Fabian International Bureau

POLICY
FOR THE
STERLING AREA

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INTRODUCTION

ALMOST EVERY man and woman in Britain who reads a daily paper or listens to the B.B.C. must be familiar with the language which has become the stock-in-trade of commentators on Britain's post-war economic position. " Dollar crisis," " balance of payments," " overseas investments," " invisible exports "—these and other phrases have been more often repeated than understood. Even the better informed have been baffled by the complexity of the problems; and none of these is more important than the future of the sterling area. In this pamphlet we aim at clarifying the principal issues involved and making some tentative suggestions about prospects that lie ahead.

The sterling area came into being in 1931, when Britain went off the gold standard. A number of countries, of which the Commonwealth (excluding Canada) formed the core, decided to peg their currencies to sterling rather than gold, and to hold their currency reserves in the form of balances with the Bank of England. Until 1939 the " sterling bloc " existed simply to expand trade between members, the pound still being freely convertible into foreign currencies. But the outbreak of war created an acute shortage of gold and dollars, which has continued ever since. In 1938 the United Kingdom could cover nine months' imports on its gold and dollar holdings—in 1951, only three. This dollar shortage has compelled sterling area members to impose exchange control, and to maintain tight import controls on non-sterling goods. There has had to be a tightening of what might be called the " rules of membership " (though, characteristically, these " rules " can nowhere be found in writing). At present they are as follows:—

(1) All dollars earned, and all gold produced or acquired by member-countries, are sold to the British Treasury and credited to the country's sterling account at the Bank of England. (There are a few exceptions to this rule, notably South Africa, which, by agreement with the Treasury, sells a large proportion of its annual gold output to the U.S.A., spending the proceeds on dollar goods for its own consumption. Otherwise all gold and dollars are paid into the central pool.)

(2) While relatively free capital movement is allowed between member-countries, no sterling area resident can buy non-sterling real assets or securities, or transfer currency outside the area, without special permission from his country's central bank. The central banks of the sterling area work in close co-operation with the Bank of England and the Treasury.

The object of the first rule is to enable all members to benefit from the gold-and-dollar pool, irrespective of their own dollar earnings, and to maximise opportunities for trade within the area.

Individual sterling area members are entitled to draw on the pool for any requirements they may have, and any drawings from the pool are charged against their sterling balances. But as the total potential demand for dollars far exceeds the supply—despite the additions to the pool since the war in the form of the U.S. and Canadian loans, Marshall Aid and M.S.A. funds—all members have to show great restraint in their dollar imports. The survival of the area depends on the maintenance of this restraint. Sanctions which can be applied against unco-operative member-governments are virtually non-existent, and many people feel that present conditions necessitate a tighter form of control, so that all members can be compelled equally to restrict drawings on the pool to essentials.

In practice, this virtual absence of sanctions has meant that any proposals for enlarging the area to include other countries come up against the crucial question: Can foreign governments be trusted, of their own free will, to restrict dollar imports to the tight limits imposed by sterling area membership? This is not just an academic question. Post-war experience shows that an irresponsible import policy by one member can jeopardise the solvency of the whole area. And, as the " banker " for the area, the British Treasury is directly involved.

POST-WAR PROBLEMS OF THE STERLING AREA

The Dollar Crisis

SINCE 1945 not only Britain but the whole sterling area has been faced with a persistent dollar crisis (though with the rest of the world the area has been in surplus every post-war year except 1951). What are the reasons for this crisis?

1. Before 1939, sales of gold from the sterling area to the U.S. were more than sufficient to offset Britain's adverse dollar balance. But, since the war, the purchasing power of gold has been approximately halved by the refusal of the U.S. (the sole important international buyer) to raise its dollar price from pre-war levels. South Africa, which produces nearly half the world's gold, has thus been transformed from a huge net dollar earner to a net dollar drawer. Had the price of gold risen in conformity with the general trend of commodity prices, the annual gain to the sterling area would have been in the region of $700 million.[1] U.S. aid since the war (excluding loans) has averaged about $450 million a year, and the annual fall in our gold and dollar reserves to the end of 1952 has averaged $90 million. So, other things being equal, if the price of gold had doubled (i.e. if its *real* value had remained unchanged), the sterling area could have dispensed altogether with dollar grants since the war (though not with dollar loans), and still enjoyed an average annual increase in the reserves of some $160 million.

[1] E. C. A.—" The Sterling Area," page 68.

2. In 1938, the overseas assets of the United Kingdom totalled about £4,500 million. In 1950, their estimated market value was down to £4,200 million,[1] while the purchasing power of the pound itself was only about 40 per cent. of its 1938 value. In other words, the real value of our overseas assets has fallen by about two-thirds—largely through sales of assets to pay for the war. In 1938, our net income from overseas investments paid for nearly 20 per cent. of our imports: in 1950, for only 4½ per cent.

However, roughly 52 per cent. of our overseas investment is in the sterling area, so only about half of the loss in investment income mentioned above represents a loss to the sterling area as a whole.

To this loss of overseas investments must be added the burden of war debts incurred both inside and outside the area. In 1938 the value of balances at the Bank of England held by overseas governments amounted to £700 million, or rather less than the total gold reserves: by 1945 they had risen to £3,700 million, while the total gold reserves amounted to only £600 million. In 1951 United Kingdom sterling liabilities had reached £4,370 million, of which £1,020 million was owed outside the sterling area. This represents a heavy burden of sterling indebtedness. Under normal conditions the maximum safe level for these sterling balances—i.e. the level at which the owners would be willing to hold them in the Bank of England—is about £1,800 million, less than half their present value.

3. In the 1930's, Britain enjoyed very favourable terms of trade, and the dominions and colonies correspondingly adverse ones. Since the war the situation has been reversed. The swing in prices against Britain and in favour of the rest of the sterling area reached about 40 per cent. in 1951, and was still some 30 per cent. in 1952.

It has not so far been found possible to work out terms of trade for the sterling area as a whole. But, since the terms of trade for the United Kingdom and for the rest of the sterling area tend to move in exactly opposite directions (the United Kingdom exporting manufactures, and the rest of the area exporting mainly primary products), and since the United Kingdom accounts for about half the area's total overseas trade, it is unlikely that the terms of trade for the area *as a whole* have changed appreciably since before the war—if one excepts the effect of the fall in the real value of gold.

To sum up: the sterling area as a whole has suffered since the war through the fall in gold values and, to a certain extent, through the loss of overseas investments and the incurring of war debts by Britain to non-sterling countries. On the other hand, prices (excluding gold) have moved in such a way as to benefit the overseas sterling area at the expense of the United Kingdom. The overseas sterling area has also benefited from the fall in the real value of its debts to Britain, and from the incurring of war debts by Britain to many of its members. The following table

[1] A. R. Conan, "The Sterling Area," page 121.

shows that Britain is no longer a net creditor to the rest of the sterling area:—

TABLE I

(£ million)	1938.	1950.
Value of U.K. investment in rest of sterling area ...	2,050	2,200
Sterling balances held by rest of sterling area ...	400	2,730
Balance of credit to United Kingdom	+1,650	—530

While the whole sterling area then has been adversely affected by wartime and post-war developments, a disproportionate share of the burden has fallen on Britain, while the other sterling area members have gained important compensating advantages. What use have they made of these advantages? Here we must draw, for the first time, a distinction between the dominions and the colonies. The following table, taken from *The Economist,* November 22nd, 1952, shows the net gain or loss of foreign currency by the United Kingdom, dominions and colonies from December, 1947, to June, 1952:—

TABLE II

	($ million)
United Kingdom	−580
Dominions	−2,540
Colonies	+820

During the same period U.S. aid amounted to $3,040 million. So five-sixths of dollar aid went, not to Britain, but indirectly to the dominions. Despite their improved terms of trade, the dominions have in almost every case incurred heavy deficits since the war, owing to a vast increase in the volume of imports.

The following table shows the trade balance with the U.S. of the United Kingdom, dominions and colonies for post-war years:—

TABLE III

U.K. ($ million)	1934-8 annual average	1948	1949	1950	1951	1952
Exports to U.S.	158	289	227	335	466	486
Imports from U.S.	462	644	700	511	901	669
Balance	—304	—355	—473	—176	—435	—183
DOMINIONS						
Exports to U.S.	125	646	545	711	983	729
Imports from U.S.	180	981	777	501	1,012	900
Balance	— 55	—355	—232	+210	— 29	—171
COLONIES						
Exports to U.S.	192	430	372	496	660	568
Imports from U.S.	50	315	300	194	193	185
Balance	+142	+115	+ 72	+302	+467	+383

These figures show how devaluation, by raising dollar prices in terms of sterling, forced the dominions to economise on dollar imports. But, except in 1950 and the first half of 1951, it has been left to the colonies to pay the sterling area's dollar bills.

Dominion demand for British goods since the war has also been very heavy, partly owing to the accumulation of sterling balances in the dominions. The following table shows the post war trade balance of Britain with the rest of the sterling area (R.S.A.), and the proportion of total British trade conducted with the area. But this and the previous table fail to do full justice to Britain, since they take no account of our considerable income from " invisible " items (shipping, banking, insurance, investment, etc.): —

TABLE IV

(£ million)	1934-8 Annual average	1947	1948	1949	1950	1951	1952
U.K. exports to R.S.A. ...	204.4 (40%)	561.4 (47%)	792.4 (48%)	934.8 (51%)	1,034.7 (48%)	1,308.7 (51%)	1,252.8 (49%)
U.K. imports from R.S.A.	257.2 (30%)	558.0 (31%)	751.9 (36%)	851.6 (37.5%)	989.5 (38%)	1,399.9 (36%)	1,437.6 (41%)
Balance	—52.8	+3.4	+40.5	+83.2	+45.2	—81.2	—184.8

Most of the increase in British exports was to the dominions, rather than the colonies. The biggest single increase was to Australia—from £38 million in 1938 to £324 million in 1951.

The heavy demand from the dominions has tended to attract British manufacturers away from dollar markets. To this extent it has delayed adjustment to the harder trading conditions of the non-sterling world and diverted British exports from earning foreign currencies. (In this respect, last year's import cuts by Australia and other dominions have proved a blessing in disguise to British industry.) Dominion demand for dollar and other non-sterling goods has also been a drain on our reserves.

Point Four in Reverse

The same criticism cannot be made of the colonies. Besides being substantial earners of foreign exchange since the war, they have in effect been creditors to the rest of the sterling area. This is shown by the change in composition of the sterling balances from 1945 to 1952. At the end of 1945, the colonies held 12 per cent. of these balances (£447 million); the dominions held 54 per cent. (£2,007 million), and foreign countries 34 per cent. (£1,234 million). By the end of 1951, the colonial share had risen to 25 per cent. (£964 million), while the dominions and non-sterling countries held 48 per cent. (£1,825 million) and 27 per cent. (£1,018 million), respectively. This redistribution was carried much further in 1952. By the end of that year, colonial sterling balances had reached a level of £1,065 million, not counting some £145 million of dominion and colonial sterling securities. Thus the rest of the sterling area has been borrowing from the under-developed colonial territories—a curious inversion of Point Four. One wonders if the African peasants realise how much they are contributing to our higher standard of living.

INVESTMENT IN THE STERLING AREA

It is clear then that tighter controls on imports by the dominions—especially Australia, South Africa, India and Pakistan—might have obviated many of the sterling area's economic difficulties since the war. Let us now look at post-war investment in the sterling area.

About £900 million of new capital flowed from Britain to the overseas sterling area between 1945 and 1951. This works out at £150 million a year, which, considering the United Kingdom's desperate capital shortage, is quite a respectable figure.

Total overseas investment in the outer sterling area is estimated (vide *The Banker,* November, 1952) at about £1,350 million between 1946 and June, 1952. (Roughly two-thirds of this would have come, on our figures, from this country; most of the rest came from the U.S.A.) Of this £1,350 million, Australia received almost £600 million, South Africa rather over £400 million, and the colonies about £240 million, mainly in Africa. The figure for colonial investment is particularly unreliable, and is made up as follows:—

Colonial Government Loans	£56 million
Colonial Development Corporation ...	£55 million
Overseas Food Corporation	£30 million
Private Investment (estimated) ...	£100 million

This amounts to less than half the value of our borrowing from the colonies during the same period (as shown by the increase in their sterling balances). Investment in other parts of the overseas sterling area was small.

What has happened to all this investment?

In the case of Australia, official estimates suggest that between one-third and one-quarter went into providing industrial capital. A large proportion of the remainder—about £300-350 million in 1951—clearly consisted of speculative " investment."

In South Africa, about a quarter of overseas investment went into commerce and industry. The same amount, or a little less, went into mining—especially gold mining. This leaves more than £200 million unaccounted for. Again, as in Australia, most of it must have been flight capital or " hot money." In both countries, much overseas capital seems to have gone to swell the real estate boom.

Dominions Investment

Exchange controls, like import controls, have been less effective in the outer sterling area than in Britain, and a good deal of overseas " investment " has simply travelled outside the sterling area altogether, via the dominions or colonies. Many observers believe that well over £100 million has disappeared in this way since the war.

Let us look a little more closely at the distribution of investment within the productive sectors of the Australian and South African economies. The object of productive investment is to raise output. The following table shows production indices for a representative selection of Australian basic and secondary industries, for 1951-52 (1938-39 = 100). In each case the indices refer to actual volumes of production:—

TABLE V

Basic Production.		*Selected Secondary Industries.*	
Wool	113	Electric motors and refrigerators ...	2,620
Wheat	104	Textiles (towelling, canvas, drills, piece-goods, rayon fabrics)	741
Lead	82	Internal combustion engines	1,096
Zinc	120	Ice cream	392
Coal	173	Beer	205
Steel	130	Tobacco	141
Meat	97	Houses completed (no pre-war figures available: 1945-46=100)	507
Milk	89		

The Australian economy has clearly made great strides since before the war. But have they been in the right direction? Wool, wheat, lead and zinc are Australia's basic exports. And although, in fairness, it must be said that 1951-52 was a bad year for agriculture, it is clear that by far the greater part of post-war Australian investment (and in 1951-52 39 per cent. of the gross national product was invested in some form or other) has gone into secondary industries. This is confirmed by the movement of employment figures.

TABLE VI

Employment in Australia by Main Industrial Groups.
('000s)

	Mining	*Factories*	*Construction*	*Transport and Communication*	*Professions*	*Other Commerce*
July, 1939 ...	52.5	539.7	150.9	198.5	262.6	374.6
June, 1952 ...	60.3	852.6	195.4	331.4	387.3	498.4

Unhappily, last year's import cuts have intensified this trend. Although some of the increased output of vehicles and engines has admittedly gone into agriculture and mining, very little progress has yet been made in developing Australia's vast natural resources, of which the free world is so much in need.

The situation in South Africa (where nearly 30 per cent. of gross national product was invested in 1951) is similar. Employment in manufacturing has more than doubled since 1938, while employment in mining has risen by only 6 per cent. The index of buildings commenced (1948 =

100) rose from 42.3 in 1938 to 151.9 in 1951; 1952's figure was 128.8. Real estate transactions are four to five times above pre-war values. While mining output has risen appreciably since 1938, the volume of agricultural exports has actually fallen. Neither in South Africa nor in Australia has the acreage under crops, nor the (white) agricultural population, shown any significant increase since 1939.

So, quite apart from the £500-600 million of overseas investment in Australia and South Africa since the war which fulfilled no useful purpose, it seems that much even of the *productive* investment in these two dominions was misapplied, in that it went into the production, not of basic essentials,but of secondary manufactures and of " services." The motives behind the drive for industrialisation and self-sufficiency in the white dominions are understandable—but none the less regrettable. For the world is at present suffering from over-production of manufactures and under-production of food and basic raw materials, as the following table shows: —

TABLE VII

Changes in the Volume of World Consumption, 1913-50.

	1913	1929	1937	1950
Food	100	116	125	131
Agricultural raw materials	100	149	194	178
Metals and fuels	100	150	170	239
TOTAL PRIMARY MATERIALS ...	100	127	140	155
Manufactures	100	152	172	247
Population	100	113	124	138

Even making allowance for the growing use of synthetic substitutes for raw materials, the world economy is clearly in danger of becoming lopsided. Food consumption per head is actually lower than it was in 1913. From this point of view, the industrialisation of Australia and South Africa—absorbing scarce capital resources which could have been used for developing backward colonial areas—has been an unhelpful trend.

It has also been unhelpful in its effect on the sterling area's current trade balance. For the new secondary industries in the dominions are mostly incapable of competing in world trade, having very high costs and serving only local, usually protected, markets. So far from aiding the sterling area in its dollar crisis, their growth has actually handicapped it. It is no accident that Australia and South Africa have been persistently heavy dollar spenders since the war. Much of the capital equipment required for industrialisation could only be supplied, in the early post-war years, by the U.S.A. But, while machinery has been the main import of the dominions from the U.S. since the war, there have also been heavy imports of American consumer goods (especially by South Africa). This again reflects the high level of investment in the white dominions. Investment, by creating employment—and thereby increasing incomes—raises costs, increases demand for imports, and in the short run makes exports uncompetitively expensive. This is not an argument against investment. No economy which does not invest can survive. But it is an argument for ensuring that investment is not wasted, and for supporting a heavy investment programme with adequate controls.

The failure of the dominions since the war to achieve dollar balance, despite their improved terms of trade, and the excessive diversion of British exports from hard-currency to dominion markets, both stem from a maldistribution of investment within the sterling area. This is directly due to the lack of any form of control over sterling area investment as a whole.

This rough analysis of the distribution of investment in South Africa and Australia should put in perspective the much smaller, though more widely publicised, vagaries of post-war colonial investment.

Colonial Investment

British investment in the colonies since the war has suffered from two main failings. In the first place, there has been too little " productive " investment by private firms in relation to public " non-productive " investment (in schools, roads, housing, hospitals, etc.). Secondly, where large-scale private productive investment has taken place, too little control over its operation has been exercised by local administrations. Too often such investment is designed purely to secure maximum exploitation of a particular natural resource, without any consideration for the living conditions of the workers. Sir Roy Welensky has stated that in 1950 about 45 per cent. of Northern Rhodesia's gross national product was diverted to this country as remittances to British investors. Much more could be done to ensure the co-operation of private capital in building up balanced colonial economies.

Colonial balances increased by about £620 million from December, 1945, to December, 1952, to a total of £1,065 million. Of this total, West Africa holds about 30 per cent., Malaya about 23 per cent., East Africa 21 per cent., Hong Kong 10 per cent., and the West Indies 7½ per cent. About one-third of these balances are held as backing for local currency, which is required to be backed 100 per cent. by holdings of sterling. So this section of the balances is not immediately available for spending. A further £199 million in December, 1952 consisted of funds held by colonial governments and other special bodies, and was fully tied up in pension funds, sinking funds, savings banks and similar commitments.

£133 million was held by the West African Marketing Boards and the Uganda Price Assistance Fund. This sum represents the difference between prices paid by the Boards to native producers of cocoa, palm oil and other local products, and the prices at which the Boards have sold these products on the world market. This £133 million is available to compensate local producers if world prices fall below local fixed prices, and cannot at present be spent on other purposes. Critics of the Marketing Board claim that, besides keeping producers' incomes at low levels, their operations have also *increased* fluctuations in those incomes. But, if raw material prices remain at their present comparatively low levels, producers should reap corresponding advantages in the future. The final settlement of this problem will have to wait on the achievement of Dominion status by Nigeria and the Gold Coast. (However, we should meanwhile associate their elected Governments more closely with the Board's policies and operations).

This leaves £370 million, held either by colonial governments and other public bodies, or as funds with United Kingdom banks. This £370 million, which represents the *true* borrowing of the rest of the sterling area from the colonies *at the present moment,* should certainly be used for colonial development.

Since colonial expenditure is controlled *de facto* from Whitehall, there is no immediate danger to us in allowing colonial balances to rise, as the owners are in no position to exercise their spending rights. But the progress of the colonies towards self-government makes such a policy short sighted, as well as selfish. If a colony, on attaining dominion status, finds itself with a large accumulated surplus of sterling, it is more likely to leave the sterling area, and use its sterling to buy dollar goods. As we have seen, Nigeria and the Gold Coast, who are among the major dollar earners in the area, also hold between them nearly one-third of the total colonial balances. Their withdrawal from the sterling area would be a major disaster for the other members.

Our borrowing from the colonies has saved us in recent years from the worst consequences of our failure to plan and control our investment in the dominions. But self-interest and fairness alike demand that this policy should end as soon as possible.

LESSONS FOR THE FUTURE

So FAR we have been concerned mainly with the errors of the past. How are we to avoid them in future? One solution which is very popular to-day (possibly because it would involve no effort on our part!) is that the Americans should raise the dollar price of gold. But there are no signs that they are willing to do so—and there is a very good reason why we should not press them on this point.

Responsibilities of Sterling Area Membership

The reason, which goes to the heart of the peculiar " club " structure of the sterling area, is this: about 85 per cent. of the sterling area's gold is produced by South Africa. South Africa is not politically sympathetic to the United Kingdom or other Commonwealth countries. It remains in the sterling area for two reasons: the convenience of free access to the London capital market, and the advantage of Commonwealth backing for its plea for a higher gold price. But the politics of the Malan regime have already led to a drastic fall in British investment in South Africa. If the price of gold were doubled (thus raising by about

50 per cent. the value of its exports), what inducement would there be to South Africa to remain in the sterling area? If South Africa were to leave the area after the gold price was raised, we woul ' certainly be no better off than we were before.

At present the sterling area is like a club with two kinds of members. One, the Dominions, are politically independent but economically too weak to face the world alone; the other group, the colonies, could in many cases stand on their own feet economically, but remain in political apron strings. Although this arrangement ensures adequate strength to the area as a whole, there is a clear danger of members in each category walking out of the club as soon as their own special disabilities are removed.

So far the Treasury has smoothed the strains of sterling area membership for the dominions, by what appears to be a policy of judicious appeasement tempered by exhortation. A blind eye has been turned to breaches of discipline, and faces saved all round by professions of loyalty and comradeship. This has been politically successful, but economically most costly. As we have seen, it has penalised the naturally polite (like New Zealand) and those constitutionally condemned to silence (the colonies). The noisy boys have secured the plums.

If the sterling area is to work effectively in future, two conditions must be fulfilled:—

1. The area's economic policies must be co-ordinated in a general plan. It is no good, for example, some countries starving themselves of necessary dollar goods if others are going to pile up large bills for non-essential dollar imports.

Policy, however, cannot be laid down and enforced solely by H.M. Treasury, but must be determined by member-governments as a whole. Each member must understand and freely accept its responsibilities under the plan. Moreover, there must be some means of applying sanctions *by the area* (not by Britain alone) against non-co-operating members.

2. If member-governments are freely to accept the constraints of membership, the sterling area must be made an intrinsically attractive proposition. Here the onus is on this country. What have we to offer to the rest of the sterling area?

The present government seems to be trying to placate the dominions by offering them sterling convertibility. This means that foreigners and dominion residents (but not British or, presumably, colonial residents) will be able to convert any sterling earned on current account (though not, in the first instance, sterling balances) into dollars. Convertibility in its pure form, as envisaged at the Commonwealth Conference last November, will now almost certainly not materialise, as the Americans fortunately refused to give the necessary financial support. But a modified convertibility, embracing also some or all of the Western European currencies, may well come into being in the not-too-distant future.

Convertibility is a mistaken policy. It would certainly impose a severe strain on our slender reserves. It would be almost impossible to maintain freedom of capital movements within the sterling area, without a flight of British capital into dollars via dominion " investment." Besides, such a policy would involve the continuation of the thoroughly bad post-war trend of the colonies earning a large dollar surplus for the dominions to spend. Britain, too, would have to cut imports drastically, in order to keep sterling scarce in world markets; otherwise our reserves would be swamped by a flood of claims for dollars. Since the success of convertibility depends on making sterling scarce, which can only be achieved by a sharp reduction in world trade, it is difficult to see how it can benefit the world as a whole.

Sterling convertibility should be postponed until our reserves have risen to the point where we can afford to abandon discrimination against dollar goods. This cannot take place until the reserves are at least four or five times their present size.

What can we offer the dominions in place of dollars? To this there are three main answers:—

I. We must supply them with the capital equipment and consumer goods at present supplied by the U.S.A.

II. We must increase the flow of investment capital to the outer sterling area. Unless the total flow of capital is increased, it is idle to expect the dominions to accept tighter control on its distribution.

III. We must try to provide long-term, stable markets for overseas sterling commodities.

What will this mean for Britain? Already, as we have seen, nearly half our total exports go to the overseas sterling area. Now that the " seller's market " is over, and harder trading conditions have returned to the world, sterling area sales no longer divert resources from hard currency markets as they did previously. Moreover, most of the dominions have now, by internal deflation or import cuts, succeeded in cutting their import bills to reasonable proportions. This was one of the main causes of the recession in consumer goods last year.

Producing for Export

It is no longer true to say, as it was a few years ago, that we sell too much to the overseas sterling area. We now need these markets to maintain full employment at home, as well as to provide us with exchange to buy our imports. Our problem now is to sell our goods wherever we can. So, as far as sales are concerned, there is no conflict of interest between ourselves and the rest of the sterling area, provided that we export products that the area really needs.

The whole post-war trend suggests that these are capital goods rather than consumer goods, and nothing in the last two years has occurred to alter this long-run assessment.

The long-term trend to-day is for backward countries throughout the world to develop their own consumer-good industries. To do this they need to import capital equipment. The world-wide industrial revolution, after a fairly prolonged pause since the 1920's, is now taking a further bound forward. So the future world market for capital goods seems fairly certain to expand, though an American recession in the next few years might well cause a sharp temporary relapse.

Nowhere is the urge towards industrialisation stronger than in the overseas sterling area. The following table shows how capital goods have dominated overseas sterling area imports from the U.S. since the war:—

TABLE VIII

Principal U.S. Exports to the Overseas Sterling Area.

	Per cent. of Total U.S. Exports to O.S.A. at Current Prices		Volume Index. 1949-50 (annual average 1934-38=100)	Exports to O.S.A. as per cent. of Total U.S. Exports of Commodity
	1934-38	1949-50		1949-50
Machinery	21	23	202	11
Chemicals	4	8	476	10
Vehicles	21	8	48	11
Steel products ...	4	7	407	12
Petroleum products ...	13	6	115	15

Source: E.C.A. *The Sterling Area.*

The smaller role played by vehicles, the only consumer good among the five main U.S. exports to the outer sterling area, since the war is noteworthy.

Obviously, increased British exports of these classes of goods to sterling markets would be a major source of dollar saving. Fortunately, Britain enjoys perhaps her greatest degree of comparative advantage in the production of many types of capital goods, such as engineering and metal goods, aircraft, ships, chemicals and instruments.

So by good fortune the world, and especially the sterling area, demands from us to an increasing extent what we are most fitted to produce. From almost every point of view we should now be moving resources out of consumer-good (especially textile) production, into the manufacture of capital equipment. But at the moment the net movement of labour in this country is in exactly the opposite direction. Why is this?

Looking back, it now seems clear that we should have made a much bigger effort, immediately after the war, to achieve this redistribution of resources. We would now be in much better economic shape had we done so. But the shortage of steel and other basic materials inevitably curtailed new fixed investment, while the housing shortage limited the mobility of labour. The demands of other priorities on our limited resources were acute. Besides, in the early post-war years, with Germany and Japan temporarily out of the picture, and a vast accumulated demand throughout the world (especially, as we have seen, in the dominions) for all types of manufactures, the easy profits which could be earned by all sectors of British industry discouraged any massive shift of resources.

Since 1951, however, none of these conditions has applied. The era of shortages and easy sales is over. Why then are we not adjusting ourselves to the changed conditions?

The fault lies with the Government's economic policy. In any society, particularly one with high levels of income tax and of employment, there are considerable forces making for inertia. All change involves risk and extra exertion. It is the task of economic policy, by the use of selective controls, to encourage resources to move where national interest dictates. The weapons at the disposal of the Government are immense: selective credit controls, selective initial allowances for capital expenditure, selective taxation rates—not to mention the use of physical controls, which a Conservative government is likely to be more shy of using!

Mr. Butler's Blunders

The present Government has made two great mistakes. In the first place, it has relied entirely on general controls. The use of Bank Rate as a means of adjusting economic activity means that all firms, irrespective of the national utility of their business, compete on equal terms in the capital market. The general shortage of risk capital moreover penalises new firms, who cannot rely on retained earnings to finance investment. A bias is given to conservatism in our industrial structure.

This is bad enough, but recently the Government has done even worse. By running a heavy Budget deficit, and by increasing domestic purchasing power through cuts in purchase tax and income tax, Mr. Butler has in fact made it more profitable to sell consumer goods at home than to produce exports or capital equipment. The dice are loaded even further against a redistribution of our resources. The result is that the British economy is moving in the opposite direction to that which is required of it. Home sales are booming, but exports are falling.

The " Butler approach " involves a laisser-faire monetary policy, a soft fiscal policy, an inflationary Budget deficit, and a relaxation in import controls. What is needed, if Britain is to play her part in the sterling area system, is the exact opposite of these things—i.e. a return, some way at least, towards the " Cripps approach." We need a much greater use of selective controls, to ensure that investment at home contributes to the needs of our export programme. Dollar-earning exports should continue to receive high priority; but an equally high priority should be accorded to dollar-saving exports to sterling countries.

But this in itself will not be enough. In addition to the great capital expenditure needed to transform our economy, we have to step up investment in the rest of the sterling area. It is now generally accepted that we should aim at a surplus of £300 million a year in our balance of payments, to be available for sterling area investment. £300 million represents about 2½ per cent. of our national income. This is the proportion of national income that United Nation experts have calculated rich countries should spend on developing backward areas. The U.S. is at present investing abroad about 3 per cent. of its national income.

An annual surplus of £300 million would enable Britain to raise by one-third the annual flow of new capital to the overseas sterling area, and to reduce the sterling balances to a " safe " level in about 15-20 years. It is about the minimum figure consistent with long-term solvency for Britain and the effective development of the sterling area.

Can it be achieved? From 1945 to 1951, as we have seen, we averaged about £150 million net new investment in the overseas sterling area every year. But this was covered by American aid worth over £300 million a year, while our short-term borrowing, as reflected in the increase in sterling balances, amounted to over £100 million a year. Since U.S. aid is likely to tail off rapidly in future, and will in any case be offset by the repayments due on the 1945 loan, we have in effect to improve our balance of payments by over £550 million a year, compared to 1945-51.

Clearly, this can only be achieved by the maximum effort on our part, and the maximum co-operation from other sterling area members. We have a right to demand that our capital is wisely used. As we have seen, nearly 50 per cent. of overseas investment in the dominions and colonies since the war resulted in no real capital formation whatsoever, and a large proportion of the remainder was devoted to industries of quite minor importance in the struggle for solvency and dollar independence. This situation calls for much stricter investment controls by the dominions. Wiser distribution of capital investment, quite apart from any increase in its total flow, can provide more development funds for the area.

A Sterling Area Organisation

At present, there is no permanent sterling area secretariat to ensure that investment is properly allocated, or that member-governments are implementing policies agreed at Commonwealth Conferences. This defect should be remedied. The situation is similar to that of Western Europe at the inception of the Marshall plan. A limited amount of American dollars then had to be divided among a number of countries. Each recipient government was asked to prepare a general plan setting out what it believed to be its minimum dollar requirements, and indicating how it would use any dollars received. At the same time, these nations set up a permanent multi-national body, the O.E.E.C. (Organisation for European Economic Co-operation), to collaborate with the American E.C.A. in weighing these various claims and supervising the distribution of dollars, and to co-ordinate economic policies in the member-countries.

For E.C.A. read the British Treasury, and for the O.E.E.C. countries the rest of the sterling area. A similar sort of organisation is desperately needed in the sterling area to-day.

What will be the effect on the British economy of maintaining such a heavy burden of overseas investment? The crucial question will be the effect on home investment. If our economy is to achieve the re-adaptation which we believe necessary, home investment must also be increased, as well as more effectively allocated. Since the war, gross fixed investment has averaged about 15 per cent. of national product, a lower proportion than in almost every other Western European country. Less than half of this investment has gone into providing buildings and equipment for manufacturing industry. Most people would say this was far too low a proportion.

In the industrial race we are falling behind, not only America (which is replacing its industrial equipment at twice the British rate), but also Germany and other European competitors. Our future depends on our industries maintaining competitive standards. Increased sterling area development will make this more difficult.

If we are to succeed in increasing both home and overseas investment, we must accept a fall in consumption in the short run. Eventually, of course, the higher level of investment should produce a more than equivalent rise in output; but meanwhile there may have to be further cuts in our welfare services, and there will certainly have to be cuts in the amount of new housing. On the other hand, if the international situation improves, a reduction in defence expenditure should be possible. In any case, the dominions should be accepting a larger share in the common defence burden. At present, Britain is spending 12½ per cent. of national income on defence; Australia is spending 6 per cent., New Zealand 4 per cent., and India and South Africa are spending 2½ per cent. each. There is considerable scope here for " spreading the load." Before the war the unequal distribution of incomes enabled the rich to do most of the country's private saving—and to grow richer in the process: we cannot tolerate a return to this position. So either the Government must continue to finance investment out of a large Budget surplus, or private savings by ordinary people must rise. But only a partial return to the war-time pattern of rationing and widespread price controls can make the latter possible, since only thus can the average pay packet yield a margin for sufficient saving. This dilemma must be squarely faced.

Alternative Sources of Capital

So much for the short run. Looking further ahead, it may be necessary, however, to find auxiliary sources of capital for sterling area development from outside the United Kingdom, so that we can devote more of our own investment to modernising our industries and improving our social services. The only possible sources of capital on a large enough scale are the U.S.A. and Western Europe. But there are difficulties with both of these. Since the war, American private investment abroad has averaged about $650 million a year, or £232 million at current exchange rates; this is equivalent to about 10 per cent. of the U.S. annual surplus on current account. Of this £232 million, about 38 per cent. has gone to Latin America, and 25 per cent. to Canada. 15 per cent. has gone to Western Europe, including the United Kingdom. Most of the rest has gone into Middle Eastern oil production.

This situation is unlikely to improve, even if the rate of return on domestic investment in the U.S. falls—as it very well may. American foreign investment is likely to concentrate more and more on the New World countries, which are strategically safe, politically amenable (on the whole), and which do not (except for the " A.B.C. bloc " in South America) discriminate against U.S. imports.

This brings us to Western Europe, and the so-called " Strasbourg Plan " of the Council of Europe. This plan envisages the gradual fusion of Western Europe, with its dependent territories, and the sterling area, in a single economic " bloc "—a veritable " third force " between the dollar and the rouble, with a population of some 950 million, and an area covering a third of the inhabited globe. At first sight, such a plan looks extremely attractive. Western Europe and the sterling area are already closely linked through E.P.U. (the European Payments Union). Western Europe is a large net importer of raw materials, and exporter of manufactures—especially capital goods; it suffers from a chronic labour surplus. The sterling area, as we have seen, suffers from a shortage of capital goods. The overseas sterling area also needs stable markets for its primary products, and the white dominions need European immigrants. In many ways the overseas sterling area is ideally fitted to replace Eastern Europe as a hinterland for the West.

It is of course recognised that any such fusion must be a very gradual process. The credit quotas in E.P.U. would have to be progressively enlarged, tariffs scaled down, and trade between the various territories completely liberalised. Finally, all countries concerned would pool their reserves.

From Europe's point of view, the advantages of such a scheme are obvious. It could prove of benefit to us too, but only if these two conditions are fulfilled:—

1. Western European countries must be both willing and able to abide by the rules of the sterling area—to keep dollar expenditure within reasonable bounds, and to maintain exchange control. Otherwise there is a danger of the whole bloc trying to live off the dollar earnings of the outer sterling area and the handful of " hard " European currencies (whose owners might in any case decide to stay out of the bloc). In other words, the Strasbourg Plan can only be accepted as a means for enabling Europe to do without dollars—not as a means whereby she can get more dollars.

2. Western European participation in the sterling area can be most useful to us as providing a source of investment capital. Unless Western Europe can acquire and make available for sterling area development a capital surplus, it is possible that the net effect of fusion on the sterling area would be unfavourable.

West European Future

To-day, unfortunately, Western Europe is still a heavy net importer of capital. But sound financial policies and a slight recession in business activity might well lead in the next few years to the emergence of surplus savings in Western Europe. Besides, large-scale emigration (the white dominions are estimated to require some 250,000 immigrants a year for full development of their economies, and Western Europe's surplus population is estimated at 4½ million) would tend to lower the demand for investment in Europe, while raising it in the dominions. There are some grounds, therefore, for regarding some sort of federation on the lines of the Strasbourg Plan as a long-term possibility.

In a world dominated by cold war and chronic dollar shortage, the Strasbourg Plan seems to offer a logical solution to problems which otherwise appear well-nigh insoluble; the problem of Europe's survival without dollar aid, and the problem of world capital shortage. We should, therefore, make every effort to ensure that the conditions which would make it possible are fulfilled. We should encourage Western European integration, we should support the movement for higher credit quotas in E.P.U., and we should press for greater trade liberalisation throughout Western Europe. But at the same time we should make quite clear the minimum conditions under which we could contemplate fusion with Western Europe. Those conditions at present are not being fulfilled, and until they are there is no likelihood that a " third force " as here described would prove an economic proposition.

Meanwhile, the burden of sterling area development must be borne for the most part by Britain alone. We have shown above what this is likely to mean for us: higher production (on O.E.E.C. estimates a minimum increase of 9 per cent. in the next year), more exports (according to the same authority, 10 per cent. more exports to non-sterling countries by 1954), fewer imports, more saving, less expenditure on consumer goods, and a more efficient allocation of home investment.

We have not yet discussed the third way in which Britain can help the rest of the sterling area—i.e. by the provision of long-term guaranteed markets for primary products. But, before doing so, we propose to examine briefly some of the priorities for sterling area development.

PRIORITIES FOR INVESTMENT

The Paley Report

THE FIRST requirement of future sterling area investment is that it should stimulate dollar earning, or dollar saving (through the development of sterling substitutes for dollar imports). Fortunately, we have in the Paley Report, published last year, some indication of the way in which American demand for, and supply of, commodities is likely to change in the next 25 years. This Report analyses the needs of the American economy in 1975, on the dual assumption that prices remain at the 1950 level, while production doubles from its 1950 figure (as production doubled between 1925 and 1950). The general conclusion derived from these, probably over-optimistic, assumptions is that the U.S.A. will be importing some 25 per cent. of its raw materials by 1975, as against 10 per cent. in 1950. Moreover, whereas in 1949 the U.S. was a net exporter of foodstuffs to the value of $700 million, by 1975 it is expected to be a net food importer, to the tune of about $1,800 million a year (at 1950 prices).

Unfortunately for us, the authors of the Report predict that most of the expected increase in imports will come from Canada and Latin America. For this reason, American private investment abroad is likely to go on favouring the New World.

The outlook for the sterling area in fact is very depressing, as the following table shows:—

TABLE IX

U.S. Imports of Main Sterling Area Commodities. ($ million)

	Total U.S. Imports, 1950.	From Sterling Area.	Estimated 1975 Imports at 1950 prices.	From Sterling Area.
Wool	320	182	415	234
Natural rubber ...	466	250	93	50
Tin	201	114	184	105
Petroleum ...	365	41	730	82
Manganese ...	42	31	63	47
Copper	218	22	800	81
Lead	119	13	308	33
Zinc	67	10	201	30
Bauxite	16	1	64	4
Iron Ore	40	1	116	3
Cocoa	230	114	253	125
Jute	130	117	52	36
Totals ...	2,214	896	3,279	830

Source: Paley Report.

This table assumes that the sterling area will continue to provide the same proportion of total U.S. imports of each commodity as it did in 1950. This may, of course, be too pessimistic—or optimistic. The anticipated fall in the value of the (present) main sterling area exports to the U.S. reflects the increasing replacement of natural rubber and jute by synthetic substitutes, and the long-term decline in the use of tin.

The Paley Report makes hard reading for those who believe that, given time, the dollar crisis will solve itself. But, besides emphasising the importance of sterling area investment, it provides some useful clues as to the form it should take. We must concentrate on the expansion of mineral and food (especially livestock) production. The sterling area has large reserves of copper, lead, zinc, bauxite, chromite, cobalt and manganese, all of which are expected to enjoy an increasing market in the U.S. If we can exploit these resources quickly and effectively, we may increase our share of the American market for these metals, and so improve on the estimates of Table IX. Besides, the area is fairly rich in the newer metals—South Africa's uranium, for example—which will presumably increase greatly in importance in coming years.

There is a further encouraging side to the Paley Report's findings.

Dollars can equally well be earned by sales to Canada or the fourteen Caribbean republics, as by sales to the U.S. In fact, the value of British sales to these markets is to-day some 50 per cent. greater than the value of our sales to the U.S., despite our extraordinary neglect of the Caribbean market. If American raw material purchases from these countries increase as anticipated, they will enjoy a considerable rise in their standards of living. British exporters will have a great opportunity of expanding sales in these markets.

Putting First Things First

But clearly, long-run sterling solvency can only be achieved (at least, at present rates exchange rates) by balancing dollar trade at lower levels. In the last chapter we pointed out that dominion expenditure on American capital goods can be reduced, if Britain steps up her exports of these goods. Similarly, sterling area investment should aim at increasing output of those types of food and raw materials which this country (and other sterling area members) mainly imports to-day from dollar sources.

Specifically, this means that we must stimulate greater production of wheat, sugar, tobacco and long-staple cotton. The reason for this is shown in the following table, which lists the main United Kingdom commodity imports from the dollar area, and is therefore more or less a corollary of Table VIII: —

TABLE X

Principal United Kingdom Commodity Imports from Dollar Area, 1948-51.

	Dollar Expenditure of United Kingdom, 1948-51 (£ million).	Per cent. of Total United Kingdom Imports of commodity coming from Dollar Area.
Wheat	125	63
Sugar	66	42
Tobacco	56	60
Crude Petroleum ...	50	30
Softwood	46	27
Raw Cotton	37	28
Copper	24	31
Aluminium	21	78
Maize	17	20
Woodpulp	15	13

Source: Trade and Navigation Accts.

Increased production of these commodities would also greatly benefit Western Europe, which relies largely on dollar sources for them at present. It might therefore be possible to persuade Western European governments to co-operate on development plans for some of these commodities, as a first step towards realisation of the " Strasbourg Community."

The Paley Report emphasises the danger, illustrated in Table VII, of increasing world food shortages. There are no signs of slackening in the rate of growth of world population. Such evidence as is available suggests that the Communist countries, formerly large exporters of food and raw materials, no longer have available agricultural surpluses for export in any great quantity. China, in fact, will probably develop fairly rapidly into an industrial country, importing food and raw materials.

Increased food production, irrespective of the effect on the dollar balance, is therefore a second priority for sterling area development. The need for greater livestock production has already been mentioned. Another, and perhaps more pressing, need is to step up rice and wheat production for South-east Asia. Ceylon to-day depends on rice imports from China, while India and Pakistan have only been saved from general famine in recent years by gifts of American wheat. The basic problem here is the shortfall in rice production since the war, owing to the civil wars in Indo-China and Burma. Until this has been made good, the whole economic and political position in South-east Asia must remain precarious.

Much can be done to raise agricultural output in backward areas by means of irrigation, fertilisers, agricultural machinery, and the use of modern crop-rotation and storage methods. But lasting improvement requires a major redistribution of population, through the removal of surplus agricultural labour from the land. In India, for example, it is estimated that present agricultural output could be maintained, even under present methods of farming, with only 75 per cent. of the labour force currently employed.[1] In Kenya rural over-population has led, as we all know, to a tragic state of unrest and civil war. When the land has to support too many people, it tends to be overworked; the resulting soil erosion ruins fertility, and reduces still further the amount of cultivable land.

So a third priority for investment is to create alternative employment in regions of rural over-population, notably in India, parts of Africa and the West Indies. This means, in most cases, a further growth of secondary consumer-good industries. Where a large part of the population is engaged in producing a commodity for which world demand is declining (such as Malayan rubber or Indian jute), investment is also required to broaden the economy's productive base.

But it is not enough simply to invest capital in plant and equipment. Roads and railways must be built to transport the products, port facilities must be developed, and (if we wish to insure against industrial and political unrest) houses, schools, hospitals and other amenities must be provided for the workers. Too much of this " non-productive " investment in the colonies has so far been left to the government. Private companies operating in backward territories, such as the Rhodesian copper companies, must be induced to devote more of their profits to raising their workers' living standards. We simply cannot afford to

[1] Vide Prof. W. Arthur Lewis: " Reflections on South-east Asia," in *District Bank Review*, December, 1952.

repeat in Africa to-day the horrors which accompanied our own industrial revolution.

Recently the African copper miners in Northern Rhodesia went on strike for three weeks; the employers estimated the cost to themselves as £4 million. Subsequently the Africans' wages were doubled by an arbitration tribunal and the companies complained that this would cost £750,000 a year. In fact it increased the share of the Africans in their product from 1 per cent. to 2 per cent.

Obviously we cannot fulfil all these commitments at once. The following table suggests a few of the possible candidates for overseas development in the sterling area. The list is by no means exhaustive, and is restricted to commodities:—

TABLE XI

Some Priorities for Sterling Area Investment.

Country or Area.	*Commodity.*	*Country or Area.*	*Commodity.*
Australia.	Lead.	New Zealand.	Meat.
	Zinc.	South Africa.	Uranium.
	Wheat.		Chromite.
	Meat.		Manganese.
	Sugar.	Pakistan.	Wheat.
India.	Bauxite.		Rice.
	Manganese.		
	Rice.	Malaya.	Rice.
Middle East.	Oil.	Ceylon.	Rice.
	Cotton.	East Africa.	Cotton.
			Rice.
Mauritius.	Sugar.	Rhodesias.	Copper.
Nigeria.	Cotton.		Chromite.
	Columbium.		Cobalt.
West Indies.	Bauxite.		Tobacco.
	Sugar.	Gold Coast.	Aluminium.
	Rice.		Manganese.

A Sterling Area Investment Board

In order to channel savings into desirable forms of sterling area development, an Investment Board will be required as an adjunct to the proposed Sterling Area Organisation. This Investment Board should have the power to raise funds in capital markets throughout the sterling area, and elsewhere. The Commonwealth Development Finance Company recently established in London represents a useful first step in this direction, but its authorised capital (£15 million) is far too small.

We have in the Colombo Plan, which embraces the Asian dominions, a useful model for future sterling area co-operation. Britain's part in the Plan is to release to India, Pakistan and Ceylon their excess sterling balances, at an annual rate of £45 million until 1957. But these dominions will require, if the Plan's objectives are to be fully reached, a further additional inflow of foreign capital of about £90 million a year over the next four years. They are desperately short of domestic capital. For example, India is devoting under its Five-Year Plan 5 per cent. of its national product to capital formation, compared to 15 per cent. in this country and 35-40 per cent. in Australia. Yet even this programme is thought by many observers to be beyond India's means. Private foreign investment in the Asian dominions is discouraged, for political reasons.

South-east Asia is perhaps the most vulnerable section of the sterling area to-day. There are many reasons for this. The rice shortage, population pressure, the additional overheads caused by the partition of the Indian sub-continent, the cost to India and Pakistan of the Kashmir dispute, over-ambitious welfare legislation in India, the discouragement of foreign capital by political nationalism, falling world demand for jute, rubber and (recently) Pakistani cotton; last, but by no means least, the lack of any effective economic planning body in any of the three dominions; all these factors have contributed to a grave weakening of the region's economic strength since before the war.

Failing another commodity boom as in 1950-51, the Asian dominions cannot be expected to balance their overall accounts for some years. Increased sterling investment in these dominions is essential, both to maintain living standards and to develop their very considerable natural resources.

The problem facing the white dominions is nothing like so serious. If internal price-levels are controlled, and investment directed to national priorities, there is no reason why these countries should not pay their way and maintain high standards of living. Nor, provided investment is forthcoming, should there be much difficulty in raising colonial standards of living, while maintaining their favourable balance of payments. But we must ensure that the colonies, and not ourselves, reap the main reward of their favourable balances. Only in this country will living standards definitely have to fall in the short run.

We come now to the third major requirement for a stable and prosperous sterling area. It is not much good investing in primary production if markets are not available for the commodities when they are produced. The instability of raw material prices, which has characterised the world economy especially since 1950, makes it extremely difficult for both exporting and importing countries to plan their economic policies. This instability strengthens the desire of primary producers to diversify their economies, despite the resulting loss of efficiency.

A Sterling Area Marketing Board

The logical corollary, then, to a Sterling Area Investment Board would be a Sterling Area Marketing Board, to regulate prices of important commodities within the area on the lines of the International Wheat Agreement, and if necessary by buying and selling buffer-stocks. Alternatively, a return to bulk-purchase buying of sterling area commodities by the United Kingdom might help to stabilise the terms of trade. It would help towards the expansion of output while maintaining reasonably stable prices, if we could interest the countries of Western Europe in bulk-purchases or commodity agreements. This country might in some cases act as a broker, offering guaranteed supplies of raw materials at predetermined prices to Western Europe on the one hand, and guaranteed markets and incomes to sterling area producers on the other. We are of course particularly well suited for an intermediary's role of this nature. Such schemes would also be a useful step towards the objectives of the Strasbourg Plan.

Nobody should under-estimate the difficulties of reaching agreement on commodity schemes. Such schemes need to be highly flexible, and it would be unwise at this stage to pin too much faith on their implementation. The practical difficulties should not, however, deter us from trying.

To be fully effective, of course, commodity schemes need the co-operation of the U.S., after Britain the world's largest commodity importer. Every effort should be made to interest the U.S. in schemes for stabilising raw material prices and sales. For one thing, stabilisation of sterling area dollar sales year by year would lower Britain's import bill. For at present Britain tends to build up stocks when reserves are high (i.e. when overseas sterling area sales are going well), and to run down stocks when reserves are low (i.e. when overseas sterling area sales are going badly). This means that Britain always tends to buy when commodity prices are high. If the reserves were not subject to such violent year-to-year fluctuations, we could afford to time our stock-piling when commodity prices are low—thereby helping to stabilise instead of de-stabilising world commodity prices. But, unless the mood in Washington changes very much for the better, chances of American co-operation are not good.

Greater co-operation from the U.S. would, of course, absolve us from most of the harsh measures recommended in this pamphlet. If Point Four were to become a living reality instead of a pious aspiration, or if America were to accept our invitation to join the Colombo Plan, the need for our £300 million annual surplus for overseas sterling area development would be correspondingly reduced. An increase in American private investment in the sterling area would have the same effect. Similarly, if the dollar price of gold were raised, or the American tariff and " Buy American " legislation abandoned, or if the U.S. assumed responsibility for a greater share of Britain's defence programme: if these things happened, the position of the sterling area would be vastly eased, and the measures proposed in this tract would be largely irrelevant and unnecessary. But there is no evidence that the Americans will do any of these things. The sterling area must therefore solve its own problems in its own way.

LONG TERM PROSPECTS

The Permanence of Dollar Dependence

IF THE short-run perils are overcome, what are the sterling area's long-term prospects? If our investment programme succeeds, the dollar problem may ease to the point at which discrimination becomes unnecessary, and the pound can safely be restored to convertibility. But this is unlikely to happen for a long time. The dollar shortage seems likely to remain a permanent feature of the modern world, for the following reasons: —

1. As mentioned above, the rate of increase of American industrial capital is roughly twice the British rate. This means that productivity differences between the two countries are increasing, in America's favour. Our investment commitments in the overseas sterling area will probably cause the gap to widen still further.

2. The self-sufficiency of the American economy means that increases in income lead to disproportionately small increases in imports. Between 1937 and 1951 American production nearly doubled, exports much more than doubled, yet imports rose by only 25 per cent. This was in a period of marked tariff reductions, whereas the trend in Washington now is towards higher tariffs.

At present about 61 per cent. of U.S. imports come from the New World, compared to 17 per cent. from the sterling area (one-fifth of which come from Britain) and 14 per cent. from Western Europe and its dependent territories. The Paley Report indicates that the proportion of U.S. imports coming from the New World will rise in the next 25 years, while the proportion coming from the sterling area will probably fall.

So there are no *a priori* reasons for expecting the dollar problem to improve, even if the U.S. maintains full employment continuously. But this is highly unlikely. Recessions are bound to occur from time to time in capitalist economies—especially in economies as volatile, and with such high production capacities, as the U.S. In fact, the odds are on a recession taking place when rearmament tails off, in 1954 or 1955.

U.S. imports in general, and imports from the sterling area in particular, are extremely vulnerable to a business recession. The evidence of the 1938 and 1949 recessions suggests that a fall of 4 per cent. in U.S. domestic consumption leads to a reduction of 25 per cent. in imports, and a reduction in imports from the sterling area by 33 per cent. Thus, as in 1949, a lull in activity which would pass unnoticed by the average American can cause an exchange crisis of the first magnitude for Britain and other countries. This extreme vulnerability springs from the nature of sterling area exports to the U.S. Britain exports luxury consumer goods like whisky, pottery, woollen and linen goods, leather goods, etc., which are among the most easily dispensable items of consumer expenditure in a recession. The overseas sterling area exports commodities like raw wool, rubber, tin, jute, cocoa, etc., which are bought in the first place for business inventories. Inventories in the U.S. are highly sensitive to fluctuations in consumer spending, so that a slight fall in sales leads to a much greater cancellation or postponement of orders.

With reserves at their present inadequate levels, the way to minimise the damage to ourselves of a possibly imminent U.S. recession, is to reduce our dependence on dollar trade. We can only hope that the Government is already making urgent plans along these lines.

Right-wing economists have two pet theories for making the pound competitive with the dollar: deflation and devaluation. The case against deflation can be briefly stated. To succeed at all, deflation would have to be fairly severe, leading to considerable unemployment and loss of production, and drastic cuts in investment. Even if this were politically possible, it could only prove a short-run solution, and would intensify our long-term problems. For it would mean a further loss in our industrial efficiency, in relation to our rivals abroad. It would mean the complete abandonment of our attempt to develop the sterling area, with incalculable results.

To maintain our position as a great trading nation, and to play our part in the sterling area, we need every ounce of resources we possess. We cannot afford to stagnate, as we did between the wars, when we adopted a deflationary policy for which we are now paying terribly in terms of loss of productive capacity and lack of welfare services. No deflationary " solution " could do more than sow the seeds of a worse crisis in the next decade.

The case for a further devaluation is somewhat more plausible. In retrospect, the 1949 devaluation appears as a striking success. But much of this success was due to quite fortuitous factors. America's recovery from recession, which took place at the end of 1949, had of course nothing to do with the devaluation of the pound; nor had the Korean war, which boosted overseas sterling area sales. Devaluation was, however, highly successful in inducing the dominions to cut dollar imports. In 1949 dominion economies were highly inflated, import controls were weak, and dollar imports in consequence unnecessarily high.

To-day, however, the scope for immediate cuts in dominion dollar imports is considerably less. In Britain, as in 1949, dollar imports are still largely subject to administrative control. There is no *prima facie* evidence that their volume would be much affected by devaluation. Dollar imports admittedly fell heavily in 1950, but we were then running down stocks. The present low lovel of stocks would not permit us to repeat this procedure. As regards exports, the indications are that British and overseas sterling area goods are competitively priced at present. The main factors hindering British sales in the U.S. to-day are the tariff and American tastes (which can perhaps be altered by more active salesmanship). Overseas sterling area exports consist, as we have seen, mainly of industrial raw materials, of which in many cases the sterling area is the sole supplier. The chief determinant of sales is, therefore, the level of U.S. business activity.

Although a lower exchange rate might help our exports, especially in third markets where sterling goods compete against dollar goods, the case for devaluation is definitely " not proven." There are two outstanding reasons why we should not devalue. First, repeated devaluations undermine confidence in a country's currency. Whenever a trade deficit occurs, customers abroad tend to postpone purchases, in the hope of getting a cheaper exchange rate. This speculative effect exaggerates each payments difficulty. Besides, with each successive devaluation it becomes more difficult to hold the internal price-level steady, and to prevent rising wages and other costs from wiping out the competitive advantage derived from devaluing. The recent history of France should be an awful warning to us of the dangers of repeated devaluations. Secondly, devaluation should be kept in reserve as a weapon of last resort, to be used only when really needed—as in an American recession.

East-West Trade

Meanwhile, we must do our best to insulate the sterling area against the risk of any such recession, by reducing our dependence on dollar goods. Can increased East-West trade help here? In the past, Iron Curtain countries have been major exporters of grain and timber, both of which the sterling area now has to import largely from dollar sources. The Communist bloc (especially China) might in theory provide a substantial market for sterling area commodities and British manufactures. There are no doubt opportunities for greater East-West trade along these lines, especially if the Malenkov regime fulfils its early promise of lowering world tension and raising the living standards of the Communist nations. Pakistan and Ceylon already have important bilateral trade agreements with China, receiving rice in exchange for rubber and raw cotton.

There are, however, two difficulties. In the first place, it is not known whether Communist countries (except China) have agricultural surpluses to export. The rapid growth of population in these countries, and the widely-reported failure of agriculture to keep pace with industrial development, suggest that they have not; moreover, they suggest that China itself may soon have to stop selling rice abroad.

But even if surpluses are available, it would be strategic suicide for this country to become dependent on Russia for food. We should remember that the present renewed interest in East-West trade reflects the growing struggle for markets in the capitalist world (which Stalin predicted last year). Is it likely that Mao Tse-tung and Malenkov really want to help capitalism solve its internal contradictions?

It is impossible to dogmatise on Soviet economic or political developments. But, while we should certainly do our utmost to expand East-West trade, we can no more rely on the Russians to solve the sterling area's problems than we can on the Americans.

We are left with the policies advocated earlier in this pamphlet: to strive, if possible in conjunction with Western Europe, by greater investment and strict import and exchange controls, to make the sterling area a viable and relatively self-sufficient entity.

No Easy Way

The world economy will probably continue to develop during the next quarter-century roughly along the lines followed since 1945, though there will almost certainly be brief periodic reversions to the inter-war pattern when business recessions occur in the U.S. Political pressures, increasing population, and the spread of industrialisation, will probably combine to keep the long-term trend of world demand in an upward direction. This means that the trends shown in Table VII will continue. Food and raw materials will remain scarce, and the terms of trade will turn increasingly against manufacturing countries. C. A. R. Crosland estimates (vide " Britain's Economic Problem," page 91) that the terms of trade for this country will worsen to 150 (pre-war = 100) in the early 1960's, compared to about 140 last year and 130 now. (In other words, a given quantity of imports in the 1960's will cost 50 per cent. more in terms of exports than before the war). This estimate reinforces the evidence of the Paley Report.

So the long-term outlook for the rest of the sterling area is distinctly bright, especially if bulk-purchase or other commodity agreements can smooth out the fluctuations around this rising trend. For Britain, the picture is more cloudy. On the one hand, bad terms of trade mean prosperous markets, since primary producers can afford to spend more on manufactures. Besides, as Crosland points out, the terms of trade for capital goods will probably deteriorate much less than for consumer goods. On the other hand, we have obviously got to achieve a large and continuing increase in the volume of our exports. This we managed to do under the Labour Government, but we have fallen back sadly since 1951. We must concentrate especially on selling goods with a high conversion-factor, on which substantial profits can be made from imported raw materials.

One thing is perfectly clear. For as far ahead as we can foresee, we are going to be under pressure to export as much as we conceivably can. In this modern world we will have to run faster and faster to stop ourselves from slipping back.

Unless the Labour Party's domestic policy faces these external problems it will be irrelevant, no matter how aggressively revolutionary it may sound: at the same time, if it *is* to be relevant, it will also have to be resolutely Socialist in content.

SUMMARY OF CONCLUSIONS

OUR CONCLUSIONS can be briefly summarised. In some ways they concur with those of the Labour Party's " Challenge to Britain." They are:—

1. **The dollar shortage must be considered a permanent feature of the modern world,** whether or not the U.S. maintains permanent full employment. No short-cut solutions—by convertibility, deflation or devaluation, or a combination of these—are likely to prove feasible. **We cannot count on American co-operation** to solve the dollar problem by raising the price of gold, increasing private overseas investment, or

abolishing the tariff. **Nor can we rely on greater East-West trade** to liberate us from dollar dependence.

2. The solution therefore rests with ourselves. The sterling area must continue to discriminate against dollar imports, and must strive for greater self-sufficiency. **Import and exchange controls must be tightened** throughout the area.

3. If the area is to become more self-sufficient, Britain must step up exports of capital goods to the overseas sterling area, and the dominions and colonies must, wherever possible, increase output of commodities at present mainly produced in the dollar area.

4. If the resources of the area are to be fully developed, a large flow of new capital from London will be needed. Maintaining this outflow, and at the same time re-equipping our economy, will take all our strength. **Even if the defence programme is drastically reduced, we must expect some fall in living standards over the next few years.**

5. To ensure that investment is correctly allocated, and national policies co-ordinated, a permanent Sterling Area Organisation will be needed on the lines of the O.E.E.C., with power to apply sanctions against unco-operative members. Such sanctions might take the form of the freezing of sterling balances in London, or denial of access to the London capital market.

6. Among the adjuncts of the Sterling Area Organisation should be the following:—

(*a*) A Defence Committee to ensure an equitable division of the burden of sterling area defence;

(*b*) An Investment Board, to raise and allocate funds for sterling area development;

(*c*) A Marketing Board, to stabilise prices and sales of sterling area commodities, by means of bulk-purchase agreements, buying and selling of buffer-stocks, or annual price-fixings as in the International Wheat Agreement.

7. Ultimately, this sterling area organisation might be widened to include some or all of the Western European nations and their dependencies. Throughout, the area must collaborate closely with Western Europe and the U.S.A., and must try to secure their co-operation in long-term commodity agreements. Every encouragement must be given to foreign capital to invest in the sterling area, **provided this does not compromise the rights of dependent territories to manage their own affairs as they think fit,** when independence has been attained.

Of course there can be no question of compelling the dominions and other independent members of the sterling area to remain within it; they are already free to leave whenever it suits them. Hence the importance of ensuring the continued attractiveness of the area to its self-governing members. But the most important thing of all is that our relationship with the present colonial areas from now on shall be such as will encourage them to remain in the sterling area of their own free will after they become independent. Nothing less than the economic survival of this country depends on this: we are the only member of the organisation which is unlikely to be able to stand alone at some date in the foreseeable future. Thus enlightened self-interest demands sacrifices on our part to persuade the colonies that there are, and will continue to be, advantages for them in the sterling area system. Continued pursuit of selfish policies could lead only to revolt and ruin. Seen in this perspective, no price that ensures survival of the sterling area can be too high; but the time remaining for us to make the payment is dangerously short.

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