sterling countries had agreed to impose them. Naturally, any one country would not be eager to set the example in this matter when the reserves were falling; the state of its own London funds rather than that of the central reserves would be the main determinant of its import policy under normal conditions. Conversely, when the state of the reserves was improving (as in the first half of 1951), there was a tendency for a relaxation by one country to be followed or even surpassed by other members — perhaps with the object of spending dollars as freely as possible while the opportunity lasted.

It would therefore seem likely that the intensification of restrictions when it occurred was a greater and more sudden reversal of policy than one would have expected under any conceivable alternative system. Policy changes proceeded by 'a series of gigantic hiccups' rather than by the process of gradual adjustment to changing situations that would have been more likely to occur had each member country held its own gold and dollar reserves.

General Effects of Dollar Import Restrictions

The main effect of a concerted policy of dollar import restrictions such as that pursued by the sterling countries is inevitably (and intentionally) to canalize their import trade amongst themselves rather than between them and the dollar countries. But this is also true of any group of countries imposing dollar import restrictions — as was the greater part of the non-dollar world during the post-war years. The particular effect of the dollar-pooling arrangements was merely to cause some sterling countries to impose less stern restrictions than they would probably have otherwise done, and for other sterling countries to restrict dollar imports more severely than if they had not belonged to the dollar pool.

The dangers of such canalization of trade among a group of countries (regarding the matter purely from their own point of view)

> is that some scarce productive resources will become absorbed in providing for the mutual exchange between participating countries of goods less essential than those which might have been received from the outside world in exchange for goods made with these resources had they been available.[5]

And this argument may be extended: there is a similar danger when resources are used to meet demands within the area under circumstances when it would have been preferable to use them to produce dollar exports, not in order to use the proceeds for buying additional dollar imports, but in order to build up the gold and dollar reserves. The present and prospective height of these reserves is clearly the important factor in both problems; if they were at a 'safe' level there would be no need to sacrifice the advantages of multilateral trade in the short run in order to build them up to, or maintain them at, a level at which they would be able to withstand the calls likely to be made upon them either when dollar import restrictions were reduced or if dollar earnings fell.

The dollar-pooling arrangements must be judged (in this context) on two criteria:

(i) Were they such as to give an accurate reflection of the judgment of the member countries about how far it was worth sacrificing some of the advantages of multilateral trade in the present in order to build up the reserves? In other words, were

[5] Professor R. F. Kahn, 'The Balance of Payments and the Sterling Area', *District Bank Review,* December 1951.

they likely to cause too much restriction of the sterling countries' dollar imports or too little?

(ii) Given the extent to which dollar imports to the sterling area were to be restricted, did the dollar-pooling arrangements bring it about that the cuts were made in the manner least damaging from the point of view of the sterling countries?

On the first criterion, the arrangements provided the possibility of general agreement amongst members about how severe dollar import restrictions should be in a given period, yet left every member free to give effect to the agreement in his own way. But if the situation changed there was no immediate and unmistakable way of indicating to members the extent to which dollar import restrictions could justifiably be relaxed or should be tightened. Moreover, different members inevitably had different views about how far relaxations were justifiable.[6] As a result, the restrictions may sometimes have been unnecessarily severe, but more often the reverse was probably true — since the reserves never reached a level that was likely to be adequate to meet the strain that would probably be exerted upon them under certain foreseeable and probable circumstances (such as a sudden fall in dollar earnings, the relaxation or abolition of dollar import restrictions or the restoration of non-resident convertibility).

The second criterion relates to the distribution of dollar import cuts amongst members. This distribution depended largely upon the extent of the conscientiousness with which different members applied the agreed policies of dollar earning and dollar saving. Only by the merest chance could this result in an optimal distribution of the cuts; ideally, demands should have been diverted from dollar to non-dollar supplies wherever (in the whole sterling area) the prices of the non-dollar commodities exceeded the dollar equivalent by the smallest margins[7] and where the sacrifice involved in making such cuts caused the minimum of reduction in economic welfare for the members imposing them, at any rate so far as the

[6] The measure of agreement necessary to operate such a system, and a suggested means of reconciling divergences in members' views upon such matters, will be discussed in Chapter IX.

[7] Or, at any rate, where this condition would hold after the non-dollar industries producing substitutes for the excluded dollar goods had developed for a limited period behind the necessary minimum of protection from dollar competition.

governments concerned could judge. Similarly, the building up of dollar-saving industries was most desirable in those cases where the costs of the sterling products were least above those of the dollar product satisfying the same demand. Whether these industries were aided directly by specific controls (for example, the allocation of raw materials and controls over capital issues) or indirectly by reason of the protection that they were afforded when competing dollar goods were excluded, these would seem to be the principles upon which the member governments should ideally have framed their policies. The criterion of 'essentiality' as such was, in fact, relevant only so far as the exclusion of 'less essential' dollar imports could actually increase total savings or improve the distribution of real income within the sterling countries. In the immediate post-war years and in the short run such effects upon saving would be likely, for if the 'luxury' goods were available only from dollar sources, the probability was that the money that might have been spent upon them (had they been admitted) was saved until the goods became available from alternative sources.[8] But in the longer run, substitutes for the excluded dollar goods became available and resources must inevitably have been diverted to satisfying these pent-up demands, except so far as specific controls could prevent this: in view of the limited extent of such controls in the sterling countries it seems certain that they cannot have prevented this from occurring to some substantial extent. Professor Kahn, in the article referred to above, refers to this danger and points out that 'the nature of the trade which flows naturally inside the sterling area is such that this danger is not very great and specific controls should be capable of looking after it fairly well'. But, in fact, whilst dollar imports remained for many years after the war under controls based on these principles, direct controls over domestic production — even assuming they could have averted the undesirable effects outlined above — were progressively abandoned.

There was, then, no inducement to member governments to apply

[8] Like this argument, the contention that the exclusion of 'less essential' dollar imports might have favourable distributional effects within the importing country (at any rate in the short run) is not strictly relevant to a discussion of the effects of dollar import restrictions as such: so far as a case exists for using import controls for this purpose, it must hold good of *all* imports of the 'luxury' goods, from whatever source they originate.

their dollar-saving import policies and to stimulate dollar-earning or dollar-saving industries in just those places (over the whole sterling area) where they would be likely to do most to improve the area's dollar accounts. And so far as the sterling area countries were likely to be in a stronger comparative cost position, relative to the dollar countries, in the production of the 'more essential' commodities, the emphasis upon the exclusion of the 'less essential' dollar goods must have afforded protection to similar industries in the sterling countries, and thereby tended to divert resources towards those industries.

In fact, those products treated for purposes of dollar import restrictions as 'more essential' — and therefore admitted relatively freely — were often those in which the sterling countries had probably a comparative advantage: the United Kingdom was, for example, probably far better able to meet dollar competition in the production of many types of capital goods than in that of most luxury consumer goods; it was therefore unfortunate that the protection thus afforded in other sterling countries to United Kingdom exporters against the competition of dollar consumer goods constituted a stimulus for United Kingdom resources to flow into lines of production in which they would be relatively unable to face dollar competition when dollar goods were once more freely admitted into sterling markets. Similarly, the relative ease with which dollar primary products (compared with dollar manufactures) could be imported into the United Kingdom meant that there was so much the less inducement for the other sterling countries to increase their output of these products, and so much the more likelihood that they would increase their output of products in which they were less well able to face dollar competition when the dollar import restrictions were removed. If dollar wheat was admitted to the United Kingdom more readily than were dollar consumer goods to the sterling area generally, the natural consequence was that consumer-goods industries were expanded in the sterling area to produce higher-cost substitutes for dollar consumer goods, whilst there was less inducement than would have been desirable for sterling producers of wheat (especially Australia, a low-cost producer) to expand their output and to concentrate upon producing types of wheat suited to the United Kingdom market. Similarly, the relatively free admission of dollar capital goods to the sterling area, as compared with consumer goods, gave United Kingdom exporters more incentive to adapt their consumer goods to the needs of outer sterling area markets than to producing capital goods of the sorts these countries required; dollar capital goods, therefore, continued to be those best suited to the needs of the sterling countries in many cases where a greater incentive to United Kingdom producers to produce comparable goods might have led to considerable long-term reductions in the sterling area's dollar imports of capital goods.

In itself, the diversion of resources towards industries considered by administrators to be 'less essential' would not necessarily have been undesirable. The objection to this sort of diversion of resources is, rather, that the protection afforded by the dollar import restrictions to industries in the sterling countries producing substitutes for dollar goods must have stimulated many industries that were not relatively well able to compete with dollar products; the selection of industries to be protected in this way on criteria of social desirability must inevitably have meant that many less economic dollar-saving industries (and probably many of the more economic ones also) were accorded this sort of protection.

It is true that the efforts made by the sterling countries to develop the most promising dollar-saving (and dollar-earning) industries made it the more likely that resources would flow towards these — provided the governments concerned were able to see which dollar-saving industries were most likely to be able to compete with dollar products after a period of special assistance. But there is no reason to believe that resources were attracted into these desirable dollar-saving and dollar-earning industries from those industries protected by the dollar import restrictions whose long-term expansion was unlikely to be economic. It is far more likely that the resources were attracted from industries that were not protected by the dollar import restrictions at all, but whose development would in fact have been more economic than that of the least competitive dollar-saving industries.[9]

It is unfortunately impossible to adduce statistical evidence to

[9] I am indebted to Mr Leicester Webb for very helpful suggestions in connection with this and the following paragraph.

show that uneconomic industries were fostered by the dollar import restrictions. Even if one could show which industries in the sterling countries (or in the non-dollar world) were those least able to compete with dollar products in the long run, it would be impossible to show which of these were fostered by the dollar import restrictions rather than by the many other influences at work over the same period. The diversion of resources into these industries resulting from the dollar import restrictions would often occur only after the restrictions had been in force for some time; it would not, therefore, be easy to trace a direct connection between the expansion of a given industry and a sudden intensification of dollar import restrictions — such as those of 1947 and 1949. Moreover, the chain of cause and effect would be especially difficult to detect since the dollar-saving industries protected would probably not be in the country imposing the dollar import restrictions; often they would not be even in the sterling area, but could be anywhere in the non-dollar world. The effects on any particular industry in any one country might well be undetectable; but the adverse effects upon the distribution of trade and resources might nonetheless be considerable, for a sort of chain reaction might be expected to cause the protection afforded by the import restrictions to spread over many countries and industries.

In theory, the sterling-area governments might have prevented resources from flowing into the least economic industries protected by the dollar import restrictions, but extensive controls would have been necessary to carry out such a policy in the face of the contrary forces tending to attract resources into these industries. The only really effective way to prevent the occurrence of undesirable effects upon the pattern of production in the long run would be to select dollar imports entirely upon criteria of relative costs; only in the short run (when resources cannot readily be transferred to the protected industries) is it justifiable to frame dollar import policies on the basis of other criteria.

The United Kingdom and the other non-dollar exporters of manufactured goods must have benefited considerably from the protection against competition from dollar products that their exports received in other sterling area markets. It is probable that the primary-exporting countries of the sterling area did not benefit to the same extent from such protection as was afforded to them by the dollar import controls of the United Kingdom and Western Europe for, taking the non-dollar world as a whole, dollar manufactured products were discriminated against more severely than were dollar-area primary products, which were more generally regarded as 'essentials' and therefore admitted fairly freely. It is true that the outer sterling area countries admitted dollar capital goods relatively freely; in fact, these could be regarded as about as 'essential' to their economies as were dollar raw materials to the United Kingdom; yet when the United Kingdom had abolished all restrictions of importance against the import of dollar raw materials (as she had done by 1953-4) the other sterling countries continued to discriminate in some measure against even capital goods from dollar countries.

This tendency for the United Kingdom to discriminate less severely against dollar imports essential to her than did the Dominions against the dollar goods that they regarded as most important to them was attributable to various causes. First, Canada's trade ties with the United Kingdom made it politically far more difficult to impose as strict a licensing policy against her primary exports — especially wheat — as could be imposed by the outer sterling area countries against the (predominantly manufactured) imports of the other sterling countries from the United States; their imports from Canada (at least of the politically important primary products) were relatively negligible. However desirable it may have been to favour Canada's primary products (compared with other dollar imports) in the United Kingdom market, this does not alter the fact that there were consequently fewer dollars available for the other sterling countries, or, for that matter, the United Kingdom, to spend on other dollar imports that might have done more to increase their productivity or living standards; nor the fact that in general it was the United Kingdom that benefited by the relatively free import of Canadian wheat, and the wheat producers in the sterling area that lost by it. Another argument in favour of the United Kingdom's policy of freeing the import of dollar raw materials so far as possible is that it increased the United Kingdom's earnings from exports incorporating these materials and from the re-export of the materials. As only a small part of these extra earnings could have been dollars, however, it is debatable how far such an argument justified a special leniency in the licensing of dollar imports of this sort — at any rate if higher imports of these goods were at the expense of the equally free import of dollar capital goods that might have done at least as much to raise the productivity and dollar earnings of outer sterling area countries. It has also been said that the United Kingdom was justified in freeing the import of dollar raw materials because these were in some sense basic to her economy; by which one is to understand that their free import would have an especially favourable effect upon the United Kingdom's industrial production or living standards. But this argument — if it is carried no further than this — is of doubtful value, since the choice of which particular dollar imports are 'basic' in this sense depends upon what alternative sources of supply of similar goods are available and at what prices: the choice of which dollar imports are of highest priority for British industry (in view of all these considerations) would surely be better determined by the price mechanism than by an administrative decision about what commodities were considered to be 'basic' — in some inadequately defined sense.

As the United Kingdom progressively relaxed her restrictions against the import of dollar raw materials in 1953-4, there can be little doubt that she benefited appreciably compared with the other members of the dollar pool, for in these other sterling countries the markets for most of her products continued to be protected by a considerable degree of discrimination against American manufactured goods.

There is a further reason to believe that the United Kingdom (and other non-dollar industrial-exporting countries where, and so far as, their goods were not discriminated against) gained at the expense of the primary-exporting countries of the sterling area from the existence of the dollar import restrictions. The main exports of the outer sterling area countries were standardized primary products sold on closely competitive terms in relatively perfect markets. Their prices to the United Kingdom were, therefore, at current exchange rates, usually (except where they were subject to bulk purchase or other special agreements) the same as those at which they would sell on world (including dollar) markets. But the natural — and justifiable — consequence of the United Kingdom importing sterling goods more freely than competing dollar commodities would be that the sterling commodities imported by the United Kingdom should be paid for at higher prices than if discrimination had not been applied. That this did not occur to any obvious extent was probably due in part to the fact that these prices were for many years held down by bulk-buying contracts, and because such a considerable increase in the sterling price of these commodities over those paid in world markets would have been resisted by the United Kingdom, whose importance as a consumer in world markets for these goods would have been sufficient, in all probability, to enforce this view.

On the other hand, the United Kingdom's exports to the other sterling countries were manufactured goods, sold in imperfect markets, where the protection afforded by the other sterling countries' dollar import restrictions readily made possible the quotation of prices well above those prevailing for equivalent products in dollar markets. Moreover, the United Kingdom exporter could also benefit from this protected position to retain his markets, despite any concealed price rises in the form of longer delivery dates and less satisfactory qualities than those of comparable goods obtainable from dollar sources.

The consequence of these differences in the nature of the goods sold by the United Kingdom, on the one hand, and by the outer sterling area countries on the other, seems, therefore, to have been a substantial movement of the terms of trade in favour of the United Kingdom and other non-dollar exporters of manufactured goods, and against the other sterling countries. It may be noted that this result in no way depends upon the argument advanced above for believing that the United Kingdom gained also from the fact that dollar import restrictions in the sterling area were more severe against dollar goods competing with her products than were her own dollar import restrictions against dollar commodities competing with the primary exports of the rest of the sterling area. These two influences tending to turn the terms of trade in favour of the United Kingdom (and other industrial exporters) and against the other sterling countries were thus separate and additive.[10] There was therefore probably good reason based on

[10] Against these considerations should be set certain effects of the transferable accounts system and of the EPU that probably favoured the

solid self-interest (whether or not this was the real motive) for the clear preference of the United Kingdom authorities for pushing on towards non-resident convertibility rather faster than towards the abolition of dollar import restrictions by the sterling countries. And there was good reason, too, for the natural inclination of the other sterling countries to prefer that their dollar import restrictions be abolished before the granting of full convertibility to non-residents. These preferences could be supported by arguments of the sort outlined above, though they were presumably in fact based mainly upon the hope that the United Kingdom might be expected to gain from increased invisible earnings if the emphasis was mainly upon the restoration of convertibility. Perhaps if the independent sterling countries had been more consciously aware of the soundness of their own case they would have been less ready to go as far as they did towards supporting the United Kingdom's attitude.

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outer sterling area countries at the expense of the United Kingdom. These will be discussed in Chapters VI and VII. The advantages of free access to the United Kingdom capital market (for those sterling countries that were net importers of capital) and other less tangible advantages of sterling area membership must, of course, also be borne in mind if one is trying to draw up any balance sheet of gains and losses from membership of the sterling system.

V

MEMBERSHIP OF THE DOLLAR POOL

In what circumstances might a sterling country benefit by withdrawing from the dollar pool? The fact that, for many years, South Africa, a member of the sterling area, did not belong to the dollar pool (although contributing a certain amount of gold to it in accordance with agreements with the United Kingdom) raises the question of whether modifications might not be possible in the obligations and privileges of membership to accord with the economic position of different members. There is also the question of whether it might be desirable for additional countries to join the dollar pool. Should the sterling area wither away — or should it extend its scope? These problems require to be approached from the viewpoint of (a) those individual members most particularly concerned; (b) the economic welfare of the present sterling countries; and (c) world trade as a whole.

The Benefit of Leaving the Dollar Pool

If a country were to benefit from leaving the dollar pool it would need to be confident that it could provide for its own dollar needs, taking good years with bad. This might consist in earning more dollars than it spent, but it might also consist partly in borrowing dollars. It would also have to be able to build up its own reserves of hard currencies (so long as the sterling and other currencies it might hold were not likely to become fully convertible into dollars). It is not likely that a sterling country leaving the dollar pool would be able to take with it more than a small proportion of its reserve requirements: the difficulties in the way of apportioning the reserves among members on any equitable principles would be well-nigh insuperable, and, even if this were done, the economy presented by the pooling of reserves means that the share a member could justifiably hope to obtain would not provide him with the same degree of security as did the ability to call upon the larger central reserve. A country would be most likely to feel able to withdraw when its dollar earnings were at an unusually high level; the more its net dollar position tended to fluctuate, the larger, other things equal, would its gold and dollar reserve — and its net dollar earnings — need to be at the time of withdrawal. And the safety margin that would have to be allowed by one small country holding its own reserves would clearly be (relatively) greater than that which need be allowed by the managers of a central pool, under which the risks of different members being faced with a serious dollar deficit in any one year can (as argued in Chapter II) be offset against one another. The seceding country would also have to hold enough dollars to pay for those deficits with non-dollar countries which its membership formerly enabled it to settle in sterling. If it continued to have a dollar surplus, which alone would enable it to benefit from leaving the dollar pool, it is certain that other countries (including sterling ones, unless there were any agreement to the contrary) would make every effort to earn some of its dollars from it by instituting export drives to sell their goods to it, discriminating against its exports where possible, and refusing to accept payment from it in non-dollar currencies. The larger its dollar surplus, relative to its total trade, the greater the probability that it would run a sterling deficit and therefore the greater would be its need to obtain sterling — at the cost of some sacrifice of its dollar earnings. South Africa and Ceylon both earned enough dollars (taking account of South Africa's gold production) to cover their dollar requirements and both had sterling deficits; if they were to move towards greater independence of the sterling area they might find themselves unable to settle a large part of their sterling deficit in sterling and find that settlement in gold or dollars was demanded for an increasing part of it. Moreover, if the seceding country wished also to hold more of its working balances in New York and to use that financial centre for its international financial services rather than London, this would involve it in the need to have an even larger dollar surplus in order to build up the necessary dollar balances.

In the light of all this necessary additional dollar expenditure, a country might be expected to leave the dollar pool only if it believed that it would then be able to import dollar goods to a higher value than it was able to do so long as it was bound by its obligations as a member of the dollar pool. It would have to take into account any extra export earnings it might hope for, as well as any additional dollar loans it might hope to raise and also the future dollar payments it would have to make for the servicing of such loans if it ceased to be a member.

Only if a country had been earning a very large dollar surplus and paying it into the pool would it be able to support the extra weight imposed by the extra dollar charges outlined above (including that of the additional dollar imports it now felt able to finance). It seems unlikely that it would be able to increase its dollar earnings substantially, unless it had been selling goods to other sterling countries at below the prices they would fetch in dollar markets — and then only if it could be sure of finding equally stable and secure markets for them in dollar countries, and if it believed that its membership of the dollar pool was preventing it from developing its potential dollar markets.[1]

As to the possibility of raising dollar loans on an increased scale once a member left the dollar pool,[2] it is hard to see why its chances of raising such loans should be greater then.[3] So far as the ability to raise loans depended upon lenders' assessment of the borrowing country's ability to find the dollars for repayment when the time came, a country would appear to have a better chance of raising such loans so long as it had the dollar pool to draw upon if the need arose. This would clearly be an important point for a country whose future dollar earnings were uncertain, whether for cyclical or secular reasons.

[1] In fact there is no reason to believe that membership of the dollar pool did have any such effect.

[2] This constitutes a considerable part of the proposals of Sir Douglas Copland to the effect that Australia and New Zealand should seek to look after their own dollar needs (see, for example, his *Inflation and Expansion*, Melbourne, 1951, p. 43). Mr John Matthai, a former Indian Minister of Finance, has made a similar suggestion for his country (*Financial Times*, 18th January, 1952). Both writers seem to have in mind principally loans from international institutions, rather than private lenders.

[3] So far as lenders might be willing to back the future of one sterling country whose prospects might be regarded as superior to those of the area as a whole, such a country might attract more loans if no longer a member. But, in fact, its ability to repay in dollars would not be enhanced by its leaving the dollar pool.

The reasons why the proposals to leave the dollar pool have been linked with suggestions that more American loans should be raised by the member in question are not always clear. There may be a feeling that in certain times past the United Kingdom Government looked with disfavour upon the attempts of other sterling countries to go to non-sterling sources for their capital, but the Conferences from 1952 onwards, pronounced clearly in favour of them whenever the loans could be used productively. If, in fact, the United Kingdom Government ever adopted such an attitude, a member wishing to raise a loan would have needed only to explain its needs and prospects of using the loan productively to the United Kingdom and express readiness to accept a sterling loan on the same terms if the capital and the required goods were available; if they were not it could then have proceeded with negotiations for the dollar loan. But at the same time, so long as it was a member of the dollar pool, it should not neglect the effect that the loan and its servicing would have upon other members (see Chapter III). The more probable reason why the suggestion that more dollars should be borrowed has been linked with the question of whether the borrowing country should leave the sterling area is that the government of such a country would have far greater incentive to negotiate such dollar loans if it no longer had the dollar pool to draw upon. But it seems unnecessary that the country concerned should suffer the disadvantages of leaving the area in order to give its government a stimulus to taking a course which is conceived as being, in any event, in its own interest. What is required is some greater incentive for outer sterling area countries' governments to play their part in increasing the dollar resources of the area, including those derived from dollar loans, where the state of the central reserves demands it, even where the level of the outer sterling area country's own international reserves (that is, its London Funds) or its own overall balance of payments does not make it so necessary to do so from its own immediate point of view. Some form of the proposals made in Chapter IX might go some way towards providing such an incentive.

As an alternative to complete withdrawal there might also be the possibility of a sort of partial withdrawal: a member might be released from some of the obligations and privileges of membership of the dollar pool yet remain a member of the sterling area in other respects — notably for the purposes of exchange control, somewhat on the lines of South Africa's position since 1948. The necessary condition for a country to benefit from such a change would again be its ability to meet its dollar requirements and build up the necessary reserve of gold and dollars whilst importing dollar goods more freely than when it was a member of the dollar pool. But if it were to retain the other advantages of sterling area membership—such as the use of sterling over a wide area, and the free flow of capital to it from the London capital market — it might also be necessary to pay for these privileges in some way, as did South Africa by the sale of a certain amount of gold to the United Kingdom in return for sterling. As has been pointed out above, the main consideration of a country with a sterling deficit would have to be to ensure that it would still be able to settle at least a large part of this deficit without drawing upon its hard currency resources and that its exports would not be discriminated against by sterling countries with the object of earning its dollars. A partial withdrawal would probably necessitate some payment of dollars by it into the sterling area pool; the problem for the seceding country would be whether the advantages it obtained would be worth the gold or dollar payment it would have to make. The latter might take the form of an annual payment — broadly speaking, this has been the effect of the various agreements with South Africa — which would compel the paying country to decide between agreeing to pay out an amount of its dollar income in this way or remaining in the position (as a full member of the dollar pool) of making larger or smaller net payments or withdrawals according to its net dollar position in each year.

A further possibility, and one which — almost inevitably in such a loose and flexible organization as the dollar pool — has occurred in fact, is for countries that had relatively strong dollar positions to apply slightly less stringent dollar import restrictions than did the other members. This seems to have been true of Ceylon in the first half of 1951 (and possibly at other times).[4] Where a country is an habitual net contributor to the dollar pool and, though it may need to draw out of the pool in some future

[4] See A. R. Conan, *The Sterling Area*, p. 155.

years, is unlikely to draw upon the pool to anything like the extent to which it has contributed, it is clearly difficult to insist upon its observing the obligations of membership as strictly as other members who habitually draw upon the pool. This argument is especially difficult to reject when the dollar surplus country in question is one of the poorer members. To put the matter squarely, it may be worth the while of the other sterling countries to bribe the net dollar surplus member to continue to contribute to the pool by winking at its laxer dollar import restrictions. This, of course, does involve them in some sacrifice of dollars, and there is no guarantee that the size of this loss will just about balance, over a period of years, the greater increment to the reserves that arises because this dollar surplus country remains a member of the dollar pool: as has been observed above, some dollars would almost certainly be earned from such a country even if it left the dollar pool, so long as it continued to run a sterling deficit. (Some form of the proposals contained in Chapter IX might conduce towards the solution of this problem.) From the point of view of the dollar surplus country, this form of partial withdrawal from membership obligations will always be worthwhile so long as it is not thereby precluded from the other benefits of membership — notably, freedom to use its London funds over as wide an area as before, free access to the London capital market, and the right to draw upon the dollar pool in an emergency.

The Effects of Withdrawal of a Member

Broadly speaking, it would be true to say that when it is in the interests of a member to withdraw from the dollar pool completely, the other sterling countries will be adversely affected in that the dollar reserves and future net dollar contributions to the pool will be reduced. But this does not mean that, conversely, when it is against the interests of the dollar pool for a member to withdraw, it will also inevitably be in its own interests to do so: the need to build up considerable idle balances of gold or dollars in the seceding country may prevent it from importing any more dollar goods than before, whilst the other sterling countries would have to import considerably fewer dollar goods or suffer a correspondingly greater drain on their reserves. Only if the advantage of leaving the pool is great enough to outweigh the extra dollar costs involved in so doing will the seceding country benefit; but, in either event, if the thorny problem of making inter-country comparisons is ignored, one might say that the totality of the countries concerned would be adversely affected because of the loss of the economies of pooled reserves. This should be qualified by the reservation that if the standard of living of the seceding country was below the average of that of the other sterling countries, any rise in its real income per head, due to the freer dollar imports, might be regarded as a net gain in economic welfare to the whole group of countries concerned, even if the other members lost an equivalent amount of real income; similarly, if a richer member withdrew, the effect on the economic welfare of the sterling countries as a whole might be justifiably held to be adverse.

The effects of a partial withdrawal would be similar in direction (though not in degree) to those of a total withdrawal. But if the partial withdrawal did not involve the dollar surplus country in building up any hard currency reserves of its own (or in additional dollar payments), the effects could not be adverse so far as it was concerned. The net result would merely be that certain sterling countries could import dollar goods less freely, whilst the partly seceding member could import them more freely. The extent of the redistribution of income involved (and the change in economic welfare of the whole group of countries) would depend upon what compensation, if any, the other sterling countries received in return for the greater freedom of import policy obtained by the dollar surplus member.

The complete withdrawal of a member who was in a position to contribute to the dollar pool would seem likely to reduce total imports from the dollar countries — again because of the loss of the economies of pooled reserves. Provided it built up an adequate dollar reserve to cover its needs, one would expect the total dollar imports of all the sterling countries (including the seceding country) to be reduced. (Alternatively, the remaining members of the pool would have to draw upon their reserves more than before, and this would necessitate more drastic dollar import reductions by them at some later date.) The greater the number of members that withdrew in this way, the more adverse would be the effects upon world trade; for not only must the reduction in direct dollar imports be taken into account but also the reduction in multilateral trade that might result from the attempts of the remaining sterling countries to increase their surpluses with the seceding country in order to earn some of its dollars.

The Effect on World Trade of a Partial Withdrawal

Similar effects might also be expected to result from a partial withdrawal on the lines of South Africa's position under the agreement of 1950 between the Union and the United Kingdom. The essence of this agreement was that the exact amount of gold earned by the sterling countries from the Union depended upon their success (and, incidentally, that of other soft currency countries) in selling to South Africa certain 'more essential' goods in competition with dollar producers. This had the merit of opening a wider area of the world's trade to competition between dollar and sterling goods. This conclusion is not affected by the probability that the decision of the South African Government about what goods are 'essential' was influenced by the intention to contribute a more or less fixed sum (£70m. was earned in this way in 1951, and £60m. in 1950) to the dollar pool.[5] An alternative method might be an undertaking to contribute dollars to the pool in payment for a proportion of its net or gross imports from the remaining members.

Financing of Transactions through New York

There is a further way in which the sterling area may appear to be loosening its hold upon members. It is considered separately here, as it is not primarily a form of release from the obligations of the dollar pool, though it may have effects upon the dollar expenditure of members and therefore upon the central reserves.

There is evidence that in 1949-50 and 1950-1 India (though there is no reason to suppose that this is a unique case) was financing an increasing proportion of her exports to hard currency countries through bills drawn upon or remittances received from

[5] See N. N. Franklin, 'South Africa and the Sterling Area', *Economic Journal,* June 1951, where it is suggested that £80m. was the figure aimed at. (Figures for 1950 and 1951 were given in the 1952 South African budget speech.)

the country of destination, and a diminishing percentage through bills drawn on London.[6]

The probable effects of such a tendency upon the dollar reserves seem to be as follows: Provided it does not constitute a means of concealing from other members dollar expenditure which would not have been made but for its being relatively hard to see, this does not appear to be a means of evading obligations under the dollar pooling system. Its extension, however, would probably involve additional dollar drawings from the pool to pay for these financial services. It would, therefore, constitute a drain upon the central reserves like any other form of dollar expenditure. Provided members of the dollar pool have clear understandings about the extent to which they shall discourage the purchase of such services from dollar countries, there can be no objection to these expenditures as such. If the sterling country concerned prefers to use its dollar drawings from the pool for this purpose rather than for visible imports, there are no grounds for objection. But there does seem to be a case for providing a direct incentive to members to exercise the same degree of economy over those forms of dollar expenditure that are not so easily controlled and not so obvious as is expenditure upon visible dollar imports.[7]

The Holding of Small Separate Gold and Dollar Reserves

The relaxation of the strictest interpretation of the obligations implied by membership of the dollar pool may take the form not of laxer import restrictions but of the building up of small separate reserves. Some of the implications of this tendency have been discussed (in connection with the proceeds of members' gold production) in Chapter III. The small reserves granted to central

[6] The following figures on the methods of financing India's exports to hard currency countries are read off the graph given in the *Reports on Indian Currency and Finance* for 1950-1. The percentages given are for the last month of the financial year stated.

Year	*Financed through London*	*Financed through country of destination*
1948-9	63%	21%
1949-50	57%	30%
1950-1	40%	45%

In 1951-2 the proportion financed through country of destination fell appreciably.

[7] See the proposals in Chapter IX.

banks are of hardly any importance; so long as they remain small in quantity they are not likely to be drawn upon, though there is (as argued in Chapter III) a case for taking them into account, when dollar import policies are being framed, in the same way as gold or dollars held in the central reserves. There also appears to have been some tendency for certain sterling countries to increase their holdings of dollar balances in American banks more than in proportion to their total oversea assets. Together with the gold holdings of gold-producing countries (Australia is the only one of these about which adequate statistics are available), these different forms of fragmentation of the reserves might achieve considerable proportions. That they should be publicized is (as argued in Chapter III) likely to be in the interests of the sterling area, for this would show that the total gold and hard currency holdings of members are appreciably more than the figures often referred to as the 'gold and dollar reserves of the sterling area'. Arguments have been advanced earlier in this chapter for believing that some element of flexibility in the obligations of membership may be both inevitable and desirable. If such changes take place quite openly, they may much more justifiably be regarded as a sign of strength and of ability to adapt the system to changing requirements. The holding of separate reserves of gold or dollars is already provided for by statutes and by official communications between governments, but no official pronouncement about their implications for, and relation to, the pooling arrangements has ever been made.[8]

As Table III shows, if due account is taken of the gold and dollar holdings of all members of the dollar pool (and not only those of the United Kingdom, which are usually referred to as the gold and dollar reserves of the sterling area), the total gold and dollar holdings of the members of the dollar pool during the years 1951-4 would have been some $700-800 million higher (or some 25-30 per cent).

[8] By Section 66 of Ceylon's Monetary Law Act (No. 58 of 1949), establishing the Central Bank of Ceylon, it is provided that 'The Monetary Board shall endeavour to hold at least a nuclear reserve in gold or other currencies freely convertible . . . into gold'. The other provisions seem to envisage a diversified reserve, not one held predominantly in sterling with an almost negligible gold or dollar holding (as has been the practice of the other sterling Dominions). The same applies to Burma's international reserves, by an Act of 1952.

TABLE III

Estimated Gold and Dollar Holdings of Certain Sterling Countries

SOURCE: *Federal Reserve Bulletin,* August, 1955.

($ millions)
(as at end of year stated)

	1951	1952	1953	1954
United Kingdom	2843	2318	3009	3190
U.K. dependencies	99	113	108	103
India	309	312	346	334
Others*	326	347	373	381
Total	3577	3090	3836	4008

*Excluding the Union of South Africa.

These figures also indicate that there was a slight but steady increase in the amount of gold and dollars held by sterling countries other than Britain over these years. The increase in Australia's holdings of her own gold production, and agreements with Pakistan, Ceylon, and Iraq to allow these countries to build up small gold holdings of a fixed amount were responsible for most or all of this rise in the separately held reserves. Although separate detailed figures for gold and for dollar exchange holdings are not available, it seems that the increase in gold holdings between the 1949 devaluation and the end of 1955 must have been about $100 million, and that the increase in dollar exchange holdings must have been of about the same magnitude.

The desire of individual sterling countries to have some separate reserves — whatever we may consider the disadvantages of such a course to the efficient working of the dollar pool — is a factor that must be given its due weight. And the convenience of each member holding small working balances in dollars must not be ignored. The natural effect of the devaluation of sterling in 1949 was to make sterling countries prefer to hold some at least of their external assets in gold or dollars, as being less likely than sterling to depreciate in terms of other currencies. Any sterling country that might in some years make a net contribution to the dollar pool was in a reasonable bargaining position to assert its wish to have this right. A country with a strong dollar balance of payments might reserve the right to refrain from paying a surplus into the dollar pool if it were not granted permisison to build up a small reserve of its own, though the probability that all the independent sterling countries (possibly excepting Ceylon) would need to draw upon the central reserves in some (if not most) years would discourage them from trying to be independent of the pool in good years by not paying in their surpluses, as this could obviously disqualify them from the right to withdraw dollars from it in bad years. The allowance of a small gold or dollar reserve was a reasonable compromise in the circumstances.

Moreover, it must have been obvious to all the countries concerned that a real sharing out of the reserves was arithmetically impossible. Even if one made the fantastic assumption that Britain herself could manage without any gold reserves, if the outer sterling area countries decided to exercise the claims on the central reserves represented by their sterling balances, the reserves would have been sufficient to satisfy only about a half of the total claims (that is, the sterling balances) of the independent sterling countries, or between one-quarter and one-third of the sterling balances of all the sterling countries including the dependent territories. The enormous surpluses that Britain would have to run with the rest of the area (to reduce the sterling balances of sterling countries) or with the non-sterling world (to raise the central reserves without increasing liabilities to the outer sterling area countries) are so unlikely for the foreseeable future that it seems the sterling countries must resign themselves to continuing to pool their gold and dollar reserves, though this, of course, does not exclude the possibility that individual countries might be strong enough in their dollar accounts to contract out of the system. Since this is so, it is essential that they work together to discover and apply the best methods of making the system work effectively.

So far as the dollars or gold held by the outer sterling area countries are no longer regarded as part of the area's total reserves for the purpose of framing dollar import policies, and as available for fulfilling the dollar obligations of all members, the accumulation of such reserves constitutes an effective reduction in the resources of the dollar pool. This is especially so as a member accumulating them is not likely to use them normally, but will presumably draw upon them only when the central reserves have fallen dangerously low and when other members are therefore forced to make especially severe economies in their dollar expenditure — which the country with the separate reserve will thus escape, at the cost of making the plight of the others worse. But if it wished to hold these reserves instead of using the same dollars to import goods that the existing policy of the sterling area would have permitted, there can be no logical objection to its choosing to do so, provided this reduction in its dollar imports does not lead to a rise in its imports from non-dollar sources (which would either increase the danger of the area having to make gold payments to 'third' countries or, if the increased import demands were for sterling goods, would increase the strain upon other members' economies). If a dis-inflationary impact was made upon its economy at the same time as it built up the separate reserve, this would reduce the likelihood of its importing additional non-dollar goods to replace the dollar goods it was denying itself. The member building up the separate reserves would be less likely to increase his imports from any source (and would probably reduce them to an appropriate extent), if the fragmentation of the reserves for which he was responsible brought about a fall in his London funds which represented as nearly as possible the real loss that he was occasioning to the other sterling countries by the reduction in the central reserve that was due to his action. The extent of the loss caused in this way would depend upon the height of the reserves at the time and the claims likely to be made upon them (notably the dollar deficits that were in prospect). The important point is that this real loss to the sterling countries would normally be larger than the loss caused (at current rates of exchange) by the fall in his London funds to the country abstracting the gold or dollars from the central reserve. But, provided this real cost to other members could be accurately balanced by an increase in their claims upon the member in question, or by a commensurate reduction in his claims on them, there would be no reason to oppose the introduction of such a measure of flexibility into the system — where a country believed it in its own interests to forgo the dollar goods it could otherwise have bought or in other ways to compensate the other members to an appropriate extent for the real loss it was thus causing them. (Chapter IX contains a proposal that might make possible the introduction of such a measure of flexibility without adverse repercussions upon other members.)

Extending the Membership of the Dollar Pool

If the dollar-pooling arrangements make possible economies in the amount of gold and dollars that needs to be held as reserve for the member countries of the sterling area, it would seem *prima facie* that an increase in the number of members should increase these economies. Viewing the matter from the point of view of the totality of the countries concerned, *including the potential new members,* and of world trade generally, this would be so. But it is apparent that only those new members who might be expected to strengthen the reserves by their adherence would be welcome to the present members,[9] and it is hardly likely that countries in such a strong dollar position would wish to join.

One of the main obstacles in the way of admitting new members would be the difficulty of securing full co-operation in implementing agreed dollar import policies under such a flexible system, depending as it does upon mutual confidence built up over a considerable period. European countries, for example, would hardly take readily to reducing their dollar imports when the reserves of the whole sterling area fell — which might well be at a time when the dollar earnings of primary-exporting members were falling and when, therefore, the reserves of the industrial nations of Europe might well be fairly high because of the favourable movement in their terms of trade that would be likely to occur under such circumstances.

Applying the analysis of earlier chapters, one might suppose that the country most likely to wish to join and also to be accepted would be one which, though at present earning a net dollar surplus, foresaw a considerable risk that this might turn to a deficit through causes peculiar to the nature of its exports. (Clearly, if the risk was merely of a cyclical fall in dollar earnings, it would not be likely to benefit greatly from belonging to the pool, as the other members would also have lower dollar earnings under similar circumstances and therefore no spare reserves for it to draw upon.)

[9] That is, taking account of the drawings they were likely to make upon them.

From the viewpoint of present members, a new member would be likely to be welcome only if its adherence promised either a net gain of dollars to the pool or if it saved the area dollars in some other way. For instance, if a persistent creditor of the sterling area in Europe joined the pool (agreeing to accept settlement in sterling in exchange for the right to draw dollars from the pool on the same conditions as other members), it might thereby be possible to reduce or avoid some immediate payments of hard currencies to that country or else to reduce gold payments under the European Payments Union, if the country in question were a surplus member of the EPU.

The sterling countries would also have to feel certain that the new member would be willing and able to co-operate closely in exchange control policy and to apply to it substantially the same principles as themselves.

In view of all these difficulties it is hardly surprising that additions to the membership of the dollar pool did not occur after the end of the war.[10] The greater freedom of payments through the transferable accounts system provided most of the advantages of multilateral settlements (from the viewpoint of the member and of transferable account countries and from that of world trade as a whole), without raising the complications involved in membership of the dollar pool.

The possibility of adding to the membership of the area (and therefore of increasing the economies and other advantages it provides) seems to depend upon the provision of some more definite means of ensuring that the new members co-operate in helping to raise the reserves than could be provided by an extension of the informal co-operation that in fact exists among the sterling countries. Moreover, some clear way of measuring the gain likely to be obtained from the addition of his membership, both by the new member and by the other sterling countries, would be desirable,

[10] The addition of Jordan in 1948 was really a reversion to the former position when Palestine was a member; the new State of Jordan re-joined the area after partition as soon as separate currencies had been established. The inclusion of the newly founded State of Libya in the sterling area in January 1952 was hardly an extension of the membership of the dollar pool as such, since the financial link with the United Kingdom was closely controlled in a way that made its 'membership' far more similar to that of the colonies than of the independent members.

so that extensions would be possible where each side believed it would gain. (Proposals advanced in Chapter IX should help to facilitate extensions of the membership of the dollar pool where, and so far as, it was expected to be in the interest of both sides that this should occur — without necessarily committing the new member to such complete adherence to the system as that of the existing members.)

VI

THE TRANSFERABILITY OF NON-RESIDENT STERLING

THE dollar-pooling arrangements of the sterling area limited, in practice, the convertibility into dollars of sterling held by countries in that area. Sterling held by non-residents was subject to various forms of restrictions on its transferability and convertibility, apart from that held by residents of the dollar area, which could — except where, as with certain royalties and other earnings, its transfer was restricted by agreement — be readily used for current payments anywhere.[1] (The attitude of different sterling countries to capital transactions involving dollars varied considerably in detail; in general, the removal of dollar capital was discouraged, but permitted where necessary.) It is with the effects of restrictions upon the transferability and convertibility for purposes of current transactions of sterling held by non-dollar countries outside the sterling area that this chapter will be concerned.

The main principles governing the use by non-sterling countries of sterling for payments to other countries were as follows. Up to March 1954 — when all non-sterling countries outside the dollar area (with three exceptions, Turkey, Iran, and Hungary, which were added subsequently) were made transferable account countries — the world was divided for purposes of sterling area exchange control into the following areas (*see also diagram, p. 86*):

(a) The dollar area — to which payments of sterling were not authorized from non-sterling countries (except from another dollar account).

(b) The sterling area — to which current payments could be made by any other country.

[1] Securities owned by a resident of an American account country could be transferred only for the purpose of repayment. Sterling balances owned by an American account country were freely available for current or capital purposes.

(c) The transferable account area — to which current payments in sterling could be made by a sterling country, by another transferable account country, by a dollar account and, if the transaction were approved by the Bank of England, by bilateral account countries. This latter type of 'administrative' transfer (in contrast to the 'automatic' transfer from another transferable account) was authorized with increasing freedom during the period up to March 1954, when current and capital payments among these countries also became 'automatic'.[2]

(d) Bilateral account countries — to which sterling payments by a non-sterling country would be authorized by the Bank of England only if the transfer were unlikely to result in additional pressure on the sterling area's reserves or in an addition to the sterling area's holdings of a currency of which it already had a surfeit.

The limitations upon transfers to and from bilateral account countries meant that it was easier for both sterling and transferable account countries to buy from each other than from bilateral account countries. (Sterling countries generally had less difficulty in making payments to, or receiving payments in sterling from, bilateral account countries than did a transferable account country.) Consequently, the system encouraged sterling and transferable account countries to trade with each other rather than with bilateral account countries. But when the European Payments Union came into existence, all Western European countries, whether in the transferable account group or not (and each EPU member was given the option of joining it, though not all of them felt the necessary degree of readiness to accept sterling from a wide group of countries), were treated similarly from the point of view of authorizing payments between them and the sterling countries, for the sterling area's EPU balance was usually affected in the same way irrespective of which European country received sterling;[3] but

[2] Except for Hungary, Iran, and Turkey, all of whom had been included in the system by 1st July, 1955. From this date, therefore, the whole non-dollar world was considered as the transferable account area.

[3] It is true that certain European countries undertook to hold sterling up to an agreed figure. This at times affected the extent to which the sterling area's EPU balances had to be settled in gold.

payments between a bilateral account EPU country and countries outside the area were subject to the usual control. There was thus a very wide area — including the oversea monetary areas of the other EPU members— over which sterling was very freely transferable even before March 1954. Up to that time, the main remaining restriction on the use of sterling for current transactions in the non-dollar world was the uncertainty of whether a payment to or from a bilateral account country would be authorized by the sterling area authorities — or, alternatively, this obstacle took the form of the costs and risks involved in making an unauthorized transfer by methods that were illegal (at any rate by United Kingdom exchange control criteria). These restrictions and difficulties may well have encouraged sterling and transferable account countries to develop their trade with bilateral account countries less than they would otherwise have done. But, on the other hand, freer transfers to bilateral account countries might have led to the currencies of these countries being accumulated by the sterling area to an unwanted extent, and as gold payments would then have become necessary, trade restrictions might consequently have had to be at least as great as they were under the actual system.

The widening of the transferable account area to include virtually the whole non-dollar, non-sterling world was a logical extension of the progressive broadening of the area over which sterling could be freely used.[4] In general, the effect of the transferability of sterling was to make countries within the area over which it operated readier to import from each other than from elsewhere. As sterling earned by transferable account countries was not convertible into gold to an equivalent value, there was not so much inducement for a transferable account country to export to the sterling-cum-transferable-account area as there was to export to the dollar area and thus to earn dollars. At first sight, therefore, the system would seem to have worked in the desirable direction of encouraging members to meet their import needs from each other and to build up their exports to the dollar area rather than to soft currency countries. But imports by these countries from each other were also, of course, exports of some other member of the group, and

[4] The whole of the non-dollar, non-sterling world was included from July 1955.

the relatively easy markets within the area naturally provided a buoyant demand for the products of industries in the sterling-cum-transferable-account area; accordingly, these countries were so much the less ready to explore ways of developing their dollar markets. Nor was there any pressure upon the individual exporter to seek dollar rather than other markets, for, unless he had illegal methods of acquiring dollars or his government operated some form of dollar-retention scheme, he received his payment in his own currency, whatever the destination of his exports. Consequently, the fact that his country would not earn gold or dollars for an export to a non-dollar country was not normally of great weight in discouraging him from turning his energies to soft rather than to hard currency markets. So far as these payments arrangements influenced governments, however, the general consequence was to encourage them to do what they could to stimulate dollar exports rather than those to non-dollar countries.

The breadth of the area over which a country could make and receive payments in sterling naturally gave each country concerned a wider range of countries in which to find the best markets and the best sources of supply; wider, that is, than if sterling had been transferable only over a more limited area. Apart from facilitating international specialization within the non-dollar world, the system had important effects due to the fact that very little gold had to be used to effect payments among the countries concerned. First, this enabled the limited supplies of available gold to be reserved for the important purposes of buying dollar goods and building up gold and dollar reserves; by agreeing to accept sterling from each other, countries in the transferable account and sterling area group were in effect creating international liquidity at a time when the most sought-after medium of settling international accounts — gold — was in relatively short supply. Secondly, the fact that gold payments played such an unimportant part in settlements between these countries made them less ready to restrict their imports from each other; trade and specialization between them were thus maintained at a relatively high level. The system did not merely discourage bilateral balancing of accounts among members — a tendency towards which would certainly have been the main conceivable alternative — but made it easier for countries concerned in the system to reduce their dollar difficulties by importing dollar-saving commodities, since it gave them a wider range of sources of supply to choose from. On the other hand, the relative lack of opportunity under these payments arrangements to earn dollars from trade with other non-dollar countries made it difficult for non-sterling countries to earn dollars by 'third country' trade to spend upon goods from the dollar area; those countries whose trade had a natural pattern of dollar deficits combined with surpluses in other currencies therefore had their trade somewhat distorted from its natural pattern. But it is difficult to see how such countries could have suffered any less distortion in their pattern of trade under any conceivable alternative system in the circumstances of the period. Above all, if sterling had not been used so widely to finance trade within the non-dollar world, the greater need to use gold and dollars for this purpose would have forced many countries to hold larger reserves of gold; and, therefore, there would probably have been, in fact, no net gain to most countries that might have hoped to earn gold from other non-dollar countries — and certainly no likelihood of net gain to the non-dollar world as a whole.

If these advantages flowed from the breadth of the transferable account system, then should not transferable account status have been given to the bilateral account countries sooner than it was? Their exclusion must presumably have led them to trade rather more with each other and with the dollar countries than they would have done under a more natural pattern of trade.[5] But bilateral account countries were excluded from the transferable accounts area either because the sterling area was in danger of having to pay gold to them, or because the sterling area already held large claims on them that they were showing no desire to satisfy in the form of goods. In the former case, the liberalizing of payments to them would inevitably have resulted eventually in the further restriction of imports from them by the sterling countries (if payments to them by countries outside the area were freely authorized); and this would have impaired rather than promoted world international specialization. Whilst, in the opposite case, if the claims

[5] 'Natural pattern' here means the pattern that would have resulted if all currencies had been freely convertible into each other.

on a country — e.g., Brazil — are not capable of being satisfied in the form of goods, the cause of international specialization is in any event to that extent not being advanced: the extension of further credits to Brazil would have merely been a form of subsidy to that country by the sterling area — not a furthering of the principles of international specialization.

The extension of the sterling system by including within its payments arrangements the transferable account countries (originally consisting principally of European countries but ultimately of the whole non-dollar world outside the sterling area) had certain important effects upon the various participating countries. The industrial-exporting countries of Europe linked to the sterling payments system through the transferable accounts mechanism gained a potentially much wider market for their exports than would otherwise have been available to them;[6] and they gained far more markets than did the United Kingdom in countries importing mainly manufactured goods, since the oversea monetary areas attached to the other EPU members were smaller in extent, and much more closely linked in their trade to the parent metropolitan country, than was the sterling area (possibly excepting the sterling colonial territories). Similarly, the outer sterling area countries gained a much wider range of sources of supply of their main manufactured imports by the inclusion, in the EPU area and the transferable accounts system, of most of the important non-dollar exporters of manufactured products; and the greater competition therefore experienced by the United Kingdom in sterling markets must have tended to keep down the prices of manufactured goods imported by these countries — an effect that would also have been expected to result from the greater specialization between the various industrial exporters that was due to the relative freedom of payments between them, to which the transferable accounts system, like the EPU arrangements, contributed. Once more, the United Kingdom received no comparable offsetting advantage

[6] The extent to which this potentiality was realized in fact in any given case naturally depended upon the extent and nature of the restrictions imposed against each other's goods by the countries concerned. But the general effect of the payments arrangements under discussion was certainly to reduce the need for, and the extent of, trade restrictions among the countries affected by them.

from the increased supplies of primary products available to her from the oversea territories of these countries, for though some of the eighteen (up to 1954) transferable account countries were themselves primary-exporting countries, the quantitative importance of this group was much less than that of the group consisting of exporters of manufactured goods. In general, the exports of these primary-exporting transferable account countries provided far less competition for outer sterling area exports to the United Kingdom than the competition provided for the exports of the United Kingdom in the outer sterling area by the exports of those transferable account countries specializing in the production of secondary products.

In general, then, the outer sterling area countries probably gained more than did the United Kingdom from the increased flow of trade due to the addition of the transferable account countries to the area of free sterling payments. It is true, of course, that the United Kingdom's invisible earnings were doubtless increased by the wide transferability of sterling, though a large part of the transactions concerned would probably have brought business to the City of London in any event, since no comparable financial centre existed in the non-dollar world. On balance, the undoubted gain to the outer sterling area countries from the transferable accounts system (relative to the advantages gained from it by the United Kingdom) must have gone a considerable way to offset the opposite balance of advantages discussed above arising from the dollar import restrictions imposed by the sterling countries, which benefited the United Kingdom (and the industrial exporters of Western Europe) more than the primary-exporting countries of the sterling area.[7] And the Western European countries probably gained more markets and more potential sources of supply from the existence of the transferable accounts system than did the United Kingdom.

The extent to which non-resident sterling was convertible into dollars was governed by agreements with the countries concerned. Of these the chief was the EPU agreement and its predecessors. Apart from the EPU arrangements (which will be discussed in the following chapter), the bilateral agreements under which gold might

[7] Chapter IV, pp. 53 et seq.

be paid were few in the later, but numerous in earlier, post-war years. Their nature was such that when the points of gold payment were approached, trade between the countries concerned was liable to be sharply curtailed, and both governments were likely to aim at a bilateral balancing of their payments with each other. As the danger of losing gold to a bilateral account country diminished, payments to it were permitted more readily by the United Kingdom. The general effect must have been that the trade of a bilateral account country was distorted in such a way as to make it difficult for it to finance a dollar deficit by earning gold from the sterling area. The extent to which it could obtain gold by this means naturally depended upon its bargaining power *vis-à-vis* the United Kingdom (or, rather, the whole sterling area, for which the United Kingdom authorities conducted negotiations). There is no reason to suppose that this bargaining resulted in the channelling of the trade of the whole non-dollar world (including the bilateral account countries) in such a direction as to secure a balance in their dollar accounts in the way that would do least harm or most good. But the gradual widening of the area over which payments to and from bilateral account countries could be made must have made it increasingly possible for the non-dollar world to find the most economic dollar-saving sources of supply. However, until the bilateral account countries were made part of the transferable account area, balances with them had to be settled either fully in gold — which meant that discrimination against them as severe as that imposed against dollar goods was likely to be practised — or fully in the 'swings' of credit provided for in the agreements with them, in which case there were no grounds for discrimination against the bilateral account countries' goods. This meant that there was no likelihood of discrimination being applied in such a way as to adapt the trade of the non-dollar world gradually in a dollar-saving direction and in the most efficient ways. This could have been done, had there been some way of settling balances partly in gold and partly in credit, and the fluctuations of trade between the countries concerned in bilateral arrangements would then probably have been less violent, and the adaptation of the pattern of trade to the non-dollar world's dollar shortage might well have been smoother and more economically effected.

Some Consequences of the Transferable Accounts System

The limits upon the transferability of sterling — whether currently accruing or accumulated sterling — which prevented it from being used to purchase dollar goods, naturally protected the United Kingdom's markets in the countries holding this sterling from competition from dollar goods: residents of the transferable accounts area could use their sterling only to buy non-dollar goods. It also, of course, protected the exports of all other transferable account countries to these markets.

It is therefore true that the other sterling countries benefited too from the protection that was afforded to them in transferable account markets by the fact that transferable account countries could not use their sterling to buy dollar goods. But this protection was probably in fact less important to them than it was to Britain, since the main transferable account countries — up to March 1954, principally the industrial-exporting countries of Western Europe — would have been likely to import sterling area primary products just as freely even if their sterling had been convertible into dollars, for most of the important outer sterling area products they purchased were competitive with dollar products (or, indeed, were sold also to the dollar area and unobtainable in the desired quantities from the dollar area). The inconvertibility of transferable accounts into dollars, then, afforded some protection to all sterling countries (and to transferable account countries) in non-dollar markets; but the countries that benefited most from this protection were clearly those countries that had most to fear from the competition of American exports. In general, this meant the exporters of manufactured goods, since it was in this type of export that the United States was most likely to undercut other exporters over a wide range of products. The fact that most countries chose to exclude mainly manufactured dollar goods rather than dollar primary exports meant that, had transferable accounts countries' holdings of sterling been convertible into dollars, the consequent increases in their dollar imports would almost certainly have been concentrated heavily upon manufactured products — and would therefore have operated strongly against the non-dollar exporters of similar goods such as the United Kingdom (and only to a much smaller extent against non-dollar exporters of primary products).

It may therefore be said that whilst the outer sterling area countries probably gained more than did the United Kingdom and the other countries exporting manufactured goods from the wide transferability of sterling under the transferable accounts and EPU system, it was the United Kingdom and other industrial exporters that benefited most (by comparison with the outer sterling area countries) from the limitations upon — or complete absence of — the convertibility of transferable and bilateral account sterling into dollars. If these conclusions are read in the light of the definite advantages the United Kingdom seems to have gained from the existence of the dollar import restrictions in the rest of the sterling area,[8] the broad effect of the whole complex of payments arrangements seems likely on balance to have worked to the advantage of the United Kingdom (and other industrial exporters) rather than to that of the outer sterling area countries.

To look from another angle at the effects of the arrangements for transferring and converting non-resident sterling, the system may be appraised from the point of view of the dollar countries. The wide and expanding area of transferability of sterling enabled the non-dollar world to economize in its use of dollars for payments to other non-dollar countries and so to use a large proportion of the available dollars for buying dollar goods. At the same time, the comparatively ready markets within the non-dollar world to which the free transferability contributed (coupled with the lack of facilities for turning it into dollars at the official exchange rates), encouraged non-dollar countries to balance their dollar accounts by buying dollar-saving goods from each other — even if this meant that they consequently devoted less effort to expanding their dollar exports. In the short run, at least, the dollar world lost by this emphasis on dollar saving rather than on dollar earning, for its main consequence was to turn the terms of trade in the favour of the non-dollar world as a whole (by comparison with what the terms of trade would have been if all non-dollar countries had been bitterly competing with each other to sell more in American markets). But it is by no means necessarily true that the total dollar earnings of the non-dollar world would have been higher had the non-dollar countries been forced (by the greater difficulties

[8] See Chapter IV.

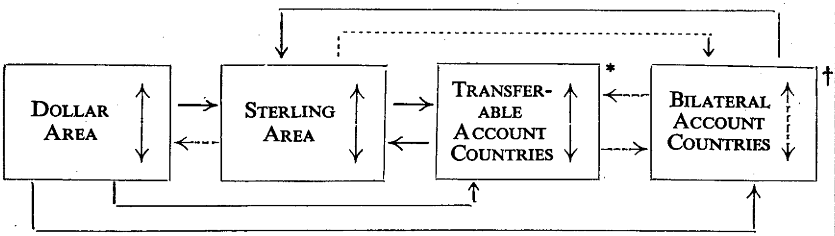
in making payments to each other that would have arisen in the absence of the transferable accounts system) to devote more resources and energy to expanding their dollar exports. Even if their additional efforts had not led to increased tariff protection by the United States, the reduction in dollar prices that would have resulted from their more intense competition with each other in dollar markets might not have been fully offset by a higher volume of dollar sales;[9] and their ability to purchase dollar goods would then have been no greater.

Although the transferable accounts system did not increase the extent of discrimination against dollar goods by the non-dollar world as a whole — indeed, the consequent economies in the use of dollars within the non-dollar world meant that more dollars were available for buying dollar goods — yet it may well have affected the extent to which different countries discriminated against dollar goods. The difficulty of earning dollars from other non-dollar countries was the opposite facet of the economy in the use of dollars for non-dollar payments attributable to the transferable accounts system. And its consequence was that a country whose natural pattern of trade was to finance a dollar deficit by its earnings from other non-dollar countries was forced to cut its dollar imports and replace them by non-dollar imports — probably to a greater extent than was desirable if the objective is assumed to be the restoration of dollar balance at the minimum of real cost to the non-dollar world. At the same time, a dollar surplus country — such as Malaya or Ceylon — by (in effect) accepting sterling from transferable account and other sterling countries, thereby accepted the obligation to divert its imports from dollar to non-dollar sources as the sterling accepted was not *de facto* fully convertible for a sterling country belonging to the dollar pool. Nor is

[9] Even if the demand for their products in dollar markets had an elasticity of more than unity, that is, if a cut in the price of the goods sold consumers brought a more than proportionate increase in the volume of their purchases, the receipts of the non-dollar exporters might still contract. For a considerable portion of the final cost of their products to dollar consumers consists of distribution costs incurred in dollars. This means that a fairly large cut in price quoted to the dollar importer by, say, a British manufacturer will lead to a much smaller reduction to the final price to the American consumer. A consumers' elasticity of demand of much more than unity may therefore be necessary if lower prices quoted by the non-dollar exporters are to lead to a rise in their countries' actual receipts of dollars.

there reason to believe that the diversion of imports from dollar to non-dollar sources was carried out in the manner that would do least damage to the trade and real income of either the dollar or the non-dollar countries. Some element of gold payments between non-dollar countries might, in other words, have made the adjustment to the pattern of trade with the dollar area more likely to occur in the most economic places; for the possibility of multilateral balancing of trade with the dollar area would have been greater, and the inducement for each non-dollar country to balance trade with the dollar area bilaterally would have been so much the less. At the same time, however, too great an element of gold payments would have led to undue restrictions on trade within the non-dollar world. The point here is that the transferable accounts system may have made payments within the area it covered too easy, and, from the viewpoint of the dollar area, it may well have encouraged distortions of trade between the dollar and non-dollar world that would not be completely defensible in the longer run. Similarly, the division between bilateral and transferable accounts countries (and the varying ease with which payments could be made between the two groups) introduced a further element of distortion into the pattern of trade, which implies that after the merging of the two groups changes in the pattern of discrimination and of dollar imports must have resulted. Some individual dollar-area exporters — and, indeed, importers — may therefore have been adversely affected indirectly by the nature of the transferable accounts system; others benefited correspondingly. Dollar-area exporters certainly benefited greatly as a group from the economy of dollars provided by the transferable accounts system. Dollar-area importers may not have received such eager attention from would-be exporters in the non-dollar world as they could have expected if there had been no transferable accounts system to provide readier alternative markets in the non-dollar world; and those dollar-area producers competing with imported products would have had more intense competition to contend with in the absence of the transferable accounts system for the same reason.

From the viewpoint of the sterling and transferable accounts countries themselves, there can be no doubt of the benefits provided by the system. Furthermore, the constant liberalizing of these payments arrangements over a growing area shows that the underlying objective was to advance the cause of multilateral trade and payments over the whole non-dollar world and not merely to protect the interests of the sterling countries (at any rate, not in any sense that would be opposed to the interests of non-sterling countries). The main doubt about the system must be whether it worked towards balancing the dollar accounts of the non-dollar world at the highest level and the most economic pattern of trade that was possible; or whether it did not encourage dollar-saving rather than dollar-earning to an unnecessary degree. One's conclusions on this matter must inevitably rest largely upon one's views about the extent to which the non-dollar world can safely become tied to the dollar market and to dollar sources of supply.



——→ = CURRENT PAYMENTS AUTOMATICALLY PERMITTED BY STERLING AREA EXCHANGE CONTROL

·········→ = PAYMENTS PERMITTED ONLY FOR TRANSACTIONS APPROVED BY THE STERLING AREA AUTHORITIES

* Until March 1954, only current (not capital) payments were permitted between transferable account countries; after that date, no distinction was made between capital and current payments between these countries.

† From March 1954 almost all, and from July 1955 all, bilateral account countries were absorbed in the transferable account group.

VII

THE EUROPEAN PAYMENTS UNION

THE situation giving rise to the European Payments Union was essentially that which also provided the setting for the dollar-pooling system of the sterling area in the post-war period, that is, an excess demand for dollar goods (at current prices and exchange rates) by a group of countries whose gold and dollar reserves were low, and whose economies had been adversely affected by the war. But whilst the sterling countries' conscious efforts had to be directed mainly towards making the best use of the gold and dollar reserves they shared and only incidentally towards maintaining the free flow of trade and payments within the sterling area (which was already relatively unrestricted), the European countries' energies were directed primarily towards re-building their trade amongst themselves, for the disruption of war-time and the network of bilateral payments agreements of the post-war period had together impaired the free flow of their trade with one another. They were, of course, mindful of the contribution that could be made to solving their dollar problem by re-building their trade with each other and with their oversea monetary areas; but, in general, it would be true to say that the countries of Western Europe consulted together under the EPU arrangements primarily in order to foster their intra-European trade, whilst the conscious co-operation of the sterling countries was concerned mainly with their dollar accounts (since trade within the area was already relatively free and expanding).

The predecessors of the EPU agreement were the various attempts to bring some element of multilateralism into intra-European payments through the Agreement on Multilateral Monetary Compensation and the Intra-European Payments schemes.[1] These

[1] For a full discussion of these schemes and the way they differed from the EPU, see B. Tew, *International Monetary Co-operation* (Home University Library, 1952), Chapter 8.

schemes, however, did not create a sufficiently large or multilaterally transferable pool of international liquidity: European countries could not readily offset surpluses earned with some of their neighbours against deficits incurred with others, and trade between any two countries was naturally likely to be sharply curtailed when either partner approached or reached the point at which it had to pay in gold for any further imports from the other, for the 'swings' of credit granted by one country to another were very limited.

The EPU agreement made possible a considerable expansion of intra-European trade, including trade with the oversea monetary areas of the member countries. It did this, first and foremost, by making a credit with any member available to offset a debit to any other. Secondly, it made available lines of credit — or 'initial creditor positions'[2] — to countries that seemed deserving of special assistance in their post-war reconstruction. Thirdly, it removed to a distant future the point at which gold would become payable on any increment in a country's deficit with the rest of Western Europe; as a country's cumulative deficit with the Union rose, however, it had to settle its debt to the Union to an increasing extent in gold, whilst creditor countries received payment increasingly in gold. Fourthly, through the undertaking of members to free from quota restrictions agreed proportions of their imports from each other, it sponsored a direct form of stimulation to trade amongst the metropolitan members.

These arrangements naturally encouraged members to import more freely from each other than they had hitherto. It also gave them an incentive to trade with each other — and to a lesser extent with their associated monetary areas — more readily than with other countries outside the Union, since purchases from outside countries might require to be settled in gold; or, alternatively, the running of a large surplus with certain non-union countries might well result in the accumulation of currencies that were neither convertible into either dollars or other currencies at an acceptable exchange rate nor into goods that were attractive at prevailing

[2] There were also 'initial debtor positions' for other countries — which made it necessary for them to run a surplus with the rest of the area before their cumulative accounting position entered their quota (and thereby gained them the right to settlement in varying proportions of gold and dollars).

prices. The incentive to import from other EPU countries was naturally strongest during the early years of EPU, when a member running a deficit with the Union had large slices of credit still to draw upon, but as a member used up his credit with the Union it naturally became less profitable to buy from other members rather than from non-EPU countries; and when the point of full gold payments was reached there was no longer any advantage to a member in discriminating in favour of European goods. When this point was reached, a member was likely to import dollar goods more freely than hitherto; for the fact that dollar import restrictions[3] were normally maintained by European countries indicates that at prevailing prices and exchange rates dollar goods were believed to be better value for money than non-dollar goods. If a member decided, however, to cut his imports from Europe in order to reduce his cumulative deficit with EPU, his demand for dollar goods would be the more difficult to restrain; whilst if he tried to reduce his EPU deficit by stimulating his exports to Europe further, this might well be at the expense of his exports to North America. In either case, the operation of the EPU was likely to intensify the dollar deficit of Western Europe (whose improvement was — or should have been — a main underlying aim of the arrangements).

A sort of *reductio ad absurdum* of this danger was the situation that arose in the first half of 1952, when the United Kingdom — whose EPU balance represented the transactions with the EPU countries of the whole sterling area — was at the point of full gold payments for its EPU deficits. One consequence was that there was no longer a pressing need to prevent European merchants from trans-shipping sterling goods to dollar markets — though such transactions did represent an unfavourable movement of the dollar terms of trade of the sterling area (and a loss of dollars). The need for the United Kingdom to improve her EPU position was just as great as the need to improve her dollar balance; and this fact received official recognition in the form of the short-lived official commodity arbitrage experiment of August, 1952, under which the resale of certain dollar commodities to Europe through the United Kingdom was permitted for a brief period. Subsequently

[3] By the end of 1954, they had been very considerably reduced, and for some countries virtually abolished.

it was made possible through Britain's commodity markets for several dollar commodities to be imported to Europe. This system naturally encouraged an increase in dollar imports into Europe (including the United Kingdom) as a whole, and since the United Kingdom in effect received payment from the reserves of the EPU — and thus indirectly from members running deficits with EPU — Europe's reserves of gold and dollars were drawn upon and Europe's dollar imports increased for no better reason than that the working of the EPU made it expedient for the sterling area to initiate a policy that led to it.

On the other side of the picture, the European countries buying these dollar goods through the United Kingdom were not under pressure to economize in purchases of dollar imports or to lament the loss of gold from the EPU reserves as they were not in most cases at the point of full gold payment: the reserves of the EPU, though in the long run every member's business, could with impunity be regarded as no one's business in the short run.

It is true that when an EPU country reached the extreme debtor position it was permitted to impose restrictions (or rescind relaxations already made) to correct its EPU balance, whilst at the same time submitting to examination and moral pressure from the rest of the Union to take the necessary steps to restore equilibrium to its economy and so to reverse by more fundamental means its balance of payments deficit with the rest of the EPU area. Once that was done, it would be committed to continuing the policy (agreed on mutually by all OEEC countries) of liberalizing further its trade with other members. It is therefore not possible to consider out of the context of these agreements about trade liberalization the purely monetary pressure exerted upon an EPU country which in itself provided an incentive to a member to discriminate against EPU countries' goods just as strongly as against goods from the dollar area once he reached or looked like reaching the one hundred per cent gold payment *tranche*. But when that point was reached, the monetary mechanism in itself certainly provided every encouragement to a member — now released from the most rigorous of his liberalization undertakings — to restrict his European imports severely. The inducement was, however, limited so far as a member believed it likely that assistance or special consideration in their import licensing would be given him by other EPU countries to the extent that he refrained from imposing restrictions on their goods as severe as those he imposed on dollar imports. In any future regional payments arrangements, therefore, it would be important to ensure that, where discrimination against dollar goods was desired, members did not from time to time have such an inducement to cut their imports from each other as severely as those of dollar goods. A payments union without an adequate fund of liquidity to draw upon as a counteracting inducement would clearly be less well placed than was EPU to limit the force of such a monetary incentive to curtail imports from other members.

Those European countries that were in strong surplus with EPU during 1951-2 (when Europe's dollar deficit was still of such dimensions as to require constant effort to overcome it) were under no real pressure to help to improve Western Europe's dollar accounts when they deteriorated in 1951. As the ECE pointed out, the seriousness of this deterioration was hidden from most European countries because they were earning gold from EPU.[4] This meant that in the main the whole burden for relieving Western Europe's dollar deficit fell on the United Kingdom and France — who were the two main EPU deficit countries at that time. Now, had these two countries been living recklessly on the rest of Western Europe and importing dollar goods excessively, there would have been a strong case for discouraging them from importing so much from Europe; though even then there would have been something wrong with a system that encouraged them to build up their dollar imports at the expense of their imports from Western Europe. But much of this large deficit was unquestionably due to temporary speculation against sterling and the French franc, which showed up in the amounts due from the United Kingdom and France at the monthly EPU settlements.[5] A purely temporary flow of speculation against sterling — which was reversed after the raising of bank-rate in March, 1952 — was thus an important reason for the gain of EPU gold to other European countries, and this removed much of the pressure upon them to play their part in closing Western

[4] *Economic Bulletin for Europe,* First Quarter, 1952, p. 8.
[5] Ibid, p. 9.

Europe's dollar gap. Moreover, so far as the sterling area's EPU deficit was caused by an expansion of sterling area imports, it was contributing to an expansion of trade within the wider EPU area. Whilst it is true that in this period the outer sterling area was importing at an unusually high level from Europe, it is hard to see how the desirability of checking such temporary over-importing from Europe would justify arrangements which threw upon the sterling area the duty of making one hundred per cent gold payments for its EPU deficit, and which thus encouraged it to relieve the rest of Europe's dollar deficit by finding the gold and dollars to increase the dollar imports of Europe (including the United Kingdom) as a whole.

At the same time, the extreme debtors to EPU, the United Kingdom and France, were under financial pressure to restrict their imports from other members severely: this is the opposite aspect of the fact that when the point of full gold payments was reached they no longer had an incentive to discriminate against dollar imports. The restrictions they imposed against imports from the rest of Western Europe in late 1951 and in 1952 led to the first contraction in intra-European trade since the EPU was formed.[6]

It is interesting to note that these difficulties had been foreseen, in their essence, by Professor R. F. Kahn at the time when the EPU arrangements were first made.[7] The danger that countries with a surplus in EPU would have every incentive to cut their imports from other European countries in order to earn gold from the Union was, however, very greatly reduced in the event by the efforts that extreme creditors made to maintain or increase their imports from the rest of Europe in order to avert the danger that their exports might be discriminated against in order to keep the Union solvent, and by their willingness to accept less than one hundred per cent gold payment (usually only fifty per cent) when their quota of credit to the Union had been fully utilized. And extreme debtor countries were restrained from maintaining severe restrictions against other members' goods for longer than absolutely necessary by the need to justify such restrictions in Paris before the representatives of other members.

[6] Ibid, p. 12.
[7] See 'A Possible Intra-European Payments Union', *Economica,* 1949, and 'The European Payments Union', *Economica,* 1950.

Moreover, the worst dangers inherent in the EPU system were avoided in what was a period of very high employment: the defects of the system would have been far more manifest if serious unemployment combined with an intensified dollar shortage had arisen in Europe. In that event, those countries that happened to be at or near the extreme debtor position, and those that were at or near the extreme creditor position, would have been under still greater pressure from the rest of the Union to cut their imports and thereby save or earn gold to help them to reduce their own dollar deficit and also in order to 'export' some of their unemployment. It is easy to see that such a situation could have brought a dangerous downward spiral of intra-European trade and employment and a further intensification of Western Europe's dollar problem. If an American recession should cause any such intensification of Western Europe's dollar problem, it would be essential that any necessary reduction in Europe's dollar imports be accompanied by the maintenance or, preferably, by an expansion of Western European countries' imports from each other — so that employment and real income in these countries could be maintained at as high a level as possible. Yet, at the same time, it would clearly be important to ensure that the inducement given to European countries to expand their imports from each other did not divert resources from maintaining or rebuilding their dollar exports, whenever and wherever an increase in the resources and energy devoted to this purpose would result in an increase in Europe's dollar earnings. But it might well be true that in an American recession nothing the European countries could do would increase Western Europe's dollar income; cut-throat efforts by individual European countries to expand their dollar exports in such circumstances might well result in a fall in the prices of Europe's dollar exports that would be sufficient to offset any increase in the volume of sales made in dollar markets.[8] There would therefore be no great danger of a fall in Europe's dollar earnings resulting from any such maintenance of intra-European trade as would be feasible in a recession.

[8] Such efforts would, of course, also be against the interests of the dollar countries in so far as it would make the restoration of full employment there the more difficult in the face of cheaper imported goods if dollar sales by European countries were in fact increased.

How effective were the *ad hoc* methods of overcoming the difficulties that arose when a country reached the extreme creditor position? The extension of additional credit and the measures to encourage exports to the surplus member certainly served to maintain the flow of exports from the creditor country to the rest of Western Europe. But if the natural pattern of trade were such that Belgium — normally an EPU surplus country — earned a surplus from Europe and used part of it to finance a dollar deficit, then the other European countries would be obliged in course of time to adjust their deficit with Belgium to the level at which they were prepared to find the gold or dollars to cover it — except so far as Belgium was willing to accept indefinitely claims upon them or other inconvertible currencies.

One defect of the EPU arrangements was that even when Belgium was at or near the point of full gold receipts, European countries could continue importing from her at a high level, since the satisfaction of part of her claims upon them was postponed. The United Kingdom's agreements in 1954 with the main EPU creditors — to repay part of these debts in gold and to fund the remainder — emphasized that ultimately these debts had to be repaid; the EPU system served to conceal the real situation and to remove the incentive to begin adjusting to them. Moreover, even those European countries that were at the point of full gold payment had no special incentive to improve their balance with Belgium; increased exports to, or lower imports from, any other EPU country would have had just the same effect on their EPU balance.

On the surplus countries' side of the problem, the EPU payments system — and the *ad hoc* arrangements for preventing a drastic cutting of imports from them by other members when the surplus countries reached the point of full gold payment — caused a diversion of the surplus countries' exports to European, soft-currency markets from the harder, extra-European markets (including dollar markets). If other European countries had practised the degree of discrimination against the exports of EPU surplus members that they would probably have preferred to practise, taking fully into account the ultimate obligation to pay gold for them that they were (in all probability) incurring, the European countries that tended to run EPU surpluses would have had to seek hard-currency markets to a far greater extent than they did. In other words, Belgian resources, for example, might well have been better used than they were — from the point of view of working most economically towards a world dollar equilibrium — in producing, say, goods for dollar markets, or capital goods to assist the Congo in increasing its dollar exports, and correspondingly less in producing goods for EPU countries.

The EPU arrangements, then, encouraged member countries to go on running a deficit with the European surplus countries for longer than they could have done if they had had to pay for them in hard currencies. This arrangement had much to commend it, so far as the surplus countries were willing to export to the other EPU countries for payment, in inconvertible currencies, in return for the greater stability they presumably hoped their export industries would obtain in European markets, as compared with the difficulties they might face if they tied themselves too closely to dollar markets and were subsequently exposed to an American recession. But, in fact, much of the credit extended by the surplus countries was merely an agreement to defer settlement of the debts owed to them. There was a case for such an arrangement, so long as the European economies were just recovering from the war and might be in a better position to make the necessary adjustments in their patterns of trade and production when their industries had recovered, but it is doubtful whether a case remained for postponing the adjustments after, say, 1952. Either it was desirable that the European surplus countries should agree to waive completely some part of the payment due to them, in return for the long-run advantages (of stability especially) that they believed they would obtain by maintaining their exports to the EPU area at a high level, or, alternatively, it was desirable that the other European countries should have had clearly brought home to them the fact that additional imports from these countries would ultimately cost them the equivalent in gold or dollars. In retrospect there seems to be no case for arrangements that concealed the real cost of imports from the EPU surplus countries by postponing gold payments to them yet which, in fact, implied or stated the obligation to settle with them eventually in gold. So far as the other European countries agreed to maintain their imports from, whilst not being released from the ultimate obligation to pay gold to, the surplus countries — even when the latter took insufficient measures to expand imports from them — the surplus countries were really giving nothing substantial in return for the maintenance of their trade in the more stable European market. Had each individual European country made an agreement not to discriminate against the surplus countries, the somewhat one-sided nature of the arrangement would have been more obvious. But the fact that the Union incurred the debts to the surplus countries served to conceal to an important extent that these obligations were incurred by all members and would ultimately have to be repaid. Although the efforts of Belgium to reverse her excess creditor position met with considerable success, this does not alter the fact that the purely financial incentives provided by the EPU mechanism provided no incentives for this change in the pattern of trade.

The lessons for any future payments unions would seem to be these. First, surplus countries (that is, countries in surplus with the rest of the Union) can often be induced to join by reason of the guarantee that exports from them to the rest of the Union will not so readily be cut (as they would be if the surplus countries were not members) when they run a surplus with other member countries. And they may be willing to pay something for the fostering of trade within the Union if they believe that it will be more stable than markets outside on which they would have to depend to a greater extent if they balanced their accounts by some trade or payments triangle extending outside the Union.

Secondly, those countries running a surplus with the Union will not be so ready to subscribe to the scheme as will those that are more likely to be in deficit — or roughly in equilibrium, taking one year with another — with the rest of the Union. These deficit countries will thus be much readier to accept payment in credits or soft currencies than will the surplus countries, and to foster trade within the Union to make up for the difficulties they may have in balancing their accounts with the outside world.

Thirdly, the EPU arrangements showed that the surplus countries had a good chance of obtaining the advantages of membership without incurring real costs comparable to those of other members, since they could count on being ultimately paid in gold, except to the extent that they (like other members) gave credit to the Union or were willing to increase their imports from other members. Above all, the EPU arrangements rendered them the service of concealing in some appreciable measure from those countries importing from them the fact that these imports would almost certainly ultimately cost gold, thus making it less likely that these imports from the surplus countries would be reduced.

It is clear that any future payments system must provide flexible arrangements whereby an array of countries, diverse in their pattern of payments and thus in the extent to which they are likely to run a surplus with the rest of the Union, can contract into or out of it for as much of its benefits as they are willing to pay for — and no more. The more a country running a surplus with the Union is willing to extend credits that need never be repaid, or that may be repaid in members' own currencies, the more will it be justifiable to impose less stern restrictions upon imports of its goods and the less necessary to adapt patterns of trade and production in such a direction as to dispense with such imports.[9]

The cumulative nature of the debt settlements in EPU had a further disadvantage that became increasingly important as deficits and surpluses of certain members increased. In the early days of EPU, the considerable lines of credit extended to all members encouraged them to import from each other rather than from outside the EPU area and least of all from the dollar area. But as a country became liable for increasing proportions of gold payments in settlement of its EPU debts there was less incentive for it to

[9] The Kahn proposals (see pp. 130 *et seq.*) would have brought this fact out into the open by granting countries in surplus with the Union immediate payment in gold for part of the debts owed to them, whilst allowing the complete cancellation of the rest. Both creditors and debtors would then have seen just what the arrangements were costing them and would have been the more likely to make the necessary adjustments to their patterns of trade and production. It is easy to doubt the political feasibility of such cancellation of debts; it would be probable, however, that, faced with the choice of complete exclusion (and therefore of discrimination against their exports), the European surplus countries would have preferred to allow some cancellation of debts owed to them and the concomitant maintenance of their exports to the rest of the payments union. If not, the other members would have benefited by having the real situation revealed to them, especially the necessity for them to reduce their dependence on exports from surplus countries.

discriminate in favour of EPU imports, until finally the point was reached where full gold payments became due — when there was clearly no incentive for a country to import from other members rather than from the dollar area. Moreover, a country that was receiving, or could hope ultimately to receive, payment in gold for any increase in its cumulative surplus with the rest of EPU also had no incentive to import from fellow members rather than from the dollar area. Admittedly this difficulty was largely overcome by the special arrangements reached with extreme creditors to encourage them to import more from other members, but there was nothing in the EPU monetary arrangements themselves to ensure that satisfactory arrangements of this sort would be reached.

The rationale behind the system may have been that whilst it was desirable at first to encourage members to rebuild their intra-European markets and thus save the dollars of all of them, once their industries had recovered somewhat from the war there was a case for encouraging them to close the dollar gap by the more direct means of increasing their dollar exports. If this was an underlying reason for adopting a system that gave a diminishing incentive to members to prefer each other's goods to those from dollar markets, the EPU system achieved its end only very haphazardly, for the greatest pressure to reduce discrimination against dollar goods applied, as has been shown, to extreme creditors and extreme debtors; it did not vary according to the need at any given time for Western Europe to economize in dollars. It is not surprising that the OEEC report for 1952 lamented the fact that Europe's dollar problem did not seem to be getting much nearer solution. It is clear that what was required was a steady pressure upon all members to economize in dollars — and to increase dollar earnings — to an extent that would not divert an undue amount of resources from the task of producing dollar-saving goods for each other. Of course, the consequence of this would not have been an equal discrimination (if, indeed, the extent of discrimination could be measured) by all members against dollar goods or in favour of EPU countries' goods; some would find that their need for dollar goods was more urgent than that of others; some would find that non-dollar substitutes for the goods they needed were more readily available. But the inducement to member countries to save or earn dollars should have been made to vary according to the intensity of the general dollar problem of Europe as a whole, and not haphazardly for individual countries from time to time according to the particular *tranche* of their EPU quota that their cumulative credit or debit with the Union happened to have reached at any given moment.

The revision of the European Payments Union made in July, 1955, and the concomitant provisions for its supersession by a European Monetary Agreement, in the event of the currencies of the main member countries becoming convertible, have been very fully described and analysed by Mr W. B. Reddaway.[10] The main features of the arrangements were as follows. First, the EPU was extended until June, 1956 (unless a majority of member countries' currencies were made officially convertible in the meantime), but the monthly settlements were to be made 75 per cent in gold and 25 per cent in credits to or from the Union (instead of 50 per cent in each as in 1954-5). Secondly, if countries holding more than 50 per cent of the total of the quotas in EPU should declare their currencies convertible, a European Monetary Agreement would come into force, by means of which a multilateral clearing was still to be made among members, but settlement would be made entirely in gold or dollars and it would be left to members' choice how far they made use of it. The extent to which they would do so would depend largely upon the prevailing market rates for their currencies, since settlements would be made at the official buying and selling prices for members' currencies, whereas more favourable terms would be available to both buyers and sellers in the market whenever the prevailing rates were not at these limits. Thirdly, under the European Monetary Agreement, which would come into force when members' currencies became convertible, there would be set up a European fund of dollars, with much smaller resources than those possessed by EPU, from which members could borrow, not automatically and as of right — as they could under EPU — but only after examination of their balance of payments difficulties and for temporary periods (some-

10 'Freeing Europe's Trade and Payments', *Bulletin of the London and Cambridge Economic Service*, in *The Times Review of Industry*, September, 1955.

what after the manner of borrowings from the International Monetary Fund). The present intention is merely to appraise the main features of these arrangements in the light of the foregoing discussion of EPU and the sterling area.

In the first place, credit must be given to the undertakings to continue and maintain the liberalization of intra-European trade that accompanied the monetary arrangements, for the one set of arrangements facilitated the other. One lesson to be learned from the experience of EPU is that adequate provisions for liberalizing the trade of members with each other are essential if settlements between members involving a considerable, and increasing, proportion of gold or hard currencies are not to result in tighter trade restrictions. Monetary arrangements without trade liberalization agreements might have done as much harm as good to intra-European trade; moreover, it must be remembered that the circumstances in which EPU operated, notably the high level of employment and the general desire to rebuild intra-European trade from the low level to which it had sunk after the war, were favourable to the liberalization of members' trade. These facts should lead to caution in applying regional payments systems of the EPU-type to other groups of countries, or even to the same group of countries in different circumstances; in particular, they might prove difficult to work in a period of general and serious unemployment.

Secondly, the extension of the principle of making settlements in fixed proportions of gold and credit, whatever the state of a member's cumulative balance with the rest of the Union (short of the exhaustion of his quota), underlines the fact that the earlier type of settlements whereby the relative extent of gold payment varied with a member's cumulative balance was now considered unsatisfactory — though whether this was for reasons such as have been advanced earlier in this chapter it is difficult for a non-official observer to judge. The continuance, so long as EPU lasted and so long as a member had not exhausted his quota, of a system whereby settlements were made in fixed proportions of gold and dollars meant that a general and consistent pressure was placed upon members to discriminate in favour of each other's goods compared with imports from hard-currency sources (which would have to be paid for wholly in gold or dollars). But the continued absence of any provision to vary the extent of this inducement as Europe's dollar situation changed — in the provisions for the European Monetary Agreement as in EPU — emphasized that the new arrangements were not framed in such a way as to facilitate the measures that might be necessary to meet any future intensification of Western Europe's dollar shortage.

Thirdly, it may be noted that the principle of trade liberalization was not extended beyond Europe — for instance, by agreements covering also those oversea countries of the monetary areas whose settlements with Western Europe were made through the Union. It is possible, for instance, that some mutual liberalization of trade with independent sterling countries might have been beneficial; New Zealand, on the one hand, was critical of tariff and quota restrictions against her food exports by European countries, whilst on the other hand, Australia's considerable import restrictions against European countries' exports might have been reduced by mutual agreement if some suitable *quid pro quo* could have been accorded to her by Western Europe. It is true that Europe did not restrict the import of the main raw material commodities purchased from the outer sterling area, but there remained the danger that when sterling was made convertible into dollars, or if a recession in the level of activity in Europe reduced the European countries' demand for raw materials, Europe's imports from the outer sterling area might have been severely reduced. Undertakings by European countries to reduce the extent of any such declines of purchases from the rest of the sterling area — at least so far as government policy could affect these imports — might well have been a worthwhile return for some undertaking by outer sterling area countries to discriminate in favour of EPU countries in the administering of import restrictions, or to limit the scale or duration of these restrictions. In any event, it is to be hoped that future European monetary arrangements will contain some provision for more direct representation of, and consultation with, non-European countries, especially those whose accounts with Europe are settled through the system and are most directly affected by the arrangements actually prevailing.

As to the European Monetary Agreement, which the 1955 arrangements intended to come into operation when the major European currencies were made convertible, a useful safeguard for the liberalization of intra-European trade was provided by according convertibility (into dollars) to all currencies that would be earned through the EPU settlements (to be made one hundred per cent in gold when the major European currencies became convertible), even from countries whose currencies still remained convertible. This would, of course, reduce considerably the likelihood of discrimination being exercised, for example, against sterling-area goods by European countries wishing to earn 'convertible' sterling. The retention of a multilateral settlement would also, as Mr Reddaway argues,[11] constitute a regional payments arrangement that would simplify the presentation of a case for some continued discrimination in favour of other members' goods — so far as that was found necessary — in a world of convertible currencies. And the tradition of trade liberalization might well continue among members even under the new 'convertible' system, though the inducement to liberalize trade further amongst themselves would be lost and though the advantages of liberalizing instead their trade with other countries might well be relatively greater than it was when intra-OEEC trade was still severely restricted. But one may doubt whether the tradition of liberalizing intra-European trade would persist strongly enough in the face of one hundred per cent gold payments if unemployment should arise in Europe or if the dollar situation of one or more European countries should become suddenly more serious. And if moral or other obligations made members reluctant to cut their imports from each other, there might yet be a serious danger that their cuts would be directed with greater intensity against the goods of associated non-member countries, especially those of the outer sterling area — who might well be suffering severely already — especially if there were an American recession in progress.

The provision for setting up a European Fund when 'convertibility' comes is relevant to these probable future problems in several ways. In the first place, since its amount is small and its assistance is not to be granted as of right, and since it is to meet only temporary balance of payments disequilibria of members, it is unlikely to hold out a very strong inducement to them

[11] Ibid, p. vii.

(compared with the EPU system) to extend or continue their liberalization of trade with other members.

On the other hand, it would be a useful form of liquidity for member countries to draw upon to meet temporary difficulties, and one to which access would not be refused them merely because they might also feel compelled to use some degree of discriminatory import controls to assist them in their difficulties. But neither its nature nor its size seems likely to be of any great use in a recession — when similar functions would presumably be fulfilled by the IMF, though the IMF might insist upon those countries drawing upon it applying far more liberal trade policies than they might feel willing to apply in the sort of circumstances envisaged. But since non-dollar currencies withdrawn from the IMF must be repaid in dollars, neither it nor the projected European Fund was as suitable for helping countries to meet their non-dollar deficits as was the EPU system.

The intention to set up such a permanent fund of regional international liquidity is to be welcomed; but both Western Europe and the sterling countries would do well to consider how some sort of fund might be devised to meet more satisfactorily both their dollar and non-dollar payment problems in times of temporary balance of payments difficulties or to eke out such assistance as the IMF might provide in times of more generally falling export incomes, especially if IMF assistance were likely to have uncongenial strings attached to it. Just as the European Fund is to consider a member's total balance when deciding whether to grant short-term accommodation, so any sterling fund would clearly have to look at the state of a member's sterling balances (which reflect his total payments). And just as the European Fund would have regard primarily to the interests of the group of countries it represented and to the desirability of discouraging retreats from trade liberalization among them, so those administering any sterling fund would have to ask whether a member making use of it would employ the funds it provided to assist the balancing of the area's accounts with the rest of the world and whether he might be induced to modify his policies in a way that would improve the area's reserves. There would also have to be provisions for deciding whether the grant of additional liquidity to a member would result in trade among members being kept at as high a level as was in their common interests. But some temporary assistance to cover short-term deficits might be made available as of right, and this function the European Fund, as at present conceived, would seem unable to fulfil. Quite apart from the accessibility of hard currencies to meet deficits arising outside the area (notably with dollar countries), there is the need to settle balances amongst members, and so far as this can be done in their own currencies, gold or dollars could be reserved for making settlements with the dollar area; this the sterling system does, but the European Monetary Agreement fails to do.

The case for making some limited amount of liquidity available within the sterling area for meeting non-dollar deficits (especially with other sterling countries) rests mainly on the asymmetry whereby Britain can run deficits with other sterling countries by running up sterling liabilities to them but no sterling country can readily run up liabilities to Britain, and has therefore to keep its sterling balances above a safe minimum. If an outer sterling-area country had as great a certainty of being able to raise short-term funds in London as Britain has that a sterling country with which Britain runs a deficit will run up sterling balances in London, this problem would not exist; but the uncertainties involved in raising and renewing short-term funds on the London money market are certainly no substitute, from the viewpoint of an outer sterling area country, for a fund of sterling available, under appropriate conditions, to meet temporary deficits in its non-dollar accounts until policies can be adopted to improve the underlying state of disequilibrium in its economy. Since the alternative to some such scheme seems to be the periodic intensification or renewal of import restrictions by countries (such as Australia) whose export income is liable to severe fluctuations, the exporting countries who suffer from these cuts would have a great deal to gain from any such scheme; and especially since import restrictions tend to be self-perpetuating, the gain to all concerned from making their original imposition unnecessary would be considerable.

The dollar resources of the European Fund could most usefully be used to supplement members' holdings of hard currencies and to assist them, in case of need, in meeting their dollar obligations.

What is needed also is some fund of non-dollar liquidity available for assisting them to meet temporary deficits in their accounts with other countries within the system. If some such fund of liquidity could be administered jointly by the sterling area and Europe, it could do much to promote trade stability and to give members a breathing space in which the necessary corrective measures could be taken, as has been shown by the experience of EPU when credit has been made available to member countries in deficit, and the reversal of trade liberalization by them has thus been reduced or prevented. If no such scheme can be devised for Europe plus the sterling area, then some such fund of sterling liquidity might usefully be considered for the sterling countries alone.

The EPU Group as an Area of Freer Trade

It is clear that the benefits of a large, stable market would be most readily afforded by a Union that included complementary economies, and for this reason it would be preferable for the Union to include primary-exporting countries as well as the industrial exporters of Western Europe. On the other hand, it may be borne in mind that the likelihood of increasing international specialization within the Union by fostering relatively free trade within it would be the greater the more competitive the economies admitted.[12] From the viewpoint of world division of labour generally, therefore, perhaps a Union of European industrialized countries alone might be preferable; from the viewpoint of any member of such a Union, actual or potential, who was intent upon maintaining stability of trade within as wide an area as possible but who believed the stability of the outside world to be suspect, a Union that could offer an array of complementary economies would be the more attractive proposition to a surplus country which it was hoped to attract within the fold. The oversea monetary areas of members

[12] See J. Viner, *The Customs Union Issue* (Carnegie Endowment for International Peace, 1950), chapter 4. The statement in the text relates to the probable effects of a given degree of liberalization. But, on the other hand, the actual degree of liberalization in fact achieved by any Union, short of a completed Customs Union, will almost certainly be greater among groups of countries whose exports are not closely competitive — as they will naturally be readier to agree to liberalization than a group of closely competitive economies.

are in a special relationship to the Union; the effect of this indirect participation is of special interest if consideration is to be given to plans for a wider economic union of relatively free trade and payments. By far the most important oversea monetary area linked to EPU was that of the sterling area. Some of the consequences of its relationship to EPU will now be considered.

The Outer Sterling Area and the EPU

Whilst the United Kingdom's dependent oversea territories were in all senses part of the United Kingdom from the point of view of the EPU machinery, the independent countries of the outer sterling area stood in a special relationship to the EPU. Although these countries were not members of EPU in their own right and did not have any specific obligations in connection with it — such as that to liberalize agreed and increasing percentages of their imports from EPU countries — they formed part of the United Kingdom's quota in EPU (which represented the whole sterling area). That is to say, payments to and from the outer sterling area countries made by or received by another EPU country (or by a country in its oversea monetary area) were cleared through the EPU machinery. The independent outer sterling area countries thus constituted a very important extension of the area over which the EPU operated, especially since the other primary-exporting countries affiliated to it through their metropolitan countries were very closely linked with the economies of their parent countries,[13] and the existence of the EPU is not likely, therefore, to have had appreciable effects upon their trade with other European countries. But the facilitating of payments between the sterling Dominions and Europe may well have had considerable effects on their trade.[14]

The fact that an EPU country could use its EPU credits to make payments to any sterling country probably served to intensify the competition from other countries in the purchase of sterling area primary products experienced by the United Kingdom.

[13] The dependent oversea territories of the United Kingdom, France, Belgium, the Netherlands, Portugal, and Italy.

[14] The term 'Dominions' is used for convenience (but with considerable inaccuracy) to mean 'the independent sterling countries outside the United Kingdom.'

Similarly, the ease with which sterling countries could purchase in Europe greatly enlarged the range of sources of supply available to the outer sterling area countries and increased the competition experienced by United Kingdom exporters in sterling markets. Moreover, the increased flow of trade between the various European countries producing manufactured goods must have helped to keep their costs down below what they would have been if European trade and payments had not been liberalized by the EPU system. And as the Dominions were among the most important buyers of European manufactured goods, they must naturally have benefited considerably from the consequently lower costs of production of European manufactures.

It is true that, in theory, one would expect the United Kingdom to have obtained a similar enlarging of her markets through the affiliation of other oversea monetary areas with the EPU. But, in fact, these other monetary areas were quantitatively much less important than those of the oversea sterling area; their economies (except probably for Indonesia) were far more directly linked to their respective metropolitan countries; and (again apart from Indonesia) they had far less independence in determining their economic, including their importing, policy than the sterling Dominions, who had complete economic autonomy.

The sterling Dominions might, however, suspect that they lost in certain ways from the closer economic integration of the United Kingdom with Europe resulting from the EPU system and the accompanying trade liberalization provisions. If Western European exporters had consequently competed more effectively with sterling producers in United Kingdom markets, this would have been one source of potential loss to the outer sterling area countries. But, in fact, the sort of goods the Western European countries sent to the United Kingdom were mostly manufactured goods and raw materials and fresh foodstuffs of categories that competed hardly at all with the raw materials and relatively imperishable foodstuffs that were the main United Kingdom imports from the outer sterling area. Fresh meat and dairy products were probably the only important European exports to the United Kingdom competing closely with Dominion exporters; and since Denmark (the main country affected) was at no time a hard currency country from the point of view of the United Kingdom, it is unlikely that if the EPU system had not existed the United Kingdom would have imported dairy products from Denmark any less freely.

Another way in which the sterling Dominions might have lost by the United Kingdom's membership of EPU is that the system may have encouraged United Kingdom exports to go to Europe rather than to the outer sterling area. That this occurred to some extent it would be hard to deny; but there is every reason to believe that, in view of the United Kingdom's own deficit with Europe in the postwar years, the expansion of its exports to Western Europe would have been necessary in any case.

Moreover, the sterling Dominions had no obligation to liberalize their imports from Europe; if they had assumed such an obligation it is doubtful whether Australia, especially, would have found it so easy to curtail her imports from Europe so drastically in 1952 and in subsequent years (though it was officially stated that these import cuts were not intended to discriminate). On the other hand, of course, it is also true that the European countries undertook no obligation to import more freely from the Dominions. In fact, however, the raw materials exported by the Dominions were of the categories usually considered 'more essential' by importing European countries, and were therefore not likely to be restricted; whilst many of the exports of the European countries to the sterling Dominions were of the luxury consumer-goods type likely to be most severely curtailed in times of balance of payments difficulty. And the pressure to correct a sterling area deficit with the EPU was felt primarily by the United Kingdom, who therefore had to cut imports from Europe more drastically than if the cuts had been shared over the whole sterling area.

In short, it seems that the sterling Dominions gained very considerably from the operation of the EPU. In a sense, they did so at the expense of (or, at least, relative to) the United Kingdom and the other European industrial exporters, for much the same reasons as we have seen that they probably benefited from the existence of the transferable accounts system.[15] These gains went a considerable way to offset the relative gain we have seen reason to believe the United Kingdom made at the expense of some, at

[15] See Chapter VI, above.

least, of the outer sterling area countries through the operation of the dollar import restrictions of the sterling area.[16]

The EPU Compared with the Sterling Area

By way of summarizing the advantages and defects of the EPU system, it is convenient to compare its main characteristics with those of the sterling area.

(1) The sterling area's pooling of gold and dollars and the fact that they were not required for the settlement of deficits and surpluses within the area resulted in substantial economies in the use of the available supply of gold and dollars. Similarly, the fund of liquidity created by the EPU agreement and the economies in the use of it brought about by the system of multilateral settlement within the EPU area effected considerable economies in the use of gold within that area.[17] If economies in the use of dollars for transactions with the dollar area were to be secured by the EPU countries, some form of dollar pooling for this purpose would have been necessary; and for a group of countries such as those of Western Europe, this would have involved more formal methods than those adopted in the sterling area for determining how freely each member should draw upon the pool. If some way of pooling dollar reserves — at least partially — could be found and made to work, the experience of the sterling area shows that considerable economies could be obtained. On the other hand, the fact that the EPU countries individually held their own respective gold and dollar reserves gave to each of them a direct incentive to economize in dollar spending and to stimulate dollar exports that was lacking in the sterling area — where informal agreements constituted the only pressure that existed to encourage members to improve their dollar balance rather than that with other areas. At the same time, this informal pressure was exerted fairly uniformly over all of the sterling countries, and it was intensified (at any rate so far as it concerned dollar *imports*) when the sterling area's reserves were

[16] See Chapter IV, above.

[17] R. Marjolin has pointed out (*Lloyds Bank Review*, January 1954) that the pool of liquidity created by EPU was about $1.4m. (of which only $1.1m. was used up to the end of 1953) compared with $800,000 or $900,000 created by the bilateral agreements previously in force, which financed a much smaller volume of trade.

threatened; by contrast, the financial incentive to buy from other EPU countries rather than from the dollar area was (up to 1954) least for those EPU countries that had built up large cumulative EPU deficits or surpluses during the period since the system began. The incentive varied not with Europe's dollar needs but with the essentially irrelevant criterion of the particular proportion in which a country was at a given time settling its marginal EPU imports in gold. If a similar system had operated in the sterling area, each sterling country would have been encouraged to relax its dollar import restrictions as its total deficit or surplus with the rest of the sterling area since a given date increased in size. It would be hard to justify the use of any such criterion.

(2) The EPU system encouraged members to prevent their balance with the rest of the area from diverging very greatly from equilibrium by increasing the scale of gold payments for debtors and by bringing pressure to bear upon creditors to liberalize their imports. Wide though the area covered by EPU was (if the oversea monetary areas are included), this meant that members were encouraged to balance their trade with a restricted area of the trading world, whereas the natural pattern of a member's trade might often be a deficit with this area balanced by a surplus with the rest of the world, or vice versa. In contrast, the sterling area — widened by the transferable accounts system —enabled sterling countries and, to a lesser extent, transferable account countries, to balance their accounts over a very wide area of the non-dollar world (virtually the whole of it after March 1954, and all of it from July 1955) and thus caused a minimum of distortion to each member's pattern of trade with the non-dollar world. At the same time, the increasing scale on which gold became payable to the EPU as a member's deficit with the Union increased, discouraged members from over-importing from the rest of the EPU area. Although this was far from an ideal method of securing such an end, some comparable means of discouraging sterling countries from drawing down their sterling balances too swiftly might well have helped to reduce the strain on the area in, for instance, the 1951-2 crisis. Preferably, however, the degree of any such discouragement should be related to a member's deficit in the short period over which the excess drawings occurred — not his cumu-

lative deficit over several years. In 1954-5 and 1955-6, the proportion of a monthly settlement payable in gold did not vary according to a member's cumulative debtor or creditor position. The criticism of the cumulative nature of the criterion upon which the proportion of gold to be paid was based does not, therefore, hold for these later years.

(3) The EPU-OEEC system provided a useful forum for discussion of members' balance of payments problems and of the ways in which their domestic policies might be modified to relieve them (as well as the ways in which members could assist one another). Furthermore, the reports of the OEEC provided public appraisals of members' policies of a kind not paralleled in the sterling system. But the informal discussions between staffs of treasuries and central banks of the sterling area may have been in their way as effective in encouraging members to adopt appropriate policies as were the OEEC consultations; the main difference was that sterling area consultations were more informal, less publicized, and less ready to touch on domestic policies (at any rate openly). Any wider payments union or organization for economic co-operation could probably usefully incorporate the best features of both; informal discussions on the more delicate matters connected with members' policies and the solvency of the whole group could be combined with the publication by a central secretariat of an objective appraisal of the ways in which members' policies were affecting the rest of the group. Even if these reports told governments nothing they did not already know, they could do much to inform public opinion of the international implications of their government's economic policies and thus perhaps make it politically more practicable for them to be modified in the light of these wider considerations. The published judgments of an international secretariat carry considerable weight if they are generally believed to be objective and well considered. A Commonwealth (or Commonwealth plus Western Europe) economic secretariat might usefully follow in the footsteps of such bodies as the Economic Commission for Europe and the Organization for European Economic Co-operation.

VIII

THE FUTURE OF REGIONAL PAYMENTS SYSTEMS

BEFORE examining the ways in which the sterling area and the EPU might be adapted to the probable future world payments situation, it is appropriate to summarize their merits and defects in the post-1945 period.

Both systems undoubtedly fostered the re-building of trade amongst their members. Both also facilitated trade and payments over a wider area, through the monetary unions linked to EPU and through the sterling area's transferable accounts system. Yet both suffered from the limitation of the area over which they operated. Neither from a world welfare point of view nor from that of the member countries is it desirable that the natural pattern of world multilateral trade should be impaired — if a more multilateral pattern can be established without forgoing the very real advantages of stability and a close and sympathetic co-operation that are possible for a limited group of countries working together.[1] The task, then, is to devise ways of extending the area over which trade, current payments, and capital movements can be freely made, but at the same time to ensure that adequate funds of international liquidity are available and that economic co-operation between countries is sufficiently close to assist individual countries in difficulties, and to maintain trade between the countries concerned at the highest and most stable level consistent with other objectives. The dollar countries must be included in this international economic co-operation; but so far as they may be unable or unwilling to participate in measures to maintain the stability of world trade, to that extent it will be necessary to rely upon

[1] 'World welfare' considerations imply assumptions about effects on the distribution of income; but changes in this are best made by grants between countries rather than by encouraging each country to impose whatever controls over trade it sees fit to apply.

international economic co-operation within the non-dollar world to secure this objective.[2]

The success of the sterling area and the EPU in developing trade amongst their members undoubtedly helped them to reduce their dollar deficit by replacing dollar with non-dollar sources of supply. The main doubt about their operation is whether this process took place in the most effective way. In particular, did the relatively easy soft-currency markets to which these payments arrangements gave such ready access encourage too great an emphasis upon 'dollar saving' production and discourage members in some measure from developing their dollar exports? At the same time, the sterling countries — or certain among them at least — may have been given inadequate inducement to economize in their dollar spending because of their ability to draw upon the dollar pool; that is to say, because the availability of dollars to any one of them did not depend primarily upon its own efforts, as an individual country, to earn and save dollars. The second main doubt is whether (assuming for the moment that the general emphasis on dollar saving compared with dollar earning was about right) the economies in dollar spending and the stimulation of dollar earning were effected in those places where the real costs were least and the prospects of increasing dollar earnings greatest.

These payments systems certainly discouraged the balancing of the members' accounts with the dollar area by the uneconomic method of bilateral balancing of the dollar accounts of each. And their general influence was very definitely in the direction of raising the standard of living both of their members and of the world generally. But these two payments systems did introduce some undesirable distortions in the pattern of trade and production of members. If these or basically similar arrangements are to play a part in any future situation, it will be desirable to remedy the main defects that were revealed by the operation of the sterling area and the European Payments Union.

The Probable Future Setting

Earlier chapters have considered the part played by the sterling

[2] The concentration on fostering multilateralism within the non-dollar world may also be justified if there is strong enough reason to believe that discrimination against dollar goods can turn the terms of trade in favour of relatively poorer countries — in the long run as well as the short.

area and the European Payments Union in the special circumstances of the post-war period up to 1955. Are circumstances likely to exist in the future sufficiently similar to justify the continuance — or the occasional revival — of these or similar payments systems in some shape or form? And, if they may still have a part to play in the future, in what ways should they be modified in order to serve the interests of their members, and also to facilitate world trade and payments generally, when currencies are more fully convertible than in the period that has been considered?

It is a safe assumption that the non-dollar world will suffer occasional threats to its reserves of gold and dollars if and when American imports or American foreign lending are reduced. At the very least, such contingencies must be guarded against in some measure by the countries most likely to suffer as a result of them. And among the countries most likely to suffer are those whose currencies are used as a means of international payment and as a form of international reserves — in particular, sterling.

It also seems likely that fluctuations in exchange rates will play only a minor part in maintaining the equilibrium of the non-dollar world's accounts with the dollar area: or, at the least, that other weapons will have to supplement such fluctuations. Whatever case may be made out for some flexibility of exchange rates, the experience of the post-war years seems to indicate that the application (at any rate occasionally, in times of especially severe dollar shortage) of dollar import controls can result in at least a short-term gain to the non-dollar world, if the alternative is depreciation *vis-à-vis* the dollar, together with the removal of these restrictions. It is true that a persistent application of these controls, especially if the selection of dollar imports is not made according to strictly economic principles, is likely to have adverse long-run effects in the shape of the protection they may afford to uneconomic industries in the non-dollar world. But some degree of direct restriction of dollar imports is a likely, perhaps even an indispensable, weapon of policy for the non-dollar world in the foreseeable future, at any rate from time to time, certainly for the sterling countries.

It may well be true that the restriction of dollar imports into the non-dollar world by means of dollar import controls will lead to the fostering of dollar-saving industries (under the protection of these controls) instead of the expansion of dollar-earning industries, and that this effect may reduce the real income of the non-dollar world by balancing its dollar trade at a lower level than would be possible if relatively more emphasis were given to dollar-earning industries — even though the control of dollar imports may turn the terms of trade in favour of the non-dollar world. The non-dollar world may prefer this state of affairs to one in which it is more closely dependent upon American markets and so more exposed to the sort of instability that may result from periodical American recessions. The extent to which a country will prefer the policy that seems to promise a greater degree of stability (over good and bad times together) to a probably higher real income in good times will depend upon how great and how frequent it expects the declines in American imports (especially of its own products) to be, and how great a degree of sacrifice of real income it believes will be involved in balancing its dollar accounts, or those of the whole non-dollar world, at the lower level. It will depend also on whether it believes that concerted discrimination against the dollar area by a group of countries can permanently move the terms of trade in favour of the non-dollar countries (including itself), and on the extent to which it believes this to be practicable.

Different countries will have different views on these matters. It is important to note that the interests of any one country would probably best be served if all other countries carried out the degree of discrimination against dollar goods that it deemed to be desirable for the non-dollar world, but if, at the same time, it was itself able to import dollar goods freely — provided that when it reduced or removed its dollar import restrictions it did not incur discrimination against itself.[3] Clearly, therefore, the free importation of dollar goods by each country will not bring about just the degree of discrimination by the non-dollar world that may in fact be desirable (from the point of view of the non-dollar countries) in any given circumstances. The sterling area's dollar pooling system brought about a degree of discrimination decided upon and

[3] See A. C. L. Day, *The Future of Sterling,* Chapter 7.

enforced by informal agreement amongst members; and the EPU encouraged discrimination in favour of members (and indirectly of many other non-dollar countries) by reducing the extent to which gold or dollars had to be paid for deficits incurred with non-dollar countries in, or associated with, the EPU. If it is accepted either that some degree of discrimination against dollar goods will be necessary or even merely that it will in fact be practised — if only from time to time — it is important to ensure that the discrimination is of the sort that will have the maximum of good (or the minimum of bad) effect for the non-dollar world. In view of the probable short-term conflict in this matter between the interests of the non-dollar world as a whole and those of individual non-dollar countries, it seems clear that some sort of co-operation among the non-dollar countries is desirable in order to secure the appropriate policy; and whilst it is preferable that the co-operation should be over as wide a group as possible, there is the possibility that its effectiveness may be reduced if the size of the participating group is so wide and the obligations of membership so loose as to include countries that will not play their part adequately.

In the international monetary system of the non-dollar world envisaged for the future there are several other relevant characteristics. First, the sterling countries will probably continue to share their gold and dollar reserves, though South Africa will continue to hold her own gold reserves, and other sterling countries may hold relatively small amounts. Secondly, each of the Western European countries is likely to hold its own reserves. Thirdly, the countries of these two groups are already accustomed to varying degrees of co-operation with one another and, through the United Kingdom which is a member of each group, with countries in the other group; and the especially close co-operation within each group is likely to continue. Fourthly, these groups are, however, likely to be ready to co-operate fully with other countries also, both in the dollar and non-dollar worlds: the Commonwealth link with Canada, and the OEEC-EPU link with the United States through the aid provided to Europe, have paved the way for such co-operation with the dollar world. At the same time, the effectiveness of the sterling and OEEC groups has been in no small measure due to their compactness; and to increase the number of countries represented at conferences and on international organizations may well do as much harm as good. Nevertheless, the understanding between these groups and the other trading nations must be close, and the International Monetary Fund seems the appropriate body for the interchange of ideas on this wider plane — coupled with the concerted reduction of tariff barriers through an extension of the General Agreement on Tariffs and Trade (GATT) in the field of trade policy.

As to the general role of the IMF, one may assume that it will be somewhat more effective than in the past in providing international liquidity; yet it is also appropriate to assume that the non-dollar world will be unable to rely entirely on this source of supply for dollars to meet a sudden intensification of its dollar problem. Dollars, from this or from any other source, are certainly not likely to be so plentiful as to dispense with the need to use those available in the most economical way. Even if adequate supplies of liquidity are available from the IMF, it will remain doubtful how far countries will be willing to pay the price demanded, a price which will in part take the form of accepting IMF proposals about their economic policies.

In these circumstances the use of dollars for making payments within the non-dollar world should be minimized, so far as this is consistent with promoting something like the optimum utilization of the non-dollar world's resources: the non-dollar world should not hold more gold and dollars idle in the form of reserves than is necessary to secure the desired degree of security against sudden, large dollar deficits. Moreover, the need to put the available dollars to best use implies that dollar imports should be chosen in such a way as to further the interests of the whole non-dollar world, but also without expecting individual countries to apply restrictions that they consider to be against their own interests (unless, of course, other countries compensate them in some adequate way for doing so).

This final background assumption deserves special stress. Each country must be assumed to be seeking to further its own long-run interest; if it is asked to make sacrifices in the interests of the other members of the group it must be given an appropriate *quid pro quo* in some other form. The fundamental objective for international organizations should be to make it in each member's interest to promote those policies that will ultimately be for the good of the whole body of members. Merely enjoining them to adopt such policies is not sufficient.

The Aims of International Payments Systems

Before considering ways in which the existing payments systems might advantageously be modified for occasional or more general future use, it is necessary to state the main ends that they, or any other international monetary organizations, should have in view.

(1) They should endeavour to facilitate multilateral trade and payments over as wide an area as possible. (The only qualification of this is, naturally, that beyond a certain point freedom of trade and payments may conflict with the other main objectives.)

(2) They should endeavour to economize in the use of gold or dollars in trade within the non-dollar world and to encourage the most economical use of the available dollars for building up reserves against any future dollar crisis, as well as for the purchase of dollar goods.

(3) They should endeavour to promote the stability of trade between the dollar and the non-dollar world at the highest possible level over good and bad years together; at the same time stability of trade within the non-dollar world should be a main objective of the participating countries.

(4) So long as the problem of maintaining equilibrium in the non-dollar world's accounts with the dollar area seems to indicate the need for a redistribution of the non-dollar world's resources in dollar-earning and dollar-saving directions, a main aim of any payments systems (or similar organs of international co-operation) should be to encourage the most appropriate relative emphasis on dollar-earning (compared with dollar-saving) projects, and to develop both dollar-earning and dollar-saving industries in those countries and in those directions where this can be done most economically.

Various possible lines of development for the sterling area and the European Payments Union will be considered in the light of these objectives.

Possible Developments of the Payments Systems

The freeing of trade and payments progressively over a wide area of the non-dollar world was certainly furthered by both the sterling area (especially through the gradual extension of the transferable accounts system) and by the EPU (especially by means of the concomitant agreements to liberalize increasing percentages of imports from other member countries). The most fruitful — and most readily practicable — modifications that could be made in these systems would therefore surely be to include the whole monetary areas of EPU countries, especially the independent countries of the sterling area, in agreements to liberalize increasing percentages of trade among members and their associated monetary areas. In addition, a similar extension of the agreement to liberalize trade might well be applied to countries not members of these unions, provided payments between them and the EPU-sterling group are in reasonable equilibrium. In concentrating upon the relaxation of quota controls, which have been the greatest obstruction to the free flow of trade in the post-war world, the EPU arrangements had an important advantage over the co-operation effected through GATT (over a much wider range of countries) in reducing tariffs. Both approaches are certainly useful and should develop together. But the EPU undertakings had certain advantages — notably the fact that when balance of payments difficulties arose, the liberalization so far undertaken could be in part rescinded; other member countries were then ready to discuss what measures could be taken to improve the balance of payments of the country that was in difficulties. Probably such a degree of understanding and close co-operation could be obtained only in a fairly small group of countries; at any rate, though every effort should be made to widen the field over which liberalization takes place, it would be unwise to prejudice the advantages derived from the close and fruitful co-operation within the relatively small group of OEEC countries. And this co-operation could well continue in some form, whatever the payments arrangements prevailing.

The payments arrangements in the non-dollar world will, of course, also be of great importance. Here a primary aim should be to keep all non-dollar currencies readily transferable into each other. An organization such as the Western European-cum-sterling group could facilitate this — whether or not their currencies were technically 'convertible' into gold or dollars — by a readiness to accept currencies of other members of the group up to certain fairly generous limits. The right to convert each others' currencies into gold on a large scale should be merely a final resource existing primarily to prevent any one member from running a serious and persistent deficit with the rest of the group, or to enable a member to continue to have a pattern of trade involving a dollar deficit where this was normal for him; but ways should be found to avoid the exercise of this right to more than a limited extent. This would, of course, make it far less likely that members will be disposed to reverse their trade liberalization measures. It would also economize in the use of gold or dollars to finance trade within the non-dollar world, and so promote the second objective — that of reserving them for use in trade with the dollar area and as international reserves held against any deterioration in the accounts of non-dollar countries with the dollar area. (Mr Sargent's suggestion —considered below[4] — that settlement of EPU balances should be in members' own currencies *convertible into any non-dollar currency,* would be a helpful line of approach to this objective.)

The liberalizing of trade and payments within the non-dollar world and the avoiding of settlement in gold or dollars must not, however, be taken so far as to prejudice the third main objective that has been suggested, namely, the maintenance of trade with the dollar world at as high a level as is consistent with a fair degree of stability. The danger is that the creation of a relatively 'soft' area of trade and payments may discourage the export of goods to the dollar area and therefore prejudice the increase in the real income of the non-dollar world that is likely to result from balancing trade with the dollar area at a higher rather than a lower level. There are, admittedly, two qualifications to this: the first is that a relatively low level of trade may be worthwhile — at least in the short run — if it enables the non-dollar world to turn the terms of trade in its favour; but too much weight should not be attached to this consideration, for the lower volume of trade would be worth while (at any rate in the longer run) only if it were compensated by a very favourable, and very lasting, movement of the terms of

[4] See pp. 150-2.

trade. The second qualification is that too high a level of trade with the dollar area may tie the non-dollar world unduly to the (allegedly) unstable American economy.

These considerations merely indicate a probability that many or most countries of the non-dollar world will want to continue policies that stimulate dollar-saving industries in some measure, and that this will be coupled with some measure of dollar import restriction (unless devaluation is preferred, even to meet purely temporary difficulties), at any rate in periods when dollar income is unusually low. It may also provide an argument for some restriction of dollar imports even in more favourable circumstances; dollar income might in this way be used to build up reserves — and so to avoid such a drastic restriction of dollar imports as would otherwise be necessary when events take an unfavourable turn. By this means, trade between dollar and non-dollar worlds can be kept relatively stable. The dollar countries may reflect that some element of restriction of imports from them into the non-dollar world in good times (that is, the use of dollar earnings to build up reserves rather than to buy dollar goods) may be well worth tolerating if it reduces the likelihood of drastic curtailment of imports from the dollar area at a time when employment is low there. (These considerations will, of course, be of less force the greater the supply of international liquidity available from such sources as the IMF to meet these contingencies.)

If trade with the dollar area is to be made more stable in this way, it is desirable that, broadly speaking, dollar import restrictions should be simultaneously relaxed (or, if need be, intensified) over the whole non-dollar world. Mr Harrod has forcefully put the case for this spreading of the burden of dollar import restrictions:[5] acceptance of his view should be qualified by greater readiness than he evinces to see those countries with a natural dollar surplus apply less stringent dollar import restrictions than others. A less distorted pattern of trade and production is likely to result from such a policy and equity to be better served by it. His preference for continuing dollar import controls as a means of speeding the grant of convertibility to non-resident sterling is also open to question, as

[5] See 'Imbalance of International Payments', *IMF Staff Papers,* April 1953.

it seems likely to result in the swifter reduction of dollar import restrictions by non-sterling countries than by members of the sterling area. But, broadly speaking, it is desirable — as Mr Harrod asserts — for the non-dollar countries to pursue policies that are generally in harmony about the extent of the dollar import restrictions of different countries. The sterling system had some success in causing the simultaneous relaxation or intensification of the dollar import restrictions of many countries spread over a large part of the non-dollar world, but the system was still far from ideal as these arrangements were vague and insufficiently co-ordinated; there was often a time lag, and some members relaxed their restrictions much further than the average, while others, notably the Colonies (as was shown in Chapter IV), relaxed theirs much less.

Clearly, a swift, generally accepted, and quickly implemented means of deciding (and expressing) the degree of discrimination to be applied by as much of the non-dollar world as possible is required. The EPU countries had no concerted means of expressing the degree of discrimination they believed should be applied by them at a given time; indeed, as has been shown, the degree of discrimination varied according to criteria that had no essential relationship to the intensity of their common dollar problem. From the beginning of July 1954, however, the agreement that future balances, with few exceptions, be settled fifty per cent in gold and fifty per cent in credit did provide some sort of mutually agreed degree of incentive to discriminate in favour of EPU imports. (Incidentally, this incentive was not as great as at first appears, since the fifty per cent that consisted of credit was likely to imply the obligation to settle in gold within a few years — especially in view of the concomitant agreements to settle much outstanding debt by gold payment and by funding; it was not in any sense a cancellation of debt.)

The fourth objective — that of encouraging dollar-earning and dollar-saving projects in those directions that were most likely to prove economic — would also be promoted by a widely distributed and roughly equal inducement to discriminate. This does not mean that all countries should discriminate more or less equally (which is what Mr Harrod seems to favour), but that a roughly equal extra inducement to discriminate should be offered to all. Those countries that believed they would suffer least from applying such discrimination would then naturally discriminate most; those that would suffer most from it would consider that the inducement to discriminate was insufficient to persuade them to discriminate as much as the others. But there should also be a consistently applied policy of importing least freely those dollar imports whose production could be most readily and economically expanded in the non-dollar world; this would imply an agreement to select dollar imports according to the criterion of relative costs. Finally, this objective would be promoted by giving each country an incentive to improve its dollar accounts such as generally existed for the EPU countries, since each of these held its own reserves. There was no such financial[6] incentive for a member of the sterling area dollar pool to concentrate on improving his dollar balance,[7] since his dollar needs (up to a generally agreed level) were met from the central reserves. But whilst the splitting up of the central reserves would further the objective of making each sterling country more 'dollar-balance-conscious' — its own dollar reserves would then reflect the degree of its success in improving its dollar accounts — it would conflict with the objective of economizing in the use of reserves, to which the dollar pooling system made a notable contribution. Similarly, if the European countries pooled their reserves to any appreciable extent, this would tend to make them so much the less concerned with directly improving their dollar accounts — though it would probably be readily combined with measures that would economize in the use of dollars for financing

[6] Though the force of moral obligation was, of course, far from negligible.

[7] The emphasis placed at the Commonwealth Finance Ministers' Conference of January 1954, upon increasing exports to all non-sterling (not merely to dollar) markets was not a denial of the need for this; there was no suggestion that imports should be admitted as freely from dollar as from non-dollar sources — which indicates that the dollar balance of the sterling area was still considered of prime importance. The implication of the emphasis on all non-sterling exports is that resources devoted to increasing exports from the sterling area were as likely to yield as valuable a return, all things considered, in the easier, non-dollar, as in the less readily expanded dollar, markets. Even at this time of rising sterling-area reserves, therefore, an inducement to economize in dollar spending would not have been out of place; in any future period when the reserves were under pressure from an American recession or from the calls upon them arising from the establishment of convertibility of sterling earned by non-residents, the need to pay special attention to dollar imports and exports would be even more insistent.

trade between them. The most helpful modifications of the existing systems would, therefore, be measures combining the desirable elements of both these essentially conflicting policies.

Certainly, the need for regional co-operation in such tasks as these is unlikely to pass away with the granting of the right of convertibility into dollars to holders of the main non-dollar currencies. The sterling countries will presumably continue to share a central reserve of gold and dollars, and will have a common interest in working to maintain its continued solvency; so far as any dollar import restrictions remain, they will be concerned to see that the burden of these is appropriately distributed. For a group of countries not sharing common reserves, a payments system aimed at economizing in the use of gold and dollars in settlement of debts between members will certainly serve a useful purpose so long as the available supply of dollars can be more advantageously used for purchasing dollar goods or in building up reserves against any future fall in the supply of dollars. Convertibility will certainly demand important changes in the policies of the payments systems; but the need for them, in appropriately modified forms and at any rate from time to time, may well be at least as great as in earlier years.

IX

POSSIBLE MODIFICATIONS TO THE REGIONAL PAYMENTS SYSTEMS

ONE possible line of development for the sterling area would be the splitting up of the central reserves. This would cause a closer approximation to the European Payments Union, and might therefore make it more readily assimilable to the latter, with each independent sterling country as a member in its own right. Various sterling countries are believed to have suggested such a development — at least, so far as concerned their own share of the reserves — at certain times in the past.

It is difficult to appraise such suggestions (at any rate from the viewpoint of individual countries) without introducing extra-economic considerations; for the holding of a reserve of hard currencies is regarded by many countries as a mark of prestige and would therefore be considered an advantage, even if no economic gain resulted. But in this connection it may be noted that the mere geographical location of the reserves is not of itself material to the essential concept of pooling. What is important is that the reserves of the whole area should be regarded as available for the use of any member in accordance with certain mutually agreed principles, and that no member should depart from these principles merely because he happens to hold part of these reserves within his own national boundaries. Provided the continuity of this guiding principle for the use of the reserves could be ensured, there would even be much to say on grounds of security for the purely physical dispersion of the reserves.

If the cost and difficulties of movement could be overcome, it might even be desirable to give to each member country in turn the duty of acting as custodian of the reserves for a fixed period (they would not need to be situated physically within its geographical boundaries), so that the United Kingdom did not bear all the odium of being the hand that held the purse-strings; this might increase the sense of responsibility of all member countries. But, on the other hand, no other central bank could speak with the weight of a tradition and experience such as that of the Bank of England, nor would other central banks possess the administrative machinery needed to manage the reserves.

The advantages of a genuine fragmentation of the reserves — that is, their distribution amongst members for each to use as he saw fit — are worth consideration. Fragmentation would restore the financial incentive for each member to concentrate on improving his dollar balance — the lack of which has been probably the main defect of the pooling arrangements. Similarly, it would avoid the difficulty inherent in the EPU arrangements whereby the United Kingdom held a quota on behalf of the whole sterling area, with the result that when the sterling area incurred a deficit with EPU (in the name of the United Kingdom), any necessary intensification or re-imposition of import restrictions against European goods tended to be focused upon the United Kingdom rather than spread evenly over the whole sterling area in ways that would have been less likely to do harm to trade. It would, however, surely be possible to spread these adjustments over the whole sterling area without having to split up the reserves.

On the other hand, the disadvantages of splitting up the reserves would be very considerable. It is impossible to devise a criterion for division that would command general support; net dollar earnings (over what period?) would be virtually irrelevant, for the exports sent by one of the sterling countries to the others have helped, directly (as with re-exports) or indirectly, to earn dollars. Again, it is hard to believe that if members held their own separate reserves they would be ready to accept sterling freely for transactions amongst themselves; and if some of their available supplies of gold and dollars had to be used for intra-sterling area trade, this would, of course, leave so much the less for their primary task of financing dollar imports.

A further objection to the fragmentation of the reserves is that they would then cease to fulfil their 'insurance' function of setting off one member's risks against those of another; assuming that every member faced the same risk of a loss of dollar income, the fact that all would not sustain that loss to the same extent at any one time made it a real economy to pool the reserves. It is true, however, that if the reserves were shared out those countries that were the worst risks would no longer be able to rely on the reserves that the 'better risks' had built up; in other words, each would be forced to look to his own dollar balance — over the long period as well as from year to year.[1]

This objection to dividing up the reserves implies that a number of small countries each holding reserves would probably have to play safe in apportioning their dollars between buying dollar goods and building up reserves to a far greater extent than one central banker for the whole area needs to do; fewer dollars would therefore be available for spending and more would be held idle.

The conclusions must therefore be that fragmentation of the reserves — in whole or in part — is desirable only so far as no equally good way of encouraging dollar economy (that is, economizing in dollar imports or encouraging dollar exports) can be devised; that considerations of prestige could theoretically — but in practice only with very great difficulty — be satisfied by a physical fragmentation (or itineration) of the reserves combined with continued application of the mutually agreed principles governing the spending of dollars; and that the pooling system has provided real economies that seem to make it far more fitted for extension in some form than for liquidation.

Nonetheless, both on grounds of equity and because the natural pattern of trade (to which policy should not be indifferent) would imply fewer cuts in dollar imports by them, those member countries that have an especially strong dollar balance should be granted some *quid pro quo* for such restraint in dollar spending (that is, such readiness to buy non-dollar goods where their prices are higher than similar imports from dollar sources) as they may exercise in the interests of the sterling area as a whole. This might take the form of allowing them to spend dollars rather more freely than the other (dollar deficit) members, or, if they preferred it, to hold for themselves a limited amount of the dollars they earned each

[1] Whilst Mr Day may well be right in arguing (*The Future of Sterling*, p. 80) that the dollar pool is less effective in offsetting these risks than formerly, it may yet be more effective than the alternative of fragmentation.

year; or it might take the form of a grant in sterling from the other members, with the understanding that it should be used for non-dollar expenditure. The pooling of dollars should not, in other words, necessarily imply a rigid identity in the principles applied to the selection of dollar imports by the various members where there was good reason for granting special freedom of choice to some.

In view of the advantages of pooling reserves, should the pooling system be extended? The main difficulty would be to secure the degree of informal co-operation over the principles of dollar spending that has prevailed at any rate among the Commonwealth sterling countries; even among them, and certainly for some of the non-Commonwealth countries of the area, it has been necessary to regulate dollar drawings from time to time (especially in the immediate post-war period) by detailed and formal agreements about drawing rights. It would probably be feasible to introduce new members (whose co-operation with existing members would inevitably tend to be less close than that prevailing among the existing sterling countries) only if some formal arrangement were devised that made clear how far members could rely on the pool for dollars and what obligations (about the severity of their dollar import restrictions, in particular) they were accepting in return for these rights. If more formal arrangements were made in order to accommodate countries at present outside the sterling area, the arrangements within the area might also have to be formalized; if so, the sterling countries would have to weigh the loss of the advantages of informality against the anticipated greater efficiency of an as yet untried more formal system.

Probably it would be best to maintain as much informality in the sterling area arrangements as possible, but with a greater degree of understanding about the extent to which dollars were to be saved (expressed if possible as a percentage preference for non-dollar goods in terms of prevailing prices at any given time); at the same time, more detailed and express arrangements could be made with countries outside the area about the extent of their rights and obligations in return for the total or partial pooling of their reserves with those of the sterling area. In any case, the possibility of using (or extending) the pooling principle among countries not linked with the sterling area might be examined; for the greater the economies that can be made in the use of dollars in trade within the non-dollar world, the more will be available as reserves and for the purchase of dollar goods: and some degree of pooling would probably conduce to a greater acceptability of non-dollar currencies for financing trade amongst non-dollar countries. (Mr Day's suggestion, discussed below, would introduce an element of dollar pooling for the EPU countries.)

Financial Incentives to Dollar Equilibrium

If the sterling countries continue to share their reserves and to impose appreciable dollar import restrictions, it is worth considering whether the introduction of some incentive to them to economize in dollars might not be desirable. Similarly, if the countries of a monetary union such as the EPU, who do not share their dollar reserves, wish to economize in dollar imports and to encourage their trade with each other to an agreed extent, this agreement might be expressed and enforced by means of a system of financial incentives to member countries to economize to the desired extent in their dollar imports. There can be no denying the political and administrative difficulties in the way of implementing such devices as those that will be described below. But if a substantial restriction of dollar imports is necessary at any time in the future, it is important to secure that the economies in dollar spending will take place where they will do least damage, and in such a way as to work towards a pattern of trade and production that will render them no longer necessary. The earlier discussion has indicated the author's view that the system of dollar import restrictions imposed by the sterling countries did not work towards a pattern of trade and production that would remove the necessity for them — or, at least, not as quickly as was desirable. Nor did it encourage the reducing of dollar imports by those countries and in those directions that would do least harm — or most good. If the theoretical solutions suggested below for this problem are found unworkable, they may at least indicate the directions in which a solution should be sought — and throw the onus upon administrators to devise more practical means of achieving the same end.

The suggestions by Professors Kahn[2] and Mikesell[3] for modifying the European Payments Union indicate a theoretically satisfactory approach to the problem of how to encourage the most economic restrictions upon dollar spending and how to expand the most promising dollar export industries over the whole of a group of countries whose members do not pool their reserves. Their proposals would give all members the same degree of incentive to discriminate against dollar goods and to concentrate upon building up their dollar exports: that is, their proposals would canalize trade among members (or among them and the rest of the non-dollar world) to just that extent deemed desirable, and they would effect the diversion of the group's trade in ways that would do least harm — or most good — to the group as a whole, rather than leaving the matter entirely to the whim of individual countries.

The essence of their proposals is that member countries would receive a special inducement to increase their exports to the dollar area and to increase their imports from each other. Professor Mikesell's suggestions would do this by giving a country a special reward for earning dollars rather than other currencies. Professor Kahn's scheme would secure payment for member countries in gold or convertible currencies for the surpluses they ran with the rest of the group, but not to the full value of these surpluses (at prevailing rates of exchange). Similarly, they would each have to pay gold or hard currencies for the deficits they ran with the rest of the area, but not to the full extent of the deficit. By applying to their intra-union surpluses or deficits an appropriate rate of discount, just the desired amount of inducement could be given to all members to reduce their dollar deficits (or to increase their dollar surpluses) without sacrificing more than the necessary minimum of the advantages of multilateral trade. The rate so applied could be adjusted in such a way as to keep the union as a whole in balance with the dollar world (or as near to a bilateral balance as was thought desirable in the light of possible hard-currency earnings from countries outside both the payments union group and the dollar area). As it achieved its purpose of reducing

[2] 'A Possible Intra-European Payments Union', *Economica,* November 1949, and 'The European Payments Union', *Economica,* August 1950.

[3] 'Discrimination and International Trade Policy', *Review of Economics and Statistics,* August 1950.

the dollar gap it could be gradually reduced until, with the reduction of the rate of discount to zero, complete convertibility of the group's currencies into dollars would have been achieved. Each member would be left free to frame his own dollar import policy. Professor Mikesell has, however, pointed out that if some countries in the payments union imported dollar goods very much more freely than did others, there might be a danger of commodity arbitrage in hard currency goods leading to a loss of dollars by the union.[4] But means might be devised to overcome such difficulties, probably on the lines that he has suggested.[5]

Such schemes are not directly applicable to a group of countries that pool most or all of their gold and dollar reserves. The sterling countries could adopt such a scheme only if a substantial part of their hard currency reserves (at least) were shared out amongst them, so that they would each be able to make to the rest of the group whatever hard currency payments might be necessary. But the difficulties involved in sharing out the sterling area's reserves among members would be immense, and their already inadequate gold reserves would be even less adequate if they had to be used to fulfil the additional task of settling deficits among sterling countries as well as settlements with outside countries. In any event, it would seen indefensible to abandon the economies achieved by the pooling of reserves in order to adopt a scheme that has been devised for a group of countries not pooling their reserves — and therefore not at present possessing the advantages due to pooling.

There is, however, a case for attempting to apply a similar system of incentives to the sterling group of countries if this could be done without giving up the pooling of their reserves. If dollar import restrictions have to be continued over a long period or if they have to be revived occasionally to meet special difficulties, it may be desirable to give member countries a stronger incentive than the purely moral pressure that has existed in the past to apply to their imports from the dollar area just the degree of discrimination that is thought necessary. It is certainly desirable that such efforts as are made to restore equilibrium to the dollar accounts

[4] In a further exposition of his suggestions, in the essay, 'The Economic Integration of Sovereign States' in *Money, Trade and Economic Growth* (*Essays in Honor of J. H. Williams*), MacMillan, 1951.

[5] Ibid, p. 88.

of the sterling area shall, so far as possible, be made in those places and by those countries that have the best prospects of improving the dollar accounts of the area at the least real cost. These are problems that clearly have to be faced. The following outline of a scheme that might — in theory at least — be applied to the sterling area system would work in the desired direction if it were found practicable. If it is not practicable — in whole or in part — it remains for other means to be devised to achieve broadly the same ends; the consideration of the following hypothetical 'model' of a solution may at least suggest lines on which policy should develop.

The essential principle underlying the Kahn-Mikesell proposals — that it should be made worthwhile to members of the payments union to conform to that policy which has been mutually agreed upon by them — is one that should if possible be applied to the sterling group. For so long as these countries pool their hard-currency earnings they are likely to feel compelled from time to time to restrict their dollar imports in some way in order to protect the reserves; and this will involve them in making a decision about how far they can and should dispense with dollar imports in order to secure other aims of policy — notably an immediate improvement in their dollar balance of payments. Having taken that decision, they will then be faced with the task of deciding how to distribute the dollar import cuts amongst their members in ways that will do the least harm. Clearly, members' views on how these cuts should be distributed will vary greatly, and there is no guarantee that all members will be equally conscientious about applying the decision of the group. Nor is it necessary or desirable that all should tighten their dollar import restrictions equally — for some may be far better able to dispense with certain dollar imports than are others.

But the incentive to improve the dollar accounts of the sterling area might be provided by crediting to members earning dollars (including the United Kingdom — though this would involve special arrangements which will be considered below) amounts in sterling larger by an agreed percentage than the value of these dollars at current rates of exchange; similarly, countries withdrawing dollars from the pool could assume the obligation to pay for the dollars they spent by drawing down their sterling balances by more than the value of the dollars they were withdrawing (calculated at the prevailing rates of exchange). It is not suggested that the 'bonus' for dollar earning or the 'charges' for dollar expenditure should be applied directly to the payments made in the course of private transactions — or, indeed, to any transactions, on private or governmental account, as they actually occurred; if that were done the system would amount merely to a system of dual exchange rates aimed at concentrating upon improving the dollar accounts of the countries applying it relatively more than their accounts with the rest of the world. The bonuses and charges would be transactions between central banks on account of the governments concerned; the settlements would be made at the end of each short accounting period — say a month. As will be indicated below, there are likely to be special practical difficulties in the way of applying the proposal for the bonus, but these difficulties do not seem to be inherent also in the imposition of the charge. Fortunately, the occasional, and probably temporary, limitation of dollar imports is more likely to be required in the future than is the encouragement of a more permanent structural change of the sterling countries' industries towards producing dollar exports. The charge to discourage dollar imports and to encourage members to apply the agreed policy in the ways that they believe will do them least harm is, therefore, likely to be of greater practical importance than the payment of a bonus to encourage dollar earning.

The two proposals will, however, first be considered together, partly as a means of elucidating the main issues involved, and partly because it is conceivable that future circumstances might arise for some group of countries in which the usefulness of some sort of bonus payment might be felt to outweigh the practical difficulties involved in applying it.

The problem facing the sterling countries at any given moment is to secure a distribution of their resources and of their demand for imports such that the advantage to them of adding one more dollar to the central reserves[6] is equal to (i) the advantage to them of

[6] Countries that are nominally sterling-area members but not members of the dollar pool — as South Africa is at present — are here excluded from consideration.

spending one more dollar upon imports; and also to (ii) the advantage to them of using for the purpose of producing goods for sterling markets the resources that might have earned one more dollar.

Such a marginal balancing should, of course, also be made between these magnitudes and the last unit of resources devoted to producing goods for other markets. If certain currencies were in especially plentiful supply, their use might be encouraged by paying members a bonus at an appropriate rate if they purchased imports from these countries; and if there were currencies less hard than the dollar but harder than other currencies, bonuses and charges might be applied to these at an appropriately lower rate. For simplicity's sake, however, it will be assumed that all non-dollar currencies are equally hard to the sterling area — a realistic assumption so far as full transferability of non-dollar currencies into one another seems to be a fairly readily attainable objective — or, at least, that differences in the degree of their hardness are not sufficient to necessitate the application of such a scheme to transactions of the sterling countries in currencies earned and spent outside the dollar area. If need be, the scheme could be adapted to encourage the saving of all non-sterling currencies — which would be the main object of policy if all sterling earned by non-sterling countries were liable to be converted into gold or dollars.

The aim would be to provide a sufficient inducement to the governments of member countries to take into account (to an appropriate extent) the effect of their policies upon the central reserves, especially in the matters of dollar imports and (if the bonus were found capable of application) the stimulation of dollar-export industries. The difficulties that would be encountered in securing agreement among members about the rate at which the bonus and charge should be fixed should not be underestimated. But one may assume that a group of countries pooling their reserves will be able to reach broad agreement about whether or not the central reserves are high enough. This question should be considered in the light of the principle that the advantage accruing to members from adding a dollar to the reserves should be balanced against that of spending the dollar on imports or using for other purposes the resources that could have been used to earn the dollar in question.

If the reserves are too low, it would clearly be appropriate to raise the rate, whilst as the reserves rise it would be appropriate to reduce and perhaps to abolish the bonus and charge. Rates at a higher level than most members were willing to countenance would mean that the reserves were being built up at a speed that was not really thought to be worth the sacrifice of dollar goods that it was necessitating, nor the incurring of obligations to dollar surplus members (or those making the biggest reductions in their dollar imports) brought about by the high level of the bonus and charge.

The rates should be regularly reviewed, preferably by a standing committee upon which all members would be represented. It might even be worthwhile to have an agreement whereby the rates were automatically raised if the reserves fell below a certain level (except, perhaps, if it was agreed that this was due to purely temporary factors), and lowered as the reserves rose past an agreed figure. It should be emphasized that the introduction of such a scheme would not involve the sterling countries in making new decisions in principle about whether the reserves were high enough. So long as they pool their reserves and are faced from time to time with the necessity to take measures to improve their dollar accounts, they are constantly faced in fact with the need to make decisions about this. The acceptance of some more formal arrangement such as that outlined would merely bring out into the open the need for reaching a considerable measure of agreement on such matters; the application of the decision would still leave members free to apply the decision to the extent that they saw fit — whilst rewarding them (to the extent deemed appropriate by the group as a whole) for making such modifications in their policies as were likely to help the dollar balance of payments of the whole sterling area.

It may be asked why a system of dollar export subsidies and dollar import taxes should not be applied to secure the same ends (assuming that exchange-rate variations cannot or should not be applied to restore balance[7]). There would certainly be considerable administrative difficulty in adopting that alternative, and there would probably also be openings for abuse inherent in such a system. Moreover, the obligations of the sterling countries under the IMF agreement and GATT would probably stand in the way

[7] An alternative that is discussed on pp. 161-2 below.

of the adoption of such export subsidies and differential import taxes paid to and imposed upon private transactions. But if members chose to pass on to private individuals part or all of the bonus or charge, there would be nothing in the scheme to prevent their doing so — any less or any more than such policies are at present precluded by their other obligations. But even if the bonus and charge were not passed on, their adoption would be likely to have considerable effects in the desired direction, since many of the decisions that affect directly the level of the sterling area's reserves are the responsibility of governments, notably the application of dollar import policies, decisions about whether to hold small separate gold and dollar reserves,[8] and decisions about the granting of special credit facilities or the allocation of capital or scarce materials (where these were controlled) in such a way as to give priority to dollar-earning or dollar-saving industries.

The imposition of a charge for dollar expenditure would seem far more likely to secure a rational allocation of dollar import controls than the somewhat haphazard system adopted hitherto. If every time a member spent dollars he had to pay an extra charge that was intended to represent the extra cost to the sterling countries as a group of the use of dollars rather than other currencies, that member would choose to buy dollar goods only where he considered that the economy of doing so (rather than buying the goods elsewhere or making them himself or doing without) was greater than the extra charge he had to pay in consequence. Throughout the sterling area, therefore, only those demands for dollar goods would be exercised that member governments felt were likely to be of greater importance to them individually than the value placed by the group as a whole upon the addition of the dollars in question to the central reserves. Moreover, the knowledge that other members also were all attempting to apply the same principles to the selection of dollar imports (and that it was in their interest to apply these principles accurately) would satisfy each member's natural desire that equity should be preserved. It would also be likely that, when a member could produce extra supplies of a commodity at not far

[8] This might be permissible under the scheme — since the payment of the bonus for dollar earnings, if and when these were paid into the pool, would serve to discourage the building of separate reserves to whatever extent members thought it appropriate to do so.

above the dollar cost, he would prefer to do so and to spend dollars only where the dollar goods were appreciably cheaper than the nearest substitutes available from elsewhere.

As mentioned in Chapter I, rough rules of thumb designed to apply something like this principle have probably been applied by the sterling area authorities in deciding which dollar imports to license. But if the suggestions made here, or the principles upon which they are based, could be applied, there would be two important changes in policy. In the first place, at any given time all members would be applying the same percentage preference for non-dollar over dollar goods, and they would all benefit to the extent that they succeeded in making an accurate balancing of the advantage to them, individually, of a given dollar purchase against the expected cost to the whole area of withdrawing the necessary dollars from the reserves, as expressed in the charge on dollar expenditure. Secondly, the principle of relative costs (of dollar as compared with non-dollar goods) would be distinguished from the less defensible and far vaguer aspects of 'essentiality' that seem to be confused with it when the sterling area's dollar import policy is not defined with the clarity that would be essential to the operation of such a scheme as that suggested.

The levying of this sort of charge would also give members an incentive to develop dollar-saving industries in those places where, in the estimation of the governments concerned, this could be done most readily. Moreover, other members might be readier to assist with the provision of capital or other necessary factors of production for the building up of dollar-saving industries if they were thereby likely to be enabled in future, when the production of the industry in question was expanded sufficiently, to avoid the necessity for paying charges for importing the similar dollar goods. At the same time, the introduction of the element of financial incentive would make it far less worthwhile for a sterling country to suggest that it should implement development programmes that might save dollars — unless it was confident that they would do this on a sufficient scale and sufficiently economically to justify the expenditure of resources on the project. It is true that the sterling countries would not usually feel confident that the charge would continue to be levied by the time these investments bore fruit; but this would in itself introduce an appropriate bias towards projects that were most likely to save dollars in the reasonably near future, for it would be these that would be favoured so long as the sterling countries could foresee that charges would continue in the near future but might be reduced or abolished in the longer run. Relatively less resources would then be devoted to those developments that would save dollars only in the longer period, when the need to save dollars might be expected to be less acute.

The requirement that the United Kingdom should pay a charge on her dollar expenditure also (in a way that will be outlined below) would afford her an inducement to devote an appropriate part of her available capital to promoting dollar-saving expenditure in other sterling countries — subject, perhaps, to guarantees that would secure to her an appropriate quantity of the dollar-saving goods when they were ultimately produced. Alternatively, she could demand a sufficiently high return upon the capital invested in such schemes (or an equity in the ultimate returns) to enable her to pay the relatively high prices that the country producing these goods would probably demand if other sterling countries had only the alternatives of purchasing the commodities from him or of paying the charge for purchasing similar goods from the dollar area.

The charge would also discourage the United Kingdom from freeing the import of dollar commodities more quickly than was justifiable in the interests of the whole sterling area. If the freeing of commodity markets made possible by removing restrictions upon the import of dollar commodities was thought sufficiently desirable to justify the greater freedom of the import of these commodities, the United Kingdom would, of course, still permit it; but the obligation to pay the charge would ensure that this was done only when the United Kingdom authorities were confident that the greater oversea earnings that this freeing of dollar commodities made possible outweighed the real cost to the sterling area as a whole (expressed in the charge Britain would have to pay for the dollars used) of the additional expenditure of dollars rather than other currencies. Moreover, those sterling countries who felt that their exports to the United Kingdom were suffering unduly in competition with the dollar commodities so freely imported to Britain would be receiving their share of the charges paid by the United Kingdom — which would be some compensation.

The bonus on dollar exports, if it were capable of application, would encourage all members to increase dollar exports to what was agreed to be an appropriate extent. It would, however, be less important to apply it in circumstances when a structural change in the sterling countries' industries was not deemed desirable: for instance, if the intensification of dollar difficulties was thought to be temporary, a tightening of import restrictions, facilitated by the levying of a charge, would be the appropriate course. Though an encouragement to expand dollar-earning industries might have been useful in the immediate post-war years, it is hardly likely to be so desirable in future. Moreover, it could not be of so much use in circumstances when government controls over materials or capital issues are very much less than in the years immediately following 1945, for the means open to them to stimulate dollar-earning industries have now been greatly reduced. Nevertheless, if dollar balance is restored primarily by encouraging members to reduce their dollar imports, it is likely that an undesirable degree of bias may be introduced in the direction of closing the dollar gap by contracting rather than by expanding members' trade with the dollar area. This may be a justifiable policy in some circumstances, but it is essential that the sterling countries consider whether the protection afforded by a long period of dollar import restrictions has not imparted more bias towards dollar-saving as opposed to dollar-earning than is desirable in their long-run interests. If a scheme involving both a bonus and a charge could be evolved, it would be possible, by levying these at different rates, to encourage the improving of the area's dollar accounts mainly by increasing dollar-earning industries (if the bonus was the higher of the two), or mainly by expanding dollar-saving industries (if the charge was the higher). It would be an important advantage of such a system that it would compel members to discuss together fully the important matter of the relative extents to which they should try, at any given time, to devote their available resources to dollar-earning, to dollar-saving, or to other purposes. Since these aims of policy inevitably compete for available resources, this is an important issue of economic policy: and it is one upon which the sterling-area authorities have publicly said little or nothing. Even if it is found not practicable or desirable to introduce a scheme such as that suggested, this issue should be brought more fully into the open.

The main difficulty in the implementation of such a scheme would attach to the paying of the bonus on dollar exports. In the first place, some sterling countries have the alternatives of selling goods in sterling or in dollar markets and there would, presumably, have to be some way of discouraging them from changes of market that would involve the area in additional dollar expenditure. Perhaps this difficulty could be met by declaring some commodities to be as good as dollars, as, for example, where similar dollar goods would have to be purchased if sterling-area producers of them sold their goods for dollars instead of to other members of the area. A still more serious difficulty would arise by reason of the sterling import content of goods exported (to the dollar area) by individual sterling countries. There would be no reason in equity to give to the country that happened to ship the goods to the dollar area the full bonus for its export, which might have been made possible in part (in full in the case of re-exported goods) by imports from the other sterling countries of the raw materials, capital, machinery, technical know-how, etc., necessary to produce the goods in question. In such circumstances it would be difficult or impossible for the various countries concerned to reach agreement on how much of the bonus should go to each. Though some of the bonus might be passed on to the suppliers of these factors of production by the country receiving it, this would not normally occur, since the private traders concerned would not receive the bonus (except so far as their governments saw fit to assist them in some way as a result of receiving it). In any event, there would be no guarantee that higher prices would in fact be paid for the factors of production supplied by other countries merely because the countries — or rather their governments receiving the bonus — could afford to do so. In all, therefore, it seems unlikely that such a device would be practicable for the sterling area, despite the advantages that might be derived from a successfully working scheme of export bonuses under circumstances where governments could appreciably influence the pattern of production, and where a considerable diversion of resources to dollar-earning industries was required.[9]

Such difficulties as these, however, do not seem to apply — or certainly not to such an extent — to the imposing of a charge on dollar imports. In the first place, the necessity for it is likely to be greater since the need to restrict dollar imports — at least from time to time — and to do so in the most economical way possible, is more likely to continue or to recur than the need to effect a structural change towards dollar-earning industries. Moreover, since governments administer dollar import licensing, the charge system would be likely to have immediate effect on dollar import policy in contrast to the probable relative ineffectiveness of paying sterling governments a bonus on their dollar exports in circumstances where they had no appreciable powers to influence directly the pattern of production.

There would be no objection to imposing the charge upon whichever country happened to import the dollar goods into the sterling area, for self-interest would make it very likely that the additional cost would be passed on in the processed or finished product — or else that the cost in the sterling area of the commodity in question would rise automatically so far as the scale of its import from the dollar area, and therefore its supply, was reduced by the importing country.

The charge on dollar imports could, therefore, be defended quite apart from the bonus on dollar exports, as being more desirable and more likely to have the desired effect on the pattern of production, and also as relatively free from difficulties connected with the equity of the device.

If the sterling area governments could be relied upon to frame their dollar import policies in such a way as to secure results the same as or similar to those that should be achieved by the imposition of a charge, there would not, of course, be any need to introduce such a revolutionary scheme. Further, there would no longer be a case for imposing the charge if all sterling countries would consistently maintain the principle of applying an agreed percentage preference for non-dollar goods — whenever it was

[9] I am indebted to Professor R. F. Kahn and to Mr W. B. Reddaway for pointing out some of these difficulties to me.

thought desirable to restrict dollar imports — and if these dollar import controls were not used to conceal other motives for import licensing (which might be completely justifiable in themselves, but not applicable to dollar import policy as such). The first stage of such a policy would be to decide upon the extent to which dollar imports were to be restricted and to express this as a percentage preference for non-dollar goods that would be publicly announced and would be varied with improvements or deteriorations in the sterling area's dollar accounts or the level of the central reserves. Informal methods to secure this degree of co-operation would clearly be preferable, but if these failed it would be well worth considering the introduction of this — or some other — method of providing a financial incentive for members to modify their policies to an appropriate extent, in accord with the wishes of the group as a whole.

If such a course were thought desirable, the working of the scheme would be possible under the existing system whereby the gold and dollar reserves of the area are pooled and held by the United Kingdom, and the claims of other sterling countries upon the dollar pool take the form of claims upon the United Kingdom. The charges levied upon all members, including the United Kingdom, would take the form of book transactions in sterling, which could be paid out to members subsequently in some equitable manner — for instance, in proportion to their total international trade in the most recent year for which data were available. Whilst, therefore, the United Kingdom, as a large dollar-importing country, would initially be debited with considerable sums in the way of charges, it would subsequently receive a considerable part of these sums back — but in a way that was related to its total trade and not in any way linked to the size of its dollar imports; in this way the incentive to economize in dollar imports would remain.

When a member's debits for the accounting period in respect of his dollar imports had been offset against his credits (in the form of his share in the total payments of charges made by all members during the period), the payment could be effected by a rise or fall in the member government's account with the Bank of England; if the United Kingdom were a net creditor in a given period (account being taken of the cost of the administration of the scheme by the Bank of England — which should be equitably shared among members), the payment would be by a reduction in the accounts of member governments with the Bank of England, each country's share of the total receipts being determined by the relative size of its total trade in the most recent year for which figures were available.

Alternatively, the scheme could be administered by a clearing union set up by the sterling countries for the purpose, though any advantages this might possess would be purely psychological, as the net result of its transactions would be the same, except if other sterling countries shared in the actual work of administering the scheme — perhaps by supplying and paying part of the staff. The proposal that there should be a clearing union system for the sterling area requires consideration quite apart from the proposals that have been made above, for the implementation of which a union holding the area's reserves, and in which the United Kingdom would be a member on the same footing as any other, would not be in any way necessary. The main advantage of a clearing union system would be the greater confidence the outer sterling area countries might feel that the interests of the sterling area were not being treated as in any way subordinate to those of the United Kingdom; the main difficulties in the way of it — quite apart from the break with tradition that it would involve — would be the problems involved in deciding how much of the United Kingdom's gold and dollar reserves should be taken over by the clearing union, and what corresponding credit with the union should be given to the United Kingdom; and what part of sterling countries' sterling balances should now rank as credits with the union.

But no such difficult and revolutionary change in the mechanism of the sterling area seems necessary; whatever the institutional setting, the important point is that members should resolve to pursue certain objectives of policy and take the necessary measures to secure them, whether these consist of some greater formalization of their dollar import policy obligations, in the form of the charge on dollar spending, or by less formal arrangements having the same end result. Whatever the means devised to secure these aims of policy, there is a very real need to agree upon them and adopt measures that will attain them. The somewhat far-reaching proposals made above have been intended primarily to draw attention to the lines along which solutions might be found. It is hoped that they at least place some onus upon the authorities to show how far they are unworkable and to ensure that if this is so, the same ends are secured by other means.

By way of summary, the main ends of policy that could be achieved, at least in theory, by the imposition of a charge and the paying of a bonus will be re-iterated in order to emphasize the main problems that face a regional payments system that pools most or all of its gold and hard currencies.

(1) *To ensure that, so long as it is thought desirable to improve the sterling area's dollar accounts, members apply an agreed amount of pressure towards doing this.* This could also be used to promote the relative emphasis on dollar-saving rather than dollar-earning industries (or vice versa) that is thought desirable in the light of member countries' desire to balance their dollar accounts by methods that are primarily either expansionary or contractionary; it would ensure that in pursuing these objects of policy the economies in dollar-spending and the stimulation of dollar-earning and dollar-saving industries took place wherever they were most likely to save or earn dollars, and only where, at least in the view of the governments concerned, the net cost of devoting resources to earning or saving dollars in these ways was less than the real advantage to the group as a whole of adding the saved or earned dollar to the reserves. If members had to agree upon a system of charges and bonuses they would be forced to agree upon such issues as these, or at least to bring their divergences of view out into the open; under the prevailing system, divergences of view are likely to lead to a dangerous drain on the dollar reserves at a time of crisis; if a system of financial incentives — even if confined to a charge — were applied, this danger would be greatly reduced.

(2) *To vary dollar import policy quickly and surely with changes in the level of the reserves.* This could also be used to ensure that members accept similar obligations to intensify or relax their dollar import restrictions without imposing a rigid uniformity upon members in the shape of agreements to cut dollar imports (or increase them) by agreed percentages (which would take no account of the varying needs and resources of different members).

A system of financial incentives would make it very likely that members would quickly modify their policies in the light of changing circumstances to accord with the needs of the area as a whole, and each country would be aware that the other members would find it in their own interests to implement in this way the decisions reached by the sterling area countries as a group.

(3) *To encourage members to take fully into account the probable effects upon the sterling area's reserves of their policies in the matter of raising dollar loans and the payment of dividends in dollars.* They should also have an incentive to take all reasonable precautions to see that the future burden with which they are saddling the sterling area's reserves — in the shape of the repayment of dollar interest and principal — is justified by the increase of the output of goods (preferably dollar-earning or dollar-saving) that will be facilitated by the raising of the dollar loan. When the loan was raised, if a bonus was paid on it to the government concerned to the extent that it was paid into the pool — i.e., in effect, not spent upon dollar goods — this would encourage members to take due account of the area's dollar position in planning where to spend the money raised by the loan.[10] And if, when the time came for repaying the loan, the dollar was still a sufficiently hard currency for the sterling countries to levy charges on dollar spending, the country to which the loan had been made would incur charges for drawing dollars from the pool to make these repayments. This would, in effect, compensate other members for the greater economy in their dollar imports that would be necessary if the dollar loan repayments were to be made — given the level at which they desired to maintain the reserves. It would also enable them to bid higher prices for the increased output made possible by the loan.

(4) *To permit some flexibility in the obligations and privileges of membership where members so desired.* The discussion in earlier chapters has suggested that there may be a case for allowing individual members greater freedom in applying the obligations of membership — where they are willing to give up an appropriate part of the privileges attached to it. This would be especially desir-

[10] And the payment of such a bonus would seem to be practicable, even if such bonuses were not paid upon dollar earnings.

able if other countries were to be admitted to the sterling area without pooling the whole of their reserves, and therefore entitled to limited privileges in return for limited obligations that would have to be more clearly defined and formalized than has been the practice among the sterling countries belonging to the dollar pool. A member producing gold might be permitted to add it to his own gold stock — that is, not pay it into the pool — if he felt that the advantage to him of doing this outweighed the bonus that the other members were willing to pay him to persuade him to add it to the central reserves: it should be quite practicable to offer gold-producing members a bonus for gold or dollars paid into the pool even if no bonuses were payable on dollar exports. A similar plan to permit members to retain part of their dollar earnings so far as they saw fit to do so (in the light of the importance attached by the group to adding these earnings to the reserves) could be worked only if it proved possible to pay a bonus on dollar earnings.

(5) *To reduce or remove the possibility that dollar-surplus colonies might have their dollar purchases unduly curtailed by the subordinating of their import policies to Whitehall.* If all colonies, like all other member countries, could choose whether to import dollar goods and pay the charge or to import non-dollar goods free from it, they would receive compensation for their restraint in dollar importing at the rate representing the value set by the agreed sterling area policy upon such economies in dollar spending; when the total of charges paid in a period were shared out, moreover, these colonies would almost certainly be net gainers — since their dollar imports are small compared with their total trade. If it were practicable to establish a bonus scheme also, the dollar-surplus colonies would, of course, benefit still more. Any such scheme of financial incentives and rewards would make it quite clear how far the restraint of the colonies in dollar-importing at any time was of their own choice; if some part of it is — as has been suggested — justifiably regarded as a *quid pro quo* for certain services (such as defence) rendered them by the United Kingdom, the exact scale and nature of this implied transfer between the United Kingdom and the colonies would then have to be brought out into the open and effected by grants between them. It is clearly of major importance that a scheme should be devised whereby the dollar-

surplus colonies can willingly continue within the sterling area dollar pool when they have complete financial and economic autonomy — which in the case of Malaya and West Africa may be fairly soon. Unless some means is found of making it worth their while to remain in the pool, these countries may well feel it preferable to try to withdraw from the system — though one may doubt whether they would be likely to gain from doing so (though they would clearly gain from importing dollar goods freely while remaining members) over a period of good and bad years, in view of the fluctuations likely to be suffered by their export earnings. If, therefore, the considerable economies effected by the dollar pool are not to be lost to the extent represented by the withdrawal of some of its most important dollar earners, some scheme must be adopted to make it worthwhile for these normally dollar surplus countries to remain in the system, or to contract out of some of the privileges and obligations of membership if they believe it in their interests to do so.

(6) *To encourage all members to take into account the interests of the group as a whole — as represented by the level of the central reserves — in framing their policies.* It is clear that members' monetary (including exchange-rate and budgetary) policies, for instance, may well have a special effect on their dollar accounts, to which the government concerned will have no more direct incentive to pay attention than it will to a similar degree of deterioration or improvement in the total international accounts of the country. Similarly, it is desirable that United Kingdom capital issues control should give a special degree of encouragement to the financing of projects likely to improve the dollar accounts of the whole area. If members were in the habit of adjusting their policies in the light of the relative importance currently attached by the area to improving members' dollar rather than their non-dollar accounts — expressed by an agreed percentage preference for increasing dollar rather than other exports and for reducing dollar rather than other imports, based on the state of the reserves at a given time — no financial incentives would be necessary to achieve this end. But so far as either a charge or a bonus scheme could be introduced it would, of course, make it far more likely that members would take into account to an appropriate extent the dollar position of a group as a whole.

Possible Modifications to the European Payments Union

A proposed set of modifications to the EPU is that suggested by Mr Day.[11] He proposes that there should be grafted on to the EPU system, as it existed at the time of writing, a device which would encourage members to improve their dollar accounts. The main features of his proposals that are relevant to the present discussion are as follows:

(1) The EPU scheme should be continued within Europe and its monetary areas; settlements between members should continue to be made in different proportions of gold and credits, varying according to the size of a member's cumulative surplus or deficit with the rest of the Union. In due course, some sterling countries might become full members in their own right, each with its own gold reserves. They should be granted attractive drawing-rights on their becoming members — largely to compensate them for what they would be likely to regard as the unsatisfactory share of the central reserves that they would probably be granted when they left the dollar pool.

(2) All payments by member countries to the dollar area should be made through the Union, which would accept gold and dollars for this purpose to the full extent of the dollar payments due from them to the United States (or other dollar country) so long as members of the Union saw fit to maintain the present degree of discrimination against dollar goods. In order that the degree of discrimination might subsequently be reduced as the European countries' reserves rose, a proportion only of the payments due to the dollar area, perhaps at first 90 per cent, would be demanded in gold from members by the Union — which would, however, hand on 100 per cent of the gold payments due to the dollar area. It must, therefore, be assumed that the EPU would have a sufficiently large pool of dollar reserves — supplied partly by members, presumably, and partly by the United States, on the assumption that this is the best way of making use of such funds as the United States sees fit to allocate to these countries for the cause of freer trade and payments. But the proportion of gold demanded in settlement of debts to the dollar area would never be less than that demanded in settlement of intra-Union deficits.

The rights of members to draw dollars in settlement of intra-Union debts should be strictly limited, and bilateral balance of each with the dollar area should be the aim; the right to draw dollars from the Union would be given only to cover temporary divergences from bilateral balance of each with the dollar area.

[11] *The Future of Sterling,* chapter 13.

It will be seen that Mr Day's suggestions go some way towards encouraging the desired degree of discrimination against the dollar area, or, rather, in favour of other members. If, as he clearly envisages, the Union includes the major part of the non-dollar world, the fact that the discrimination is in favour of other members (a less inclusive term than the whole non-dollar world) rather than against the dollar area may not be a serious defect; but it should be borne in mind that the latter is the preferable objective, and that payments should be freed over as wide an area of the non-dollar world as possible, including countries that do not see fit to join the Union.

The degree of discrimination imposed by a member country would, under Mr Day's scheme, depend to a large extent upon its cumulative balance with Western Europe; indeed, it would be affected by that balance even more than it was under the actual EPU system. A member's settlements with Europe would be in changing proportions of gold and credit varying according to his cumulative deficit with other members, and this would determine the extent to which European imports were likely to be preferred to those from the dollar area. Furthermore, the extent to which a member was encouraged to reduce discrimination against dollar goods when the dollar situation improved would depend in large measure upon the proportion of gold and credit he was at present paying to the Union in settlement of his intra-Union debts.

Mr Day's suggestions are open to almost all the objections to the EPU system raised in earlier chapters (on the lines of the criticisms made by Professor Kahn). The cumulative nature of the settlements would ensure that a member whose normal pattern of trade involved a deficit with other members was under *increasing* pressure to avoid this — and to import more dollar goods — as the years went by. Indeed, since under Mr Day's scheme discrimination would cease whenever a member's gold payments to the Union were as much as the proportion of gold demanded from members in settlement of debts to the dollar area, extreme debtors to the Union (who were paying almost entirely in gold or who expected to do so in the near future) would have no incentive to improve their dollar balance rather than that with the rest of the Union.

Mr Day's suggestions would fail to secure the advantages of pooling so far as individual sterling countries ultimately entered it holding their own separate reserves; but his proposed method of making settlement with the dollar area would establish a form of pooling for the European countries. And in certain circumstances, as we have seen, there would be no inducement to a member to improve his dollar balance rather than his balance with the rest of the Union.

In view of these drawbacks to his scheme, one is tempted to examine other possible methods of attaining the same ends more efficiently; such a radical revision of the EPU as he suggests would be justified only if there were no better way of achieving the same result with no more radical a departure from the existing order. If the sterling countries were to join any such system as individual members, they should first consider whether some desirable improvement in the nature of their own co-operation might not be prejudiced by it. They should also consider how any more formal revision of the sterling area's own arrangements might be linked up with whatever is decided upon as the successor to EPU.

One proposal that should be considered is that of Mr Sargent, who has suggested that the EPU countries should settle their balances with each other in their own currencies, but with these currencies fully convertible into all non-dollar currencies, though not into gold or dollars.[12] (By this we must presumably understand 'any non-dollar currency not itself convertible into dollars'; any non-dollar currency becoming fully convertible would presumably have to be excluded.) As Mr Sargent says, this would certainly have the advantage of encouraging members to balance their accounts with the whole non-dollar world, without concentrating any necessary import cuts upon fellow members of EPU, as they are liable to do when these imports are more likely to cost them gold than are any others and when hitherto they have been importing goods relatively freely from this source.

Such an arrangement would certainly promote multilateral trade within the whole of the non-dollar world to the utmost of the European countries' power. As Mr Sargent recognizes, difficulty

[12] 'The Reform of EPU', *Bulletin of the Oxford Institute of Statistics*, February-March 1954.

would arise if some non-European non-dollar currency became hard from the viewpoint of Europe (or rather the Union) as a whole. The main objection, however, would be the complete absence of settlement in gold or dollars between members of the Union, which would make it impossible for any member to finance his dollar deficit to any extent at all by his earnings from other parts of the Union. He would still be able to negotiate settlements to some extent in gold or dollars with countries outside the Union, and if his dollar needs were great enough he would be thus encouraged to build up his exports to countries outside the Union that might be willing to settle partly in gold. But the complete impossibility of earning dollars from the rest of the Union would lead to an unnatural distortion of the non-dollar world's trade. On the face of it there is no reason why a country that has a strong natural pattern of surplus with Europe balanced by a deficit with the dollar area should not be enabled to finance part of its dollar deficit with its earnings from the Union. Even if such patterns of trade are being discouraged by the Union in some measure, this policy should not be taken so far as to make it quite impossible to sustain them.

Moreover, the complete absence of any gold or dollar settlement between European countries would probably tend to make markets within the area unduly soft; that is to say, that more of members' resources would be diverted from building up their dollar exports towards building up their dollar-saving industries than would be strictly desirable. Mr Sargent's proposals would further the objective of economizing in the use of dollars for the financing of trade within the non-dollar world and also, in the interests of stability, that of reducing the extent to which non-dollar countries are tied to dollar markets; but they would tend to give less than due weight to the desirability of maintaining trade between dollar and non-dollar areas at the highest level consistent with a fair measure of stability. There would be no way of using Mr Sargent's system to encourage the most appropriate emphasis upon dollar earning compared with dollar saving; and the proposals would be likely, if implemented, to lead to a lower level of trade between dollar and non-dollar areas than would be desirable in the interests of maintaining and increasing the level of real income in all countries concerned.

Any attempt to implement Mr Sargent's suggestion would give rise to at least one practical difficulty: countries such as Belgium or Western Germany, which apparently have a natural surplus with the rest of Western Europe, would not be likely to adhere to any scheme that gave them no rights to earn gold from Europe. At the least, these countries would have to be given specially favourable treatment in some shape or form. Moreover, those countries such as the United Kingdom, who believe it to be in their own long-run interest to give non-residents holding their currencies the right to convert them into dollars, could clearly not adhere to a Union in which it was a fixed rule that the members' holdings of each other's currencies could not be converted into dollars. Certainly, the degree and nature of the right to convert might well be limited; and every effort should be made to see that countries did not use this right to build up unduly their idle reserves of hard currencies to an extent that was not justified in terms of dollar goods forgone, since to do so would increase the size of the idle reserves held in the non-dollar world. The element of gold or dollar payment, of course, should not be completely excluded.

Nevertheless, the establishment and maintenance of a free and general inter-convertibility (or inter-transferability) of the currencies of the non-dollar world must be an aim of high priority — higher, in all probability, than that of full convertibility of current earnings into dollars. And some variant of Mr Sargent's scheme would have much to commend it. One possibility might be to settle balances within the payments union partly in gold (or convertible currencies) and partly in currencies fully transferable within the non-dollar world (except into currencies themselves convertible into dollars). This would certainly be preferable to the actual EPU system, which confined settlement of the non-gold portion of intra-area settlements to credits usable only within the area, but which gave the prospective right to gold payments at some future date, even if the Union currencies had not in fact by that time become generally convertible into gold.

If the adoption of the Kahn proposal that amounts to a cancellation of part of intra-Union balances were found unacceptable, a feasible alternative might be as follows. An agreed proportion of each month's balances should be settled in gold — thus giving the agreed degree of inducement to members to import from each other, rather than from the dollar area. The remainder should be payable in the way Mr Sargent suggests — that is, in currencies convertible into any non-dollar currency. Even if some of the main European currencies were convertible for currently accruing balances, it would still be possible, by agreements among European countries through the Union, to limit the extent of this to the right to turn only a stated proportion (or an agreed total in a certain period) of their earnings of the 'convertible' currency into dollars — on the understanding that the remainder would be fully convertible into any other non-dollar currency. The proportions could vary from country to country, and also from time to time as the strength of the convertible currency waxed and waned. It could thus be a useful means of transition to — or a temporary retreat from — full convertibility.

The Kahn proposal for partial cancellation of intra-Union debts should not, however, be excluded from consideration. If the remainder of the balance due in an accounting period were settled in convertible currency (or perhaps part of it in very widely transferable currencies), the cancellation of the remaining proportion of the balance due in an accounting period might be rendered more readily acceptable to creditor countries. This procedure would avoid the cumulative building up of debts to the Union, the extent of whose ultimate convertibility into gold would depend upon future negotiations. As has been indicated above,[13] vagueness about how far debts to the Union will ultimately involve the payment of gold can be strongly criticized as serving to conceal the real state of affairs from both debtor and creditor countries, and thus removing the inducement for them to make the changes in their pattern of trade and production that will eventually be necessary if equilibrium is to be restored to the accounts of the countries concerned. Both those countries that are likely to be in surplus with the Union and those likely to run a deficit with it should be quite clear about how payment will be made between them. An adequate inducement will have to be provided for the former in the shape, probably, of a greater percentage of payment in convertible currencies than need be paid to one of the second group when he

[13] See p. 94.

achieves a surplus. But if no satisfactory arrangement can be reached with a potential European surplus country, there is no reason why the remaining countries should not form a union among themselves for the promotion of trade between them — especially to defend themselves against a deterioration in their dollar accounts or a world trade recession.

Within the sterling area a comparable scheme adapted to a group of countries pooling their reserves could be evolved on the lines already suggested. It would be effective in securing the desired ends if agreement could be reached on the basic rate or rates involved, especially the more practicable rate to be applied to discourage dollar imports where appropriate. (This, of course, is also the crux of both the Kahn-Mikesell and the Day schemes.) It could, on the other hand, be held in reserve in case more informal methods of securing the same ends among the sterling countries were unsuccessful. The continuance of the more informal methods hitherto adopted might be preferred; but if so, it would be desirable to adopt more clearly defined principles to ensure that discrimination was practised in the way that would bring the greatest long-run gain. Either arrangement could be grafted on to the EPU as it now stands or in any of the forms that have been discussed. Or, rather, it would be truer to say that it would be independent of the EPU arrangements; the sterling countries would continue to share a common quota in the EPU, and the arrangements made within the area would continue to be quite independent of the arrangements made by the sterling area with the EPU group. If the present (1955) EPU system were maintained and settlement made mainly or wholly in gold or convertible currencies, some form of incentive scheme could usefully be applied to payments between the sterling area and the rest of the Union to encourage all sterling countries to exercise economy in spending European currencies and to find ways of increasing their exports to Europe. This would imply a sort of double-decker scheme of discrimination, one that rewarded dollar economies more than those made in European currencies. Once again, if the full theoretically-satisfactory scheme were deemed cumbersome, unworkable, or too formal, ways should be found of obtaining the same or similar effects by applying agreed principles about the degree of discrimination to be applied generally throughout the sterling area against European goods and about the extent to which industries earning European currencies should be given a special stimulus.

There would be no essential reason why a European country — or any other — should not be admitted to the sterling area dollar pool, even if it continued to be a member of EPU. If the sterling area was applying a more rational system of discrimination against dollar goods than the haphazard system applied by other non-dollar countries holding their own reserves, the consequent broadening of the group that was selecting dollar imports according to relative costs would improve the chances of reducing the non-dollar world's deficit at the lowest real cost. The outside country might agree with the sterling countries that neither would discriminate against the other's goods (regardless of their EPU cumulative surplus or deficit if the outside country were a member of EPU); and it might contribute a sum (perhaps its whole gold reserves) to the central reserves of the sterling area. In return it might be allowed to draw on the central reserves of the area, either to a defined extent or as freely as other members, provided it exercised a degree of discrimination against dollar goods similar to that exercised by them at the time; to this end it would be helpful to be able to express the degree of discrimination practised, in the form of a percentage preference for non-dollar goods at existing prices. If the co-operation of the incoming country could be relied upon as fully as that of sterling area governments, such an agreement might be workable without more formal arrangements; if not, it would be helpful to have a system of financial inducements to the incoming country to earn and save dollars as in the form outlined above.

Such inducements could be readily grafted on to any sterling area scheme of this sort that might be adopted; but they could also be evolved to meet the need for a more formal arrangement with such an incoming country on the supposition that the sterling countries prefer to work towards the desired end among themselves by less formal methods of co-operation. They would, in either event, bridge the difficult barrier that at present makes it hard to extend the dollar pooling system, namely, that it is an informal arrangement depending upon a long tradition of mutual understanding and co-operation, so that no other country could enter on a similar footing. More formal arrangements within the area might facilitate the making of more formal arrangements with outsiders who desired to enter the pooling system; but it would not be essential to adopt such a scheme internally, though a full consideration of it and of alternative methods of achieving the same ends would surely serve to show the advantages of making such arrangements with outsiders — relations with whom are not conditioned by a long tradition of informal co-operation in the matter of drawing upon the dollar pool. Along such lines as these the pooling of dollars, and therefore the economies made in their use by the non-dollar world, might be greatly extended.

X

REGIONAL PAYMENTS SYSTEMS AND CONVERTIBLE CURRENCIES

THE foregoing proposals have been made only partly in the context of the very limited degree of convertibility into dollars of most dollar currencies that prevails at the time of writing. It is believed that some form of them could be used (1) to make the best of the present limitations upon convertibility and of the present degree of discrimination against dollar goods; (2) to work towards convertibility and non-discrimination in a manner that would maintain the real income of the non-dollar world at the highest possible level while this was being done, yet retaining for each country complete liberty to frame its own economic policy; (3) to facilitate the maintenance of convertibility or non-discrimination or both, should they be attempted by the main non-dollar countries; and (4) as a system that could be held in reserve in case the non-dollar world was forced to withdraw, to an agreed extent, from the degree of convertibility and non-discrimination that had been attempted — for instance, because of a world recession, coupled with a drain on member countries' reserves of dollars that was too great to be met from available sources of emergency dollars such as the IMF.

In each of these cases, the incentive given to sterling and EPU countries to improve their dollar accounts would encourage members to effect, at the lowest real cost to the group, the economies in dollar imports that were necessary for rebuilding or maintaining the reserves needed to support the desired degree of convertibility and non-discrimination. The proposal to give outside countries certain rights to draw on the sterling area's dollar pool would be a way of extending the convertibility of sterling in step with the reduction of dollar import restrictions by the sterling countries; where there were dangerous risks in granting convertibility to all non-sterling countries it could thus be granted to those countries whose co-operation could be assured in restraining dollar imports to the extent being practised by the sterling countries. It could also be a means of ensuring that the countries receiving this right did not reduce their imports from sterling countries in order to increase their earnings of sterling and convert it into dollars. There should be the added advantage that if this route to convertibility were used, there would be much less danger of convertibility being extended to non-dollar countries faster than dollar import restrictions were abolished by the sterling countries.

There are strong grounds for preferring that advances along these two routes should go hand in hand rather than that further advance in one direction should be sacrificed for a spectacular establishment of the other. The bias, if any, should be towards relaxing the sterling area's dollar import restrictions rather faster than the right of convertibility is extended to countries outside the area. The sterling countries' restraint in the matter of dollar imports has been the prime reason for the raising of the reserves to the point where either or both of these advances are under consideration, and, in all justice, there is much to be said for seeing that the sterling countries reap rather more advantage from this fact than do non-dollar countries outside the area, which do not share the credit for the rebuilding of the sterling area's reserves.

Moreover, if the opposite policy were adopted, and members of the sterling area found that non-sterling countries were consequently able to import dollar goods appreciably more freely than they, the strain on their loyalty to the sterling area would be considerable, and the state of affairs would constitute a poor advertisement for the advantages of membership. And there is good reason to favour the gradual relaxation of dollar import restrictions over the whole non-dollar world, rather than concentrating the freeing of dollar imports upon one group — in this case, non-sterling countries if non-resident convertibility preceded the abolition of dollar import controls by the sterling countries; less distortion of the natural pattern of trade is likely to result, and less protection to be given to any one domestic industry in any single country. This means that the adjustment in each individual case will be much less severe when the dollar import restrictions are eventually removed than if the industries of certain countries were protected by especially severe dollar import restrictions whilst dollar import restrictions were relaxed greatly elsewhere. Finally, if dollar goods were admitted very much more freely to non-sterling than to sterling countries — as a result of moving faster towards non-resident convertibility for sterling than towards non-discrimination by the sterling area — the relative plenty and consequent lower costs of dollar goods in competing countries would give them a considerable advantage over the sterling countries.

If the advance were made primarily by giving individual non-sterling countries defined rights to draw upon the sterling area's reserves, this would emphasize the undoubted fact that the restoration of the convertibility of sterling is an advantage that can be maintained and shared only so far as those benefiting from it play their part in establishing the conditions that will ensure its permanence. Moreover, an advance along this route would be more readily reversible, should an intensified dollar shortage or a miscalculation of the consequences of convertibility make this necessary. On the other hand, a general advance to virtually complete convertibility of non-resident sterling is irreversible in the sense that the shock to world confidence that its reversal would bring about might prevent another attempt from being made for a long time to come. It is true that an approach by way of 'commodity convertibility' would be fairly readily reversible, but any such reversal could deal a severe blow at the United Kingdom commodity markets concerned. Moreover, the commodity approach gives a special privilege to certain countries — notably, of course, the United Kingdom, whose merchants benefit from the additional earnings that result from it and whose consumers and manufacturers benefit from this complete abolition of dollar import restrictions against certain commodities of great importance to them.

Similarly, this sort of convertibility brings great advantages to those other non-dollar countries who happen to require the dollar commodities whose import to, and re-export from, the United Kingdom is permitted. On the other hand, there are inevitably other equally deserving countries which might have preferred to buy different dollar commodities through the United Kingdom; and the other sterling countries may well be maintaining dollar import restrictions upon commodities often no less essential to them than are the freely imported dollar raw materials to the United Kingdom.

These countries would naturally prefer a greater degree of choice about the ways in which their sterling is convertible into dollar goods. And, especially since the sterling area's dollar import restrictions seem to have benefited the United Kingdom considerably, at the expense of the other sterling countries,[1] there are strong grounds for granting the other sterling countries the main say about how these restrictions should be relaxed. Ideally, the relaxations should not be focused upon commodities chosen merely or mainly because their free import and re-export is likely to be most advantageous for United Kingdom merchants and consumers, but upon those commodities whose freer dollar import is likely to do most to raise the standard of living of the whole non-dollar world, or, at the least, the sterling area.

It is true that to grant to a defined group of countries (including countries at present outside the sterling area) the right to convert sterling into dollars, whether to a limited or unlimited extent, would tend to focus the relaxations in the non-dollar world's dollar import restrictions upon a few countries. But the number of countries enjoying the privilege on such terms as these could be as wide as was desired, for to extend it to more countries would not increase the strain on the reserves so long as the right to draw was closely related to the obligations assumed in the shape of a dollar contribution to the pool, or a readiness to import freely from other members, or to discriminate not less against dollar goods than the sterling countries were doing at any one time. The main limiting factor would be the skill of the governments concerned in drafting agreements that would express the relative advantages to both sides of giving and receiving this fuller right to convertibility. If one opposes the extension of convertibility by special arrangements with individual countries or groups of countries, on the grounds that it would be preferable to extend it over a wider area, one is in effect saying that the right should be given also to unreliable countries who would exercise such a strain on the reserves as would make the maintenance of convertibility very problematical.

Even when the main currencies have been made fully and officially convertible into dollars, there may well remain an important place for institutions such as the sterling area and a modified

[1] See Chapter IV.

form of European Payments Union, for the control of the balance of payments of these groups of countries with the dollar area (in such a way as to maintain the convertibility of their currencies with the minimum of adverse effect) is far more likely to prove successful if they co-operate closely in matters related to their international trade and payments.

One method of keeping their dollar accounts in equilibrium may well be the use of exchange-rate variations — either occasional changes of a fixed rate or of variations within limits. As most countries would probably prefer some element of fixity of their exchange rates with other non-dollar countries, this is likely to mean that most of them would keep their exchange rates fixed on sterling or another main currency and that variations in the major currencies *vis-à-vis* the dollar would then be used to keep the non-dollar world's accounts with the dollar area near to equilibrium. If this method is used, it is clear that there will be considerable need for close consultation among the various countries concerned in order to carry out an exchange rate policy *vis-à-vis* the dollar that will command their general approval.

In any event, it is unlikely that flexible exchange rates would be able to bear the whole of the burden — and perhaps not even the main part of it — when the dollar accounts of these countries were undergoing periods of difficulty, for adverse speculation against their currencies might well be encouraged rather than checked by depreciation *vis-à-vis* the dollar at such times — especially if their gold and dollar reserves were not particularly large. Moreover, in times of appreciable unemployment in the United States, exchange-rate variations might be a far less defensible way of endeavouring to restore balance; and it is in such circumstances as these that dollar import restrictions would be most generally considered defensible as a means of checking the spread of unemployment. Accordingly, the extent of the devaluation necessary to restore equilibrium might be great enough to involve a very serious adverse movement in the terms of trade of the non-dollar world, whilst the use of discriminatory dollar import restrictions might be a means of greatly reducing the fall in real income that the non-dollar countries would have to undergo. In addition, there may well be circumstances in which no alteration of the exchange rate of non-dollar currencies *vis-à-vis* the dollar would restore balance of payments equilibrium whilst still permitting full employment in the non-dollar world[2] — though it is unlikely that these circumstances would be readily recognisable when they occurred, at any rate in time for the appropriate policy decisions to be made.

There may also be longer-run arguments for the use of some degree of dollar import restrictions. The reduction of the uncertainty and technological unemployment in the non-dollar world attendant upon the rapid rate of technical progress in the United States may afford grounds for preferring a lower level of trade and dollar import restrictions upon certain goods to a higher level of trade and the greater instability it might carry with it. Some countries may also feel that by checking the demand of some of their population for dollar products, savings of foreign exchange and of internal resources will be be made without a proportionate loss in consumers' satisfaction — on the grounds that much of this consumption is based on 'snob-value' rather than rational preferences. Poorer countries may at times find import controls — especially upon luxury goods of types most readily obtainable from the dollar area — a more effective and administratively practicable method of checking internal consumption or of redistributing income than taxation policy.[3]

These and other arguments can be used in various circumstances to support dollar import restrictions. At the same time, it is very probable that, if left entirely to themselves, countries will be tempted to impose dollar import restrictions of a type that will not be the most likely to secure the main aims of policy for the non-dollar world as a whole; to select dollar imports on somewhat vague criteria of social desirability rather than real costs; and to refrain from imposing them in circumstances where they would be desirable from the viewpoint of the whole non-dollar world, and when other non-dollar countries as a group would find it well worthwhile to bribe the non-conforming member to follow a dollar import policy similar to their own.

[2] I am indebted to Professor T. W. Swan for having pointed out to me that such a situation is at least theoretically possible.

[3] In these paragraphs I have had in mind the discussion of these matters in 'The Dollar Crisis Revisited' by T. Balogh, *Oxford Economic Papers*, September 1954.

It would seem, therefore, that if dollar import restrictions are to be imposed, this policy of discrimination should be adequately considered by all the main non-dollar countries acting in concert: and that they should agree on the main principles to be applied in selecting dollar imports and the main aims of the policy of discrimination, as well as on the circumstances in which it would be justifiable to tighten or relax restrictions.

Moreover, in order to secure conformity to the main principles agreed upon, it will probably be necessary to persuade some countries that would otherwise not have chosen to impose dollar import restrictions (or at least not restrictions imposed in accordance with the agreed principles) to do so by instituting some form of incentive system. In fact, it may very well not be in any individual country's own interest to apply dollar import restrictions that are undoubtedly in the interests of all non-dollar countries considered as a group. Whilst informal 'gentlemen's agreements' may secure the necessary submission of one country's interests to those of the group where the tradition of close co-operation is well established and the need very acute — as amongst the sterling countries in the immediate post-war period — this is unlikely to be sufficient to ensure an appropriate concerted policy of dollar import restrictions in the longer period, if and when these may seem to be necessary, especially if it proves possible and desirable to remove them completely in good times and is then necessary to revive them to meet a suddenly occurring difficult situation. In such circumstances it would be essential to have some appropriate machinery available that could be set in motion to secure a logical, concerted policy of dollar import restrictions that will do the maximum of good (or minimum of harm). In other words, at the very least, the sterling area and the successor to the EPU should in the future (whether separately or as one single monetary organization) consult regularly about the problems involved in securing the equilibrium of their accounts with the dollar area. Moreover, they should draw up a plan of economic defence — which would include a fully thought-out policy for applying the desirable minimum of dollar import controls in different foreseeable situations — a plan that could be brought into effect at short notice in the event of a serious deterioration in their dollar accounts.

It has not been the author's intention to pronounce upon the weight of the various arguments in favour of some measure of dollar import restrictions. They are of sufficient weight, however, to make it likely that various governments will at times see fit, rightly or wrongly, to apply such restrictions. It is clearly important to examine to the full the circumstances in which they may be desirable, and the principles that should govern their application, but for the present purpose the main point is that machinery should be set up to minimize their adverse effects and to secure the participation of as wide a group of countries as possible in the implementation of whatever policy of dollar import restrictions is thought desirable, and to secure the desired effects with a minimum of disruption of the channels of world trade. It is notable that a wide range of opinion among economists would advocate dollar import restrictions under some circumstances — if only as a means to facilitate the establishment of convertibility of the major currencies for non-residents. And it seems that the IMF and GATT have agreed that quantitative discriminatory import restrictions could be imposed by members if the Fund's ability to supply dollars to members was seriously affected — for example, by the use of the resources of the Fund to support the restoration of convertibility to major currencies.[4]

Throughout this book the viewpoint adopted has been almost exclusively that of the countries participating in the payments systems discussed, and that of the groups themselves, each considered as a whole. The justification for this is that the sterling countries and those of Western Europe have a set of payments problems to face *vis-à-vis* the outside world — and the dollar world in particular — towards the solution of which the adoption of suitable payments mechanisms can contribute considerably. This is not to deny or to minimize the importance of wider problems, nor the considerable possibilities of international co-operation on a wider scale, but merely to limit the field of discussion to the question of what these two payments systems (or future similar organizations) might do

[4] *General Agreement on Tariffs and Trade, Basic Instruments and Select Documents: Third Supplement; Decisions, Resolutions, Reports, etc. of the Ninth Session* (Geneva, 1955), Reports Relating to the Review of the Agreement: Quantitative Restrictions, Sections 20 and 21 on the Balance of Payments.

to help themselves — given the various relevant circumstances over which they either have no control or which, of necessity or of convenience, they have to meet by action through other organizations or by other means.

It is, however, important to consider how other countries will be affected by the successful solution of the problems raised by the sterling area and EPU systems or by future payments systems that share their principal features.

The main purpose of such systems is to facilitate the making of payments among members and, at any rate in the case of the sterling area dollar pool, to maintain or improve the state of the dollar accounts of the group as a whole. To the extent that these objects are successfully furthered by the co-operation of the countries participating, certain effects on the rest of the world are likely.

First, as to non-dollar countries outside the systems. If the payments arrangements among members of these groups and the trade arrangements accompanying them encourage them to trade to a greater extent within the groups, this may mean that an outside country cannot achieve such ready access to markets or to sources of supply in the areas concerned as it otherwise could. But the adverse effects on international specialization that this would imply can be minimized, first, by making the currencies of members readily transferable amongst all countries in the non-dollar world, and, second, by a readiness on the part of all concerned to join in reciprocal reductions of trade barriers with countries outside the systems on the lines of the trade liberalization effected by the OEEC countries. The view has already been expressed that if other countries are willing to enter the payments systems on terms similar to those for members, this should be encouraged; indeed, the greater degree of formalization of the sterling area arrangements that has been proposed would probably facilitate the introduction — or partial introduction — of new members, since their obligations would be far more definite and enforceable, whereas the very informality of the present sterling area arrangements virtually precludes the addition of new members to the group.

It might be added that, so far as the existence of such organizations does tend to affect the pattern of world trade, there is no *prima facie* reason to suppose that this will work to the advantage of those within the group rather than of those outside it — except, perhaps, that if those within the group constitute a larger part of the trading world than those outside it, they may stand to lose less from the channelling in some measure of their trade within the group than will outside countries who will have been — to however small an extent — cut off from markets or sources of supply over a wider range of countries than those within the groups.

So far as the existence of these payments arrangements effects economies in the use of gold or convertible currencies — by making it unnecessary (in greater or smaller measure) to use them for payments among members — the countries concerned will be to that extent better able to pay the gold or convertible currencies for goods purchased outside the area, and this will clearly be a benefit also to countries outside the group.

This same economy in the use of dollars will clearly have important effects upon the other group of outside countries — namely, those in the dollar area. Certainly such promotion of trade amongst members of the group as is undoubtedly the effect of the freer trade and payments tends to make them more likely to trade with each other and less likely to trade with the dollar area; but it also means that members of the group have more (or all, in the case of the sterling countries belonging to the dollar pool) of their dollar earnings and reserves available to finance purchases from (and payments such as dividends and interest to) the dollar world and other countries requiring payment in gold than if they had to use part of them to finance their trade and payments with each other. It is unlikely that this effect, which enables them to purchase more from the dollar countries than they would if the regional payments systems did not exist, would be outweighed by the undoubted incentive that such payments arrangements provide for non-dollar countries to concentrate less on expanding dollar-earning industries, and thus to reduce the dollar earnings and therefore indirectly the dollar-spending power of the countries belonging to the regional payments system.

It seems, then, that the existence of such regional systems is unlikely to affect adversely the total of exports from the dollar area, though the particular arrangements adopted can considerably affect the amount and the pattern of the dollar spending of each of the members of the group, and this will clearly affect the dollar area.

And if adequate arrangements can be devised for ensuring that where dollar imports have to be reduced — in circumstances where for one reason or another the use of exchange-rate adjustments is thought undesirable — this is done in those directions where the dollar product can be most readily replaced by similar goods from other sources, international specialization will be better served than if each country within the payments union chose where he would make his dollar import cuts in accordance with vaguer and less defensible criteria. The diversion of resources in the dollar area away from those export industries where the dollar area's comparative advantage was least would also be in the long-run interest of the dollar area. The successful implementation of policies that would divert resources throughout the countries concerned in directions that would be most likely to improve their dollar accounts at a minimum real cost would reduce the extent and the likelihood of the dollar import cuts that the countries concerned would have to apply (and dollar exporters therefore to suffer) in the event of a deterioration in their dollar accounts. It is in the interests of both dollar and non-dollar countries that such dollar import controls as are applied should be concerted by the non-dollar countries applying them in such a way as to maintain as far as possible the advantages of international specialization. In the two main roles of regional payments arrangements, then — the economizing in the use of dollars for payments between participating countries and the framing of the most appropriate dollar import policies — the interests of the countries in the union and those in the dollar area are likely to be broadly similar. The precise arrangements adopted by these payments systems are therefore clearly a matter of considerable importance to the whole of the trading world.

It is true that regional payments systems, even if broadly based, must be less satisfactory than adequate arrangements to secure the same ends covering the whole trading world; but they may also be better than wider groups that are unable to function smoothly — for instance, because some members are unable to carry out their obligations or to reach agreement with the rest. The wider the group the greater these difficulties must be; and there is a strong case therefore for retaining regional groupings to fulfil tasks that wider groupings such as the IMF and GATT are unable to perform. And there is no need to apologize for the fact that such groupings will be better able to confront the economic might of the United States or Soviet Russia, and to negotiate on more nearly equal terms with them than could any of the individual countries they comprise; some of the aims of the groups may, then, be divergent from those of outside countries, and there is no need to be ashamed to acknowledge that this sort of function may well be a motive for forming less than world-wide (or less than virtually world-wide) economic organizations. But this need not prevent such groups of countries from working amicably with countries outside the group; and there is everything to be said for an extension, where practicable, of the effective area of close co-operation — perhaps, as a beginning, between the independent outer sterling area countries and those of Western Europe.

At any rate, since there is likely to remain a place for the sterling area organization — and perhaps for some sort of successor to the EPU — even if monetary co-operation on a wider plane increases, it is important that the lessons to be learned from the experience of these two regional payments systems in the post-war decade should be taken to heart, both by the countries directly concerned and by others.

INDEX

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