ESSAYS IN INTERNATIONAL FINANCE

No. 17, September 1953

PROBLEMS OF THE STERLING AREA

WITH SPECIAL REFERENCE TO AUSTRALIA

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INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS AND SOCIAL INSTITUTIONS

PRINCETON UNIVERSITY

Princeton, New Jersey

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International Finance Section

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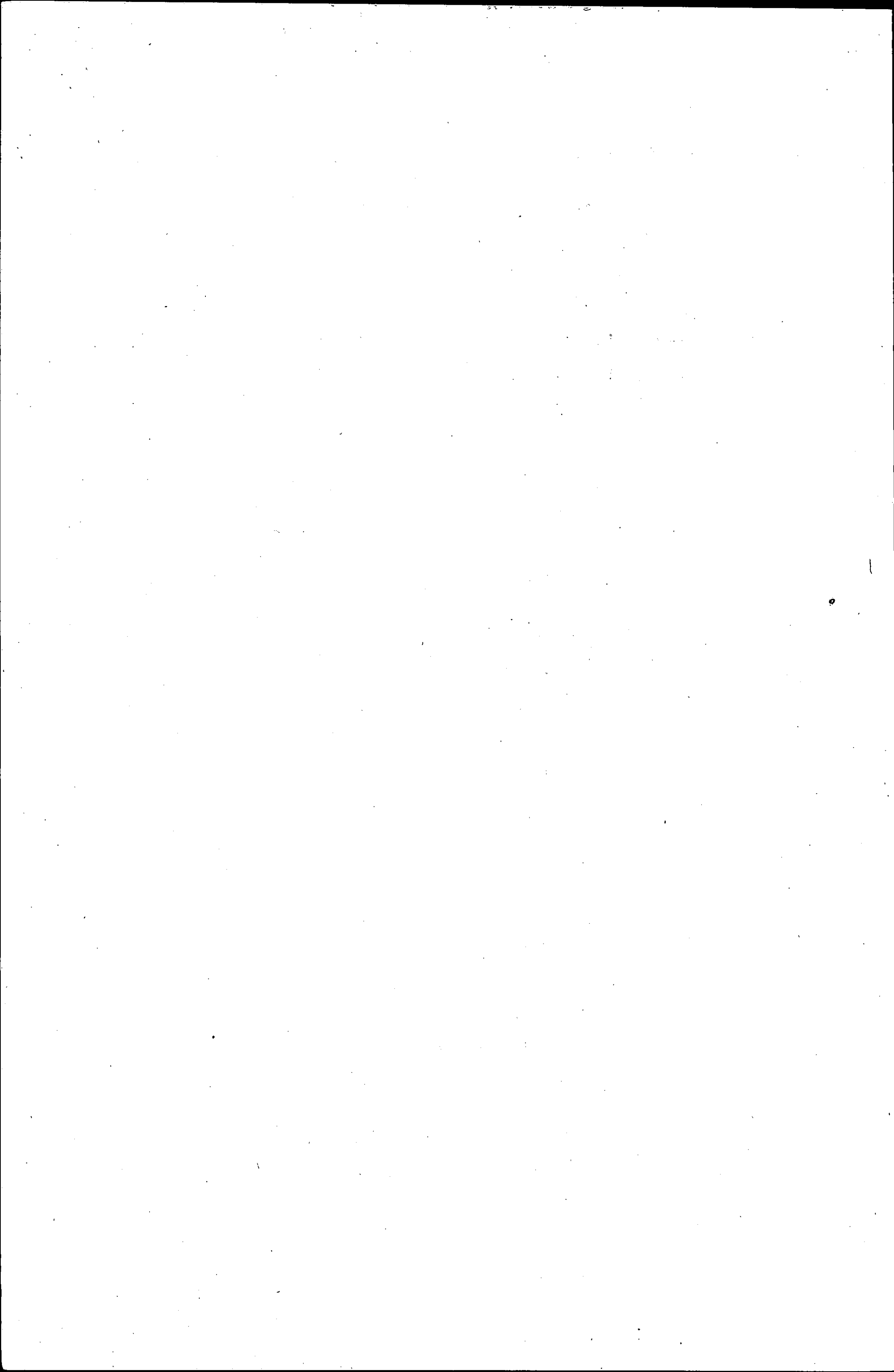

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I. INTRODUCTION

IN the latter stages of the 1939-45 war, when policies were being evolved for a united world operating through a new and grand conception of a United Nations and its agencies, plans for cooperative action on the economic front, in international finance and trade, were discussed with much fervour and hope. The world economy was to make a fresh start, comradeship in the many and varied arts of peace were to supplant comradeship in war, and even the vanquished were to find a place eventually in the new dispensation. Many of us were engaged in international discussions designed to produce a blue-print for the new order. We were aware of the obstacles, or at least of some of the more important—such as the disparity between the dollar and non-dollar countries, the development of the new nations that were to emerge from the conflict, the shortages of capital and the alteration in the main sources of supply, the difficulties of abandoning the autarchic practices inevitable in war, the vast problem of relief and rehabilitation. On this last problem, and on it alone, the fine fervour of cooperation in war was carried over into the peace, but even this was abandoned in 1946 as the conflict between the communist and non-communist worlds began to dominate the international situation. With the death of UNRRA, the high hopes of a world economy, taking shape on the lines of the wartime plans, had finally to be abandoned, and the economic divisions in the western world began to emerge.

Some day perhaps these massive forces will be seen in their correct perspective. One may express the opinion that the early termination of UNRRA was the first decisive move in a series of developments that were to divide rather than unite the world economy; indeed, it may be said that it was at this stage, the end of 1946, that the pattern of the post-war economy with its new groupings began to emerge, and that the onus was on individual nations to make their decisions, in so far as they were able, as to the group to which they would belong.

II. A DEFENSIVE MECHANISM

It was in this atmosphere that the sterling area began to emerge as one of the major features of the post-war economy. Fifty years earlier, the idea of a "sterling area" would have been regarded as a *reductio ad absurdum*. Sterling was the world currency, London the main source of capital supply for the whole world, and the Bank of England the most influential single institution in the world economy. Two wars, a depression, the emergence of the welfare state, the increasing devotion to control for positive ends and to restriction as a short term solution of long term problems, and finally the rise of the United States as by far the most powerful economic unit in the western world, quickly altered the position of sterling, of London as a source of capital, and of the controlling mechanism that could be operated through the Bank of England and the London money market. The sterling area was the response of the United Kingdom to the series of changes in the world economic situation that commenced with World War I and are still in progress. Just as nature abhors a vacuum, so in the course of economic evolution there are few, if any, complete breaks with the past. It is easy to trace the development of the sterling area from the end of the 1914-18 war, at first slowly and perhaps without conscious purpose, but later under the impetus of a definite plan to retain as wide an advantage for sterling as the circumstances permitted. We see it, for example, in the privileged position of trustee stocks in the London money market in the twenties, in the association of emigration and capital movements, in the hesitant expression of Imperial Preference in 1923, in the steady pressure of most Dominions for favoured treatment in finance and trade in the United Kingdom and the growth of a school of thought there favouring this course, in the circumstances attending Britain's abandonment of the gold standard in 1931, and finally, and most clearly at this stage, in the protective measures taken at the Ottawa Conference in 1932. With the malaise of the thirties these tendencies were strengthened, and with the burden of World War II it was but a short step to the control of capital movements, the blocking of currencies, restrictions on dollar purchases and limitations on international transfers of currencies.

Thus the sterling area emerged largely as a defensive mechanism, and its history since the end of the war suggests that by and large it has been driven from one defensive position to another. It is well to bear this evolution of the sterling area in mind in reflecting on how membership in it affects an overseas country like Australia with a largely dependent economy, and in setting out the considerations that led Australia to adhere willingly to the sterling area and its practices.

It may be argued that Australia had in fact no choice. That would be true only if we assume that its economic policy in the post-war period was a given and fixed force that the country was powerless to alter, and that this, combined with a devotion to the maintenance of the closest association with the United Kingdom, set the course. In these circumstances, an independent line of action leading to a freely convertible currency, to the abandonment of trade restrictions, to free movement of capital (and especially to an adequate supply from abroad) was not a practicable objective. I think it would be more correct to say that it was never seriously considered as a possible course, that officially, and to a large extent in non-official circles, the dollar gap, the need for trade restrictions, the desire to avoid overseas capital commitments and the fear of an unstable dollar area were the over-riding considerations. The alternative course was not seriously pondered, nor was there a penetrating analysis of the logical consequences of taking the course that actually was followed. It was not perhaps realized that it was the line of least resistance, in part making virtue of necessity whilst sticking to the traditional path and obtaining the greatest relief in the shortest period.

Whether this would be true of the other members of the sterling area I am in no position to say, and I have no doubt that the views I have expressed on the Australian position will be controverted. It would be wrong, however, for the critics to assume that, in putting the problem as I have, I am unmindful of the advantages that accrued to Australia from membership in the sterling area. That Australia believed there were substantial advantages is not open to question, and I shall deal with this aspect of the problem later. It need only be said at this stage that membership offered to Australia the opportunity of proceeding on a somewhat progressive and advanced economic policy, without undue embarrassment from the impact of world economic forces, whilst at the same time sustaining quite a high level of economic expansion. Thus in the short run, and as an answer to the special problems of changing over from a war to a peace economy, of implementing a somewhat ambitious social policy, and of embarking on a heavy investment programme both public and private, membership in the sterling area offered great attractions. Not all of these considerations would apply to other members, of whom some no doubt were influenced by their holdings of sterling, and some by long standing association in trade and finance with the United Kingdom.

The sterling area today consists of the members of the Commonwealth (other than Canada) together with Ireland, Iceland, Burma, Iraq, Jordan and Libya, and of course all the British colonies which would be included in the generic term Commonwealth. Canada alone

among the members of the Commonwealth chose to take an independent course, and to go the hard way of working towards freedom from restrictions and free convertibility of her currency. These decisions were taken in 1946 at a time when the striking developments in new resources and in investment, that were to follow, could not have been foreseen, and it remains an open question how far Canada would have been along the road to her goal had fortune not been so kind. But it was a deliberate choice, and no one doubts that the goal would have been reached sooner or later. It involved for Canada the blending of internal social and economic policy with the maintenance of a cost structure competitive with the world outside. The substantial measures taken by Canada in the post-war period to promote social justice and provide social services were fitted into a policy designed to restore the largest possible measure of economic freedom and the highest degree of productivity. This is a point that must not be overlooked. A British Prime Minister was responsible for enunciating the now well established principle that self government is to be preferred to good government, and many countries may argue that the pursuit of social justice is to be preferred to economic freedom and high productivity. At least those who chose the sheltered path offered in the sterling area would plead this in extenuation, and perhaps in the short run they might be able to make a case. It may be doubted whether it would be true of the long run and, after all, the pursuit of high productivity and economic freedom is not inconsistent with the promotion of social justice, and may well lead to a higher level of social justice because of the higher standard of living.

III. THE SUPPLY OF CAPITAL

If we pause to look at the developments that have already taken place within the sterling area, we may find justification for this point of view. In the first place, the sterling area can no longer provide the capital it needs for development. The United Kingdom is not able, as it was in the halcyon days, to provide capital in full and sufficient quantity at low rates of interest. As far as Australia was concerned, this was not regarded as a serious matter in the immediate post-war period. From 1931 to the end of the war Australia had been paying off external debt, the total amount so redeemed being nearly £A200 million.* Australia was anxious to avoid a renewal of heavy commitments for external debt and interest payments, the experience of 1930-33 being still too fresh in mind. By 1950 external interest payments,

* Throughout this essay £ refers to pounds sterling and £A to Australian pounds. The present official rates of exchange are £1=\$2.80 and £A1=\$2.24.

as a percentage of Australian exports, had fallen to nearly 5% compared with over 20% at the close of the twenties, and a much higher figure during the period of actual difficulty in the depression of the early thirties. Moreover, at the end of the war and for a period of some five years thereafter, there was an active movement of capital from the United Kingdom to Australia, some £500 million in all going into investment opportunities or being transferred temporarily in the belief that the Australian pound was bound to appreciate, perhaps to the extent of being brought back to parity with sterling. This large inflow of capital gave the money market great buoyancy, eased the balance of payments and enabled Australia to proceed with a rapid rate of development without, as in the old days, having to make a conscious effort to borrow overseas. But it was a temporary phase, and the inflow of capital was to be reversed in 1951, when it was seen that the Australian pound would not be appreciated, and when the heavy rate of importing caused a rapid drain on London funds despite the record price of wool. From June 1951 to June 1952 London funds fell from nearly £A850 million to a little more than £A350 million, by far the largest yearly drain on Australia's overseas reserves ever experienced.

Meanwhile, it had become clear to the government, and to unofficial circles concerned with high financial policy, that the rate of development contemplated by Australia could not be sustained without some regular inflow of capital for investment. Australia, in common with Canada and other countries, had ambitious post-war development plans involving heavy immigration. Indeed, the Australian immigration plans, relative to the size of the existing population, are by far the most ambitious of any undertaken by the newer countries with scope for migration. From 1947 to 1952 Australia experienced a total annual growth of population of 250,000, or 3%. This is a high rate of growth on any standards but, with the capital equipment required for industry, agriculture, transport, power and social amenities, under modern conditions of high technical and living standards, it involves a rate of investment of about 30% of gross national product. Obviously, this cannot be obtained from local savings, not even if heavy taxation is levied to provide a considerable ingredient of public investment from government revenue.

In practice the Commonwealth Government has in recent years financed, from revenue, capital works to the extent of approximately £A100 million per year. Additional capital from abroad was thus essential if the high rates of development and immigration were to be sustained. This became apparent in the middle of 1950 when the first approach was made to the International Bank for Reconstruction and

Development, and an amount of $50 million obtained for each of the next two years. It was clear that, as a regular source of capital for development on the scale required, the resources of the sterling area were not sufficient. This is the experience of other countries in the sterling area which have problems of development demanding capital resources. It is highly likely that the deficiencies of the sterling area as a source of capital will become more pronounced because higher living standards, and devotion within the area to the welfare state, will slow down the rate of saving, while the demands of the members of the sterling area for capital for development are likely to expand. So, on this vital front, it would appear that the sterling area is fighting a losing battle, and that some at least of its members must contemplate a financial association outside the area by which their capital needs may be satisfied. It is not necessary to dwell on the significance of this for the future of the area. Either the rate of development must be slowed down, or special arrangements made to obtain supplies of capital outside the sterling area—that is, from the dollar area.

I discussed this problem in 1950 and suggested then that the Commonwealth countries as a whole should agree upon their capital needs for the maximum rate of development required, decide how much collectively and individually could be provided from the sterling area itself, and how much would be needed from the dollar area.* Since the last mentioned funds would be required for development and long term investment, the transaction could be regarded as a sound financial transaction, providing a suitable opportunity of resuming the pre-war or nineteenth century practice of export of capital, without which it is not possible for the world economy to work efficiently. There were some obvious obstacles in the way of such a proposal. There was naturally some official reticence to proceed boldly on the assumption that London could no longer supply sufficient capital and that some regular arrangement with the dollar area would be necessary. The members of the Commonwealth were themselves hardly agreed individually, still less collectively, on the need for it, while neither the money market in the United States nor Congress was altogether prepared for what was then an unusual transaction. Since then, however, the climate has changed and it is admitted that both short and long term capital from outside the area is essential if sterling is to be strengthened and if the rate of economic development is to be sustained. In these circumstances the slogan "Trade, not Aid" was hardly the most tactful way of expressing the difficulties facing the Commonwealth and the sterling area, or of pointing the way out.

* *Foreign Affairs*, July, 1950. This has been reprinted in my essays *Expansion and Inflation* (Melbourne: Cheshire, 1951).

IV. CHANGES IN THE TRADE PATTERN

This problem of capital supply is perhaps the most significant factor affecting the structure of the sterling area and the enduring contribution it can make to the fortunes of its members and to the working of the world economy as a whole. But we have also to consider the relationship to the world economy of the economy of the area as a whole, and of those of its individual members. In this respect one of the most significant developments is the change in the proportion of trade enjoyed by the members of the area within the markets of the area itself. In the comparison that follows I take the pre-war period and 1950, because 1950 was clear of the great impact of higher prices for commodities of international commerce and was unaffected by the restrictions that had to be imposed early in 1952. On this basis, it is found that exports from the United Kingdom to overseas members of the sterling area have risen from about 48% of total United Kingdom exports to 55%. The market for British exports, presumably manufactured and engineering products, was more favourable in the sterling area than in the outer world. This would be quite natural for a number of reasons—some of the members of the sterling area had accumulated sterling for the purchase of United Kingdom goods; all members preferred purchasing within the sterling area to incurring dollar obligations; the general restriction on dollar imports was strengthened in 1949 to deal with the crisis in the sterling balances of that year; and in many sterling area countries preferences and trade practices favoured British goods as against foreign goods. For all these reasons the markets in the sterling area were weighted in favour of the United Kingdom. To this must be added the fact that the markets of the overseas members of the sterling area were buoyant, partly because of the rising prices of the foodstuffs and raw materials produced by the countries concerned, and partly because their rate of development was high. On the whole, Britain lost little by close trade ties with the members of the sterling area; it is likely that on balance there was a gain, and this may well have become more pronounced as the ex-enemy countries, Germany and Japan, came into the market, and the general condition of shortages gave way to a more easy state of supply.

What was the situation with regard to the exports of the overseas members to the United Kingdom market? As a whole, the proportion of their exports going to the United Kingdom declined considerably. Table I below illustrates the point.

Canada is a special case, as she is not a member of the sterling area. A decline in her exports to the United Kingdom was to be expected under conditions in which dollars were hard to acquire. But for all

TABLE I

EXPORTS OF OVERSEAS MEMBERS TO UNITED KINGDOM

(As percentage of total value of exports)

	1937	*1950*
Australia	50	39
New Zealand	76	66
India	33 (India and Pakistan together)	22
Pakistan		17
Ceylon	46	24
South Africa	38	26
Canada	40	15

the other Commonwealth countries, themselves members of the sterling area, the movement is too significant to be ignored. If this condition is maintained, it is clear that the relative importance of the United Kingdom market has declined since the war. But this is precisely what one would expect to happen, and it is a trend that may well continue in the years ahead. For one thing, in the post-war world there has been a more wide-spread, as well as a greater, demand for defence supplies probably than at any other time in peace. This could not but affect the trade of the overseas members of the sterling area who produce a wide range of the basic materials used in defence supplies. Then there is the general tendency, especially in the United States, for the demand for raw materials to outstrip supplies on present capacity to produce. The output of the American economy is expanding at the rate of some 2½% per annum, and at this rate the gross product of the economy will double in less than 30 years. Such a contingency would involve a very heavy increase in the American demand for raw materials—in some cases a more than proportionate increase. Indeed, the prospect of the American economy becoming increasingly dependent on overseas supplies of materials is one of the most significant features of the post-war economy, as well as one of the most encouraging. The Paley Report has brought the main facts into prominence, but it may be doubted whether public opinion and official policy have yet caught up with the inevitable trend of events. Equally true is it that the spectre of the dollar problem, that for too long after the war dominated thought and action in some sterling area countries, including Australia, tended to obscure this more significant and hopeful factor. It is, as it were, a double edged weapon in that it requires the United States not only to lay out more dollars for essential supplies, but also to sustain development loans or to supply finance in some form, so that the output of these essential supplies will keep

pace with the demand. It is not merely that the United States will demand more and more of certain materials of which she is in short supply. The countries that will have to step up their production, and the overseas members of the sterling area play an important part here, will also be demanding increased quantities of capital equipment during the gestation period in which they are expanding their output of basic materials. So, on this basis, there is some hope of an expanding world economy; the underlying economic forces are working mostly in the right direction, though they often have to contend with strongly entrenched lobbies that will endeavour to set back the normal course of events. To assume, as too many do in the face of what we must admit is pretty strong evidence, that the lobbies will win, is to accept defeat before the event. For the overseas members of the sterling area, this whole development of a stronger market outside the area for basic materials is a matter of great moment, and must affect, almost as much as does the problem of capital supply, the structure and development of the sterling area. The overseas members of the area will continue to expand their production of manufactured goods and to build up their transport systems and power supplies, but their principal source of development and wealth in the next two decades will be in exporting certain basic materials and foodstuffs which we have seen are likely to be demanded in increasing quantities. The members of the sterling area can supply largely increased amounts of such goods as rubber, tin, burlap and jute, wool, diamonds, hides and skins, cocoa, tea, spices, uranium, tobacco and perhaps oil. But this in turn depends upon satisfactory plans for expanding production; so the problem of capital supply and the problem of trade converge on the same point, namely a closer association than was contemplated in the years immediately following the war between the members of the sterling area, collectively or individually, and the dollar area.

V. RESTRICTIONS AND SOCIAL POLICY

So far, I have concentrated rather on long term problems of the sterling area, and the prospects it offers its overseas members with respect to capital supply, development and trade. A close liaison between the area as a whole and the dollar area, with the clearly defined object of working towards convertibility of sterling into dollars, would have enabled the members of the sterling area to obtain the short term benefits offered by the area to their attenuated post-war economies, whilst avoiding policies that might interfere with the rate of development and the expansion of trade.

The short term benefits of membership of the sterling area were

very real and important, especially to a country like Australia whose dollar deficit was persistent and who wanted a breathing space to proceed with certain measures of social policy and to embark upon ambitious development plans. In the first place, by pooling the dollar resources of the whole area and embarking on a well defined programme of dollar restrictions, it was possible to economise in the demand for dollars as a whole, to spread the risks and to relieve a country like Australia from the constant fear of a dollar shortage. Throughout the whole of the post-war period up to June 30th, 1951, the Australian deficit on current account in dollars totalled $486 million. In only one year (1950-51, when wool was at its highest price), did Australia have a dollar surplus on current account, the amount being $71 million. In the last two years there have been deficits, that for 1951-52 being $166 million and that for the first half of 1952-53 $41 million. It is, of course, impossible to isolate transactions and to be sure that any given import or export added to or subtracted from the dollar reserves of the area as a whole. Thus wool sold to the United Kingdom for sterling may earn dollars when sold in the United States in the form of a woollen garment; indeed, it may be the means of turning labour and plant in the United Kingdom into useful dollar earners. Wheat supplied to the sterling area reduces the demand of the area for dollar wheat. But it seems fairly clear that Australia, if left to her own resources after 1946, would have made heavy weather on the dollar front for some years during which, as a member of the sterling area, she in fact enjoyed comparative immunity, subject to imposing restrictions on dollar imports and channelling her trade so as to ease the demand of the whole area for dollars.

Whether this has been in the long term interest of the Australian economy is a much more debatable point. Australia has been compelled to adopt an increasingly restrictive policy, first as regards dollar trade and financial transactions, and later as regards transactions within the sterling area itself. This culminated in the special difficulties of early 1952, when several of the Commonwealth members of the sterling area had serious balance of payments difficulties and had to impose restrictions on both trade and financial movements in varying degrees of severity.

This is not the place to examine the special problems that arose to embarrass the Australian economy in 1951-52 when there was a drain of London funds of over £500 million, but this much can be said with assurance: if Australia had been less insulated from the impact of forces in the world economy, the difficulties that were at last recognized in March 1952 would have become apparent much earlier. A policy of restriction, without any countervailing measures to ensure a flexible

control of costs, money market trends, capital movements and the balance of payments, inevitably exposes a country to the dangers of violent changes in the balance of payments, which in turn will require further measures of restriction, of insulation from the world economy, and create the very conditions that produced the periodic difficulties from which Australia and the other members of the sterling area have suffered. It will in each case, as in 1949, be argued that there were special circumstances, such as the mild American recession and the decline in prices of primary products, but as each difficulty is met by resort to stronger measures of insulation, the sterling area as a whole becomes more remote from the world economy, and less able to make its final adjustment to independent convertibility and freedom from financial or trade restrictions. There can be little doubt that there is more widespread recognition of this fact now than at the end of the war, but it has come only after the experience of the alternative policy has exposed its long term inadequacy and basic weakness. *Facilis descensus Averno*, but truly in this of all matters it is an Herculean task to lift oneself back to the freedom of the upper air.

There is now common agreement among the Commonwealth members of the sterling area that a basic change of policy is needed, and that new objectives should be set. This emerged from the conference of Commonwealth countries held in London in December 1952, when all members agreed to work for the ultimate convertibility of sterling and to adopt current policies designed to attain this common goal. Unfortunately, there were widespread balance of payments and other difficulties confronting most overseas members of the sterling area, and the conference met not long after there had been another general resort to restriction, this time to a considerable extent on trade within the area, which was hardly an auspicious beginning for the new policy so recently agreed upon. The new policy actually required among the members of the sterling area a general willingness to raise standards of productivity, to bring costs more closely into line with costs in the dominant members of the world economy, to adjust budgets and financial policies so as to eliminate all inflationary trends, and to contribute, by such financial and economic virtue, to the general strengthening of sterling. It is one thing to move on a common front in devising measures that will afford protection from a common danger, as was done in the development of the sterling area in the early post-war years, but it is quite another to march together on a common front that involves sustaining pressure over a wide area, by a series of somewhat stern measures that may be needed to achieve a highly desirable objective.

VI. LIABILITIES OF THE UNITED KINGDOM ON SHORT TERM

Before looking at this aspect of the problem, as it affects Australia in particular, there are three problems of a more general character that require attention. First, there is the altered position over recent years of the United Kingdom in respect of its liabilities to the overseas members of the sterling area. In December 1945 the total liabilities of the United Kingdom in sterling were £3,688 million; on June 30th 1952 they were £3,397 million. The amount and distribution of these liabilities in recent years have been as follows:

TABLE II

UNITED KINGDOM SHORT TERM STERLING LIABILITIES

(*millions of pounds sterling*)

	1938 June 30th	*1945 Dec. 31st*	*1951 June 30th*	*1952 June 30th*
Total liabilities	778	3,688	4,168	3,397
Dependencies (colonies)	n.a.	447	908	1,042
Other sterling area	n.a.	2,007	2,192	1,513
Total sterling area	380	2,454	3,100	2,555
Non-sterling	398	1,234	1,068	842

The item "other sterling area" is mostly the self-governing members of the Commonwealth. In making comparisons it is necessary to bear in mind the altered value of money, and perhaps all the figures in the column for 1938 should be multiplied by 2.5 to make them reasonably comparable with the post-war figures, while even in the post-war period some allowance should be made for the general fall in the value of money. Even so, one of the outstanding facts which emerge from the table is the greatly increased liability of the United Kingdom at a time when her general position has been less favourable. Despite all the measures taken to enable countries with "blocked sterling" to use it for the purchase of much needed goods, especially capital equipment, and the heavy drain on sterling in 1951-52, the liabilities are still not far short of what they were at the end of the war. It will be recalled that in the immediate post-war plans, especially those surrounding the negotiation of the American loan to the United Kingdom in 1945, one of the objectives was to get rid of the heavy commitments made by England during the war, some of which were rightly regarded as part of the cost of the war. But the holders of sterling balances did not take this view, and the problem has remained one of the obstacles to the

recovery of sterling. During the war Australia was in a relatively good position in this regard, in that she sold her goods abroad at rather low prices and did not accumulate large balances. They totalled only £135 million at the end of 1945, and this, after allowance has been made for changes in the value of money, would be about equivalent to the figure regarded before the war as being safe. (Before the war it was thought that £60 million was a desirable minimum and £80 million a very sound reserve.) After the war, however, reserves were built up to a maximum of approximately £650 million, due mainly to heavy imports of capital and rising prices for exports. As we have seen this favourable position was quickly dissipated by the events of 1951-52 when the large deficit in the balance of payments occurred.

Apart from the high level of the balances as a whole, their distribution raises some special problems. At the end of the war India (now Pakistan and India) had balances amounting to £1,260 million, whereas at the high point in 1951 the balances of the two countries were £880 million and by 1952 they had fallen to £755 million. The decline in the balances of the overseas members of the sterling area other than the colonies (mostly Commonwealth countries) was from £2,007 to £1,513 million. On the other hand, the colonies, or dependencies as they appear in the table, showed an increase in balances from £447 in 1945 to £1,042 million in 1952. Even in the years 1951-52 they increased their balances at a time when nearly all other countries found it necessary to draw upon balances. These drawings, in fact, were financed in part by building up the holdings of the colonies. Some critics have gone so far as to say that the United Kingdom has been meeting its liabilities on short term account by borrowing from the colonies. Clearly, the colonies have, in this respect, been a present help in time of trouble, but it is hardly to be expected that they will not wish shortly to step up their rate of development and to draw more heavily on sterling imports of capital equipment and consumption goods, and thus to use up part of their balances. In a position of strength, it would be assumed that the higher the level of liabilities of this nature, the stronger would sterling be, but it is one of the changes that has come over the scene since the war that high liquid reserves held in London may be a source of weakness. It is significant that these liabilities are still relatively much larger than before the war, that in the aggregate there has been little change since the war, and that the most important variation during that time has been the increase in respect of the colonies. For the dollar area and the O.E.E.C. countries the liabilities had fallen from £621 in 1945 to £375 million in 1952.

VII. GOLD AND DOLLAR BALANCES AND THE STRENGTH OF THE MONEY MARKET

If we turn to the position of the gold and dollar balances of the sterling area, the second general problem I wish to raise, we get a picture that is scarcely any more reassuring. In terms of United States dollars the position in recent years has been as follows:

TABLE III

GOLD AND DOLLAR RESERVES OF STERLING AREA

(*millions of U.S. dollars*)

1949, December	1,688
1950, December	3,300
1951, June	3,867
1951, December	2,335
1952, June	1,685
1952, December	1,846
1953, June	2,367

These reserves are, of course, considerably less than the short term liabilities of the United Kingdom, but that is not the appropriate test to apply.* The appropriate test as regards the final reserve of gold and dollars is whether, in a difficulty, it would be possible for the United Kingdom to summon the aid of financial resources to meet all current obligations, as does a bank under pressure. Before the war, and especially in the buoyant days of the 19th century, it was possible for the United Kingdom by bank rate and other fiscal measures to turn a short term drain on reserves to her favour. It is no longer possible to do this, and thus the level of reserves becomes a most important ingredient in the problem. The stronger the inherent position of a money market, and particularly in respect of its command on the resources of others in the short period, the less need is there to worry about the size of reserves, so that, paradoxically as it may sound, the strongest market is the one that can afford to maintain its solvency in all circumstances on the smallest reserves. This was undoubtedly one of the achievements of the British money market in its days of great strength. Perhaps never before was there a market the mechanism of which was so well developed to economise in reserves and at the same time to

* The gold and dollar reserves of the sterling area are not all strictly at the disposal of the United Kingdom, but as custodian of the reserves and banker for the sterling area, the liabilities of the United Kingdom on short-term would be regarded as being a first-claim on the reserves.

command strength when danger threatened. A recent study of the Bank for International Settlements puts the position as follows:

> "In order to be able to meet demands of this nature [*temporary* deficits in balance of payments] and to avoid being inconvenienced by the varying requirements of the market, *the United Kingdom must possess adequate monetary reserves.* At the end of 1952, the United Kingdom's gold and dollar reserves amounted to £659 million, while the authorities are reported to have at their disposal other dollar resources (in the form of stock-exchange securities) to the amount of £300-350 million. Thus it is possible that the reserves amount altogether to £1,000 million ($2,800 million)—not a negligible amount but certainly not an ample reserve in view of the stresses and strains to which the London market may be exposed both by drawings on sterling balances and also by adverse changes in the United Kingdom's own current balance of payments, especially at a time of fluctuating business conditions. In 1938-39 the United Kingdom was able to cover, pound for pound, the outflow of funds to other countries while still maintaining reserves equal to its liabilities, but nowadays this is no longer possible. For this reason, the utmost importance must be attached to the question of how to strengthen the central monetary reserves in London. Steps taken to this end will, of course, have an enduring effect only when conditions of financial stability have been so far restored in the United Kingdom and in the rest of the sterling area that there is no longer any great danger that funds provided for the strengthening of the reserves might be dissipated in the course of current spending."*

This sets the problem clearly and fairly, both for the past and for the future. It is the same problem individually, as well as collectively, for the members of the sterling area but, as mentioned before, it is a question to be pondered whether collective responsibility for taking the less popular line can achieve the results that would be possible if each member were faced by the prospect of individual responsibility for a solution of its own difficulties. This is one of the great and difficult problems that confront the sterling area. Certainly, the prospect of improving the position is vastly enhanced by a collective determination to take the necessary measures, such as that which was asserted at the London conference in December 1952, and re-affirmed at the post-coronation conference in June last. The action of any one member of the Commonwealth, in respect of its future in the sterling area, must

* Bank for International Settlements, *The Sterling Area* (Basle, January, 1953), pp. 78-79.

therefore be in part determined by its judgment of the actions of others, unless the individual member is to continue to take short term solutions for what are long term problems. The extent to which the appropriate measures will be taken will be registered mainly in the movement in the gold and dollar holdings of the sterling area, but also in the views of the non-sterling world on the strength of sterling, and this in part will also be registered in the level of the London gold and dollar reserves.

VIII. THE PRICE OF GOLD

The third matter of a general nature, affecting the non-sterling area perhaps more than the sterling area, is the price of gold. This is a subject that still lights the fires of nineteenth century enthusiasm for financial orthodoxy. During the whole of that century it was believed in the most respected circles of the world that the price of gold should be stable, though by the end of the century the United States was the home of the gold and silver heresies for curing the malaise of the long deflation of the seventies and eighties. The wheel of time has turned half circle, and the mantle of respectability has fallen on the United States, while the United Kingdom assumes the role of devil's advocate, and South Africa, in this particular field, can stray from the paths of unbending rectitude. Such are the strange changes in emotional reactions that changes in fortune can impose upon the most traditional minds. I have long held the view that a rise in the price of gold would help not only the sterling area, but also the dollar area, and make an important contribution to the solution of the dollar problem. I may be permitted to quote in brief what I said on this matter in an address in November, 1952 in the more favourable climate of Australia, though at the Pioneers Club in Sydney!

> "Finally, I touch on a problem that smacks of financial unorthodoxy in the more conservative quarters of the United States. I refer to the price of gold which has remained stable since 1935 while all other basic materials have increased in price many times over. No doubt the authorities in America fear that a rise in the price of gold would induce inflation in the United States, and raise prices and costs, but this, if it did happen, would be the very thing to restore freer trading relations between the United States and the sterling area. It would make a contribution as sure as a lowering of costs in the sterling area, and both changes are needed. At one blow it would increase the earning capacity of the sterling area, and provide the greatest single contribution to the solution of the dollar-sterling problem. Before the war the pattern of the sterling area in relation to the dollar was that Britain ran a deficit

of $350 million and the overseas sterling area a surplus of $50 million, while receipts from newly mined gold brought in $500 million. Receipts from gold are now much less and account in part for the changed position of the sterling area. A higher price for gold would provide immediate relief, and also establish a basis on which adjustments in the cost structure of the two areas could be made for their mutual advantage."

As long ago as October 1949 Professor John H. Williams in an article in *Foreign Affairs* referred to this problem in sympathetic terms. A doubling of the price of gold would restore it to "its pre-war relationship to the price of other commodities." Professor Williams further stated that it was argued in Europe that such a change in the price of gold would "relieve the general dollar shortage by as much as $1 billion a year." But he recognised that it would encounter strong American resistance, would perhaps ease the position only temporarily, and would from the American standpoint be "reminiscent of the gold inflows of the inter-war period and their monetary and banking repercussions." Nevertheless, he thought the proposal deserved careful study.*

I don't think it has been seriously proposed that the price of gold should be doubled, nor has any responsible person suggested that a rise in the price of gold, without any other action by the sterling area, would alone suffice to solve the major problems of the area. Admittedly, as Professor Williams indicates, there would be a tendency to turn such a measure into just another short term solution, and to be back again in the maelstrom of balance of payments difficulties, inflationary pressures and demands for more restrictions. The rise in the price of gold, to be effective, would need to be accompanied by a range of monetary, fiscal, and broader social measures designed to reduce costs in the sterling area, and it was in this context that I suggested the measure. Certain of the international economic problems raised by the rigidity in the price of gold have recently been discussed by Mr. Harrod in a study sponsored and published by the International Monetary Fund, though the conclusions reached are not accepted by the authorities of the Fund as a basis for policy on gold or any other matter.†

Mr. Harrod has some highly interesting observations to make upon the nature and causes of the imbalance of world trade after the war. He finds that the over-all trading surplus of the United States in the period 1950-52 was not greater than in the twenties or thirties, but

* Williams, J. H., *Economic Stability in a Changing World* (Oxford University Press, 1953), p. 144.

† Harrod, R. F., "Imbalance of International Payments," *International Monetary Fund Staff Papers*, April 1953.

that in the latter period the surplus has caused embarrassment mainly to Europe, and that the embarrassment is due to "the reduction in the newly mined gold available for it." Mr. Harrod makes it clear that this is not the whole story, that there have been great increases in the demand for American exports as well as in the capacity of America to produce at highly competitive prices. In the twenties the surplus of the United States in the current balance of payments was met by American investment abroad, in the thirties it was met by large shipments of gold to the United States including sufficient gold to finance overseas investment into the United States, and since the war it has been met by American aid. Mr. Harrod shows that a comparison of the pattern of world trade in the period 1950-52 with that in the thirties reveals that "the greatest single item of difference is seen to be the shrinkage in the goods value of the newly mined gold available for central banks and treasuries." Had the value of newly mined gold borne the same relationship to goods and services after the war as it did in the thirties, the world could have paid for the whole of the American surplus without loss of reserves and without aid other than on military terms.* As it is, the prospect is for more restrictions on American imports as the American aid is scaled down.

Though the problem has fallen mainly on Europe, there is little doubt that the sterling area would have gained greatly by a rise in the price of gold, both directly from the increased export receipts and the relief thus given to its own balance of payments problem, and indirectly because of the greater freedom of trade possible in the O.E.E.C. countries, which have a special relation to the members of the sterling area, both directly and indirectly, through the United Kingdom. It would be absurd to claim that any one factor can be held responsible for so complex a problem as the dollar shortage, or that there is any one measure that will offer a complete solution, but of all the influences at work the one that has had the most deleterious effect on the sterling area, and on the non-dollar world in general, is the rigidity in the price of gold. Unfortunately, the problem has been regarded in certain circles as one that admits of no discussion, in other circles as an attempt by some to gain unworthily at the expense of others, or as opening the way to further intensification of the very inflationary forces that already have done such damage to the western economy, and particularly to the non-dollar area. But if the rise in the price of gold were accompanied by the appropriate measures that were contemplated at the London conference for correcting internal disequilibrium, the im-

* This conclusion is based upon the assumptions of a substantial rise in the price of gold, perhaps two and a half times the pre-war price, and an increase in output of one-third. These are assumptions scarcely likely to be realised.

pact of a rise in the price of gold as an inflationary force would be confined to the United States. There is good reason to argue that a mild inflationary influence there would hasten the correction of the imbalance of the world economy of which the dollar shortage is the principal product.*

IX. A CHANGE OF FRONT, DECEMBER 1952

For Australia, as for all members of the sterling area, these three problems affecting the future of the sterling area have a special significance. The persistence of a large volume of short term liabilities in the London money market, and the ever present shortage of gold and dollar reserves, leaves the whole sterling area with little "elbow room." There is little doubt that the area as a whole would be strengthened by a rise in the price of gold, though it must be emphasised that this measure alone would not suffice to solve the problems of the area. The level of liabilities and assets reflect the condition of the sterling area, and changes in these levels are the manifestations of its weakness or strength. The problems that have afflicted the whole area ever since the war have proved so far intractable, and the area as a whole has found it necessary to have recourse from time to time to an increasing measure of restriction on both trade and financial transactions, not only between the area and the outside world, but at times within the area itself. In the past year the United Kingdom has been making a brave and not unsuccessful effort to reverse this tendency and to restore some of the fiscal devices that characterised the money market in the days of its strength. This is in keeping with the decisions made at the important London conference of the Commonwealth in December last year, when the Commonwealth members of the sterling area agreed to work towards the convertibility of sterling and freer trade. There was a general undertaking to adopt fiscal policies that would eliminate inflationary pressures within the individual countries, to work towards a reduction in costs so that the area as a whole would have a stronger competitive position in world markets, to concentrate upon development projects that would build up the dollar earning capacity of the area, to conserve capital resources for this purpose, to allow the rate of interest to reflect more directly the state of the capital market, to discuss with the United States the provision of finance for some form of stabilisation fund to guarantee the strength of sterling within this general framework of policy, and to seek greater freedom of trade,

* For an able presentation of the case for the maintenance of the present price of gold, see the essay in this series by Mr. Miroslav A. Kriz: "The Price of Gold," ESSAYS IN INTERNATIONAL FINANCE, No. 15, July 1952.

especially in the practices of the United States. All this marks a clear departure from the methods adopted by the area as a whole since the war, and by the individual members.

This new approach was made at a time when new measures of restriction had recently been imposed by many members of the area. These measures were adopted to correct a balance of payments problem being experienced in greater or less degree by most overseas members of the Commonwealth. This problem followed the traditional pattern of an economy in disequilibrium, when it had allowed its costs to rise in response to higher export income, and then had to face a fall in the value of its exports and of its export income. Most of the overseas members are peculiarly subject to this tendency to disequilibrium, and no doubt the existence of the balance of payments difficulties had a good deal to do with the change of heart at the London conference. It would be cynical to attribute the change to the familiar precept of the devil becoming a saint, but there is little doubt that the general emergence of balance of payments problems had focussed attention upon the real issues and given a greater sense of reality to the discussions that resulted in a new definition of basic policy.

X. THE BUOYANT YEARS

For Australia the problem was of special importance because her imports had reached such a high figure as to endanger the level of London funds. This was due to the big increase in costs and money incomes after the very high prices that had been received for exports, notably wool and metals, in 1950-51, had been transmitted into the economy as a whole; to the high level of investment and development, creating a demand for capital equipment; to the fall in export prices and a less favourable season, bringing about a decline in the value of exports; and to additional imports becoming available to fill outstanding orders. Perhaps a few illustrative figures will underline the nature of the problem with which Australia was faced. It was on the whole rather more severe than for the other overseas members of the Commonwealth. Owing to rising prices and imports of capital, the Australian economy had enjoyed five buoyant years commencing with 1946-47 as the following table will show.

Under the influence of this high inflow of earnings and investment, the gross national product expanded rapidly from £A1,617 million in 1946-47 to £A2,724 million in 1949-50 and £A3,841 million in 1951-52. Little wonder was it that the demand for imports rose to such levels. From £A208 million in 1946-47 they rose to an all time high of £A1,053 million in 1951-52. London funds had been built up from

TABLE IV

AUSTRALIAN EXPORTS AND CAPITAL INFLOW, 1946-47 TO 1951-52

(*millions of Australian pounds*)

	1946-47	*1947-48*	*1948-49*	*1949-50*	*1950-51*	*1951-52*
Exports	265	397	522	594	975	667
Private Capital Inflow	40	80	138	230	83	67

£A218 million in June 1947 to £A843 million in June 1951, but the quick change in the economic scene in 1951-52 brought the level of London funds down to £A362 million in June 1952, a loss of £A480 million in one year. It was not surprising that severe restrictions had to be imposed even on imports from members of the sterling area, and that financial controls had to be strengthened. This made an unfavourable atmosphere for the new policy. It should not, however, be assumed that the period of buoyancy in Australia had not been one of considerable advance. On the contrary, it is probably true to say that the rate of expansion in this period exceeded all other bursts of investment in the history of the country. I have already drawn attention to the heavy immigration and the high rate of population growth. Gross capital investment showed a remarkable expansion in the period, rising from £A269 million in 1946-47 to £A1,124 million in 1951-52, or from 17% to 29% of gross product. Indeed, this high rate of expansion was in itself one of the causes of the disequilibrium in the balance of payments that occurred in 1951-52. It was a factor, not the main one, in raising the level of money incomes and in increasing the propensity to import. But as long as it was sustained by heavy imports of private capital, it was not a major factor in producing the disequilibrium that necessitated recourse to fresh restrictions in March 1952.

XI. IMPORTANCE OF PUBLIC INVESTMENT

Traditionally, Australian development has been buttressed by substantial borrowing overseas on *public* account. In the last great development and migration period, in the twenties, specific provision was made for borrowing by the Commonwealth Government of £34 million to finance the absorption of migrants while, at the same time, the Australian states were steady and substantial borrowers in the London market. Prior to the depression in 1930, Australian borrowing averaged £A30 million per annum, a high rate in relation to a national income of about £A600 million and a level of exports varying between £A120 million and £A150 million. When the depression came, the overseas debt be-

came an almost intolerable burden, and the experience of the early thirties in servicing a large fixed-interest bearing debt, interest on which, in the worst years, amounted to no less than 25% of exports, was not soon to be forgotten.

If after the war London had been able to resume its former role as a lender on large account, Australia may well have resumed *its* former role as a borrower on large account for development. But to go outside the sterling area at a time when the dollar problem was so forbidding an ogre was beyond the limits of financial prudence. In any case, the facilities for borrowing in the dollar area were not available except as part of the general operations of the varying systems of financial aid embarked upon by the United States from 1947. Moreover, with the heavy imports of capital and the favourable terms of trade, Australia appeared to have ample supplies of capital for her ambitious post-war development and migration plans.

Had there been urgent need for additional foreign capital in the early years after the war, Australia would have been forced to reconsider her development plans or to seek foreign investment. This would have raised some fundamental questions concerning the sterling area which did not in fact arise in the special circumstances in which Australia then found herself. But recent events have emphasised the need for more foreign capital if the plan of development is to be sustained. With investment running at over 25% of gross product (and this is the figure required if the rate of immigration is to be maintained and the major development projects now embarked upon to be vigorously completed) some overseas capital is essential. Australia commenced borrowing from the International Bank for Reconstruction and Development in 1950 at the rate of $50 million per annum, but this figure is far from adequate to supply the capital needed in present circumstances.* In order to encourage the inflow of private American capital, Australia has recently entered into an agreement with the United States to avoid double taxation, but it may be doubted whether the movement of private capital will be sufficient under any foreseeable conditions to provide the capital required.

In Australia, most of the power and transport facilities are developed by public authority, and to this must be added the steady stream of what may be called new social capital (schools, hospitals and some of the housing) required for an expanding population. Hence it follows that public investment must always be a considerable proportion of total investment, perhaps not less than 35%, if the economic resources of the country are to be developed rapidly and a high rate of population

* None of these funds was actually disbursed by the Bank in 1950 and disbursements during 1951 and 1952 were at an average annual rate of about $40 million.

growth sustained. In these circumstances, a condition of the maintenance of a high level of private investment is that public investment should be vigorous, and this in turn requires that the market for fixed-interest bearing securities should be favourable. This has not been the case in Australia in the last eighteen months, since the inflow of private capital ceased and the difficulties in the balance of payments arose. In part this may be attributed to the inflation of the past three years when the general level of prices (the cost of living) rose by some 65%,* and to the hardening of the rate of interest being reflected inevitably in the prices of government securities which have declined by over 10%. But it would be more realistic to attribute the difficulties in obtaining public capital to a general shortage of capital, rather than to the special and perhaps temporary technical features of the Australian money market. Capital for public investment is, as we have seen, no longer available in the United Kingdom on the scale either of pre-war times or of the present needs of Australia, and the simple fact is that no market of the magnitude required exists elsewhere. It is not merely a question of Australia supplanting the capital supplies formerly available in the sterling area by going elsewhere; it is a question also of seeking to have the facilities for the special type of borrowing Australia needs established at the new source. I return to this problem in the last section. Suffice it to emphasise once more that this problem of capital is much more important to the future of the sterling area and to the development of Australia and other overseas members of the area than, despite the experiences of the past two years, is generally realised.

XII. THE PROBLEM OF COSTS

It is not surprising that the cost structures of some members of the sterling area should have got out of line with the trends of costs in the leading industrial countries of the non-sterling world. Certainly this is true of Australia, and it may be attributed to two main factors. First, there is the element of insulation from a world economy inherent in the practices that have been adopted to safeguard the balance of payments against an acute dollar shortage, leading later to a more widespread application of these restrictive practices. Second, there is the impact on the cost and income structure of the economy of higher incomes from export. Changes in the level of export income are eventually spread throughout the whole income structure of the economy, though not always evenly or with anything approaching abstract justice. In considering the causes and course of the depression of twenty years ago, much attention was given to this process, the spreading effect of costs

* The December quarter of 1952 as compared with the average for the year 1948-49.

and the repercussions from changes in export income, and a first approximation to the theory of the multiplier was worked out.* Nothing has happened since 1930 to invalidate the conclusions then arrived at as to the basic importance in the Australian economy of changes in export income, except perhaps that the mechanism by which repercussions can be spread has improved. The impact is transmitted more rapidly than before because of the more widespread adoption of the practice of the quarterly adjustment of wages and incomes to changes in the cost of living. For instance, apart from the application of this principle to wages, under direct determination by tribunals, practically all "the white collar brigade" now have a cost of living allowance that varies quarterly with the published figures of the cost of living. Hence, when the great increase in export prices took place in 1950-51, and there was a general shortage of labour, a rapid income inflation was quickly set in motion. The most immediate cause was the extraordinary rise in wool prices, resulting in the value of the wool clip (which had been £A58 million in 1945-46 and £A194 million in 1948-49) rising to the record height of £A636 million in 1950-51. National income quickly responded. It had risen to £A2,293 million in 1949-50, from approximately £A800 million just before the war and £A1,293 million in 1945-46. In 1950-51 it rose to £A3,116 million, an increase of £A820 million, or approximately 35% in one year. It will be noticed that the national income as a whole rose by more than the original increase in export income. This is the effect of the multiplier. The repercussions from a rise or fall in export income are substantially greater than the movement in export income itself.†

Money incomes have remained high, and even rising, in spite of the reverse in export prices. Thus national income rose to £A3,238 million in 1951-52, and the general level of wages continued to rise, though at a slackened pace. But it would be wrong to assume that the costs of production in industry rose by the same amount; on the contrary, with the less buoyant conditions of 1951-52, and the reverse in the employment situation, there is a good deal of evidence that costs have fallen from their high peak. This is due to a general increase in efficiency. On the other hand, it would be equally wrong to assume that this increase in efficiency is sufficient to offset the fall in export prices as compared with the rise in money incomes. Since the beginning of the great export

* See Giblin, L. F., *Australia, 1930* (Melbourne University Press, 1930); Copland, D. B., *Australia in the World Crisis* (Macmillan, 1934); and *The Australian Tariff: An Economic Enquiry*, by a group of five economists (Melbourne University Press, 1929).

† Perhaps 2.5 would now be an appropriate figure in place of the original figure of 3 that Giblin obtained for the multiplier under the conditions of 1930, when the position in the economy of export income was relatively more important than at present.

boom in the middle of 1950, the increase in money wages has been over 40%. This is perhaps a modest figure for the actual increase. The current weekly wage rate in Australia is nearly 70% above the average for 1949, but in the less buoyant conditions of the moment, the actual earnings have not increased in this proportion.

Suffice it to say, however, that there has been a great increase in money incomes and costs, in response to the recent expansion of export income, and now that prices for exports have fallen, the cost structure would seem to be out of line with the prospects of the export industries, and of local industries competing with imports. These latter industries enjoy the protection of the tariff, and more recently the special shelter afforded by import restrictions. Fortunately, there are signs that the volume of export production is now recovering. Under the stimulus of higher volume, and rather stronger prices for wool than were expected, the value of Australian exports in 1952-53 reached the high level of £A873 million compared with £A675 million in the previous year. But the situation is vulnerable, as it is perhaps to a less degree in other overseas members of the sterling area. Any further reverse in export prices would create many difficulties. Here again there is little "elbow room" for removing the restrictive practices that have been adopted to an increasing extent over the past five years. This weakens the resistance of Australia and similar countries to the continuance of these practices which themselves undoubtedly weaken the sterling area. On the one hand, Australia will want to cling to the sterling area in so far as it insulates her economy from the growing harshness of a competitive world; on the other hand, she will want the capital that the outside world can offer for her development. Such is the dilemma that confronts perhaps many members of the sterling area. It does offer shelter against the immediate difficulties of the balance of payments, and the distorted cost structures that have developed, but it does not offer a solution of the long term needs of the sterling area for expansion of markets, population growth, and development of economic resources.

XIII. RESPONSIBILITY OF UNITED STATES

There is no doubt, however, that the general lines of policy adumbrated at the London conference present the only course that the members of the sterling area can pursue if they are to make the maximum contribution to the solution of the problems of the sterling area and the ultimate convertibility of sterling. They represent, in general, an austere fiscal policy, an attack on costs, and the direction of development into channels that will promote the maximum output of much needed food and raw materials, exploit the possibilities of non-sterling markets, and

encourage local industries that have good prospects of competing with imports without too much special tariff or other assistance. This is the heroic course, the path of economic virtue in a world where the standards of economic virtue have been softened somewhat by the pressure of social forces. It is by no means certain that even the most rigid adherence to this course over a considerable period, by all members of the sterling area, can alone attain the objective in a world where other and more powerful forces may easily deny victory to the virtuous. There are in fact three fronts on which the plans for a rehabilitated sterling can founder, and all of them are largely in the hands of the United States to determine. These are, first, the price level of the major commodities of international commerce, second, the supply of capital for development, and third, the relaxation of tariffs and restrictions on the import trade of the United States and the dollar area in general.

First, as regards the future of the general price level, any widespread tendency for the prices of the leading commodities of international commerce to fall much below the pre-Korean levels would create overwhelming difficulties for Australia and other overseas members of the sterling area. The prize for fiscal and economic rectitude would then be elusive and the sterling area would be consigned to the task of Sisyphus. It would face a losing battle against the forces of a world deflation.

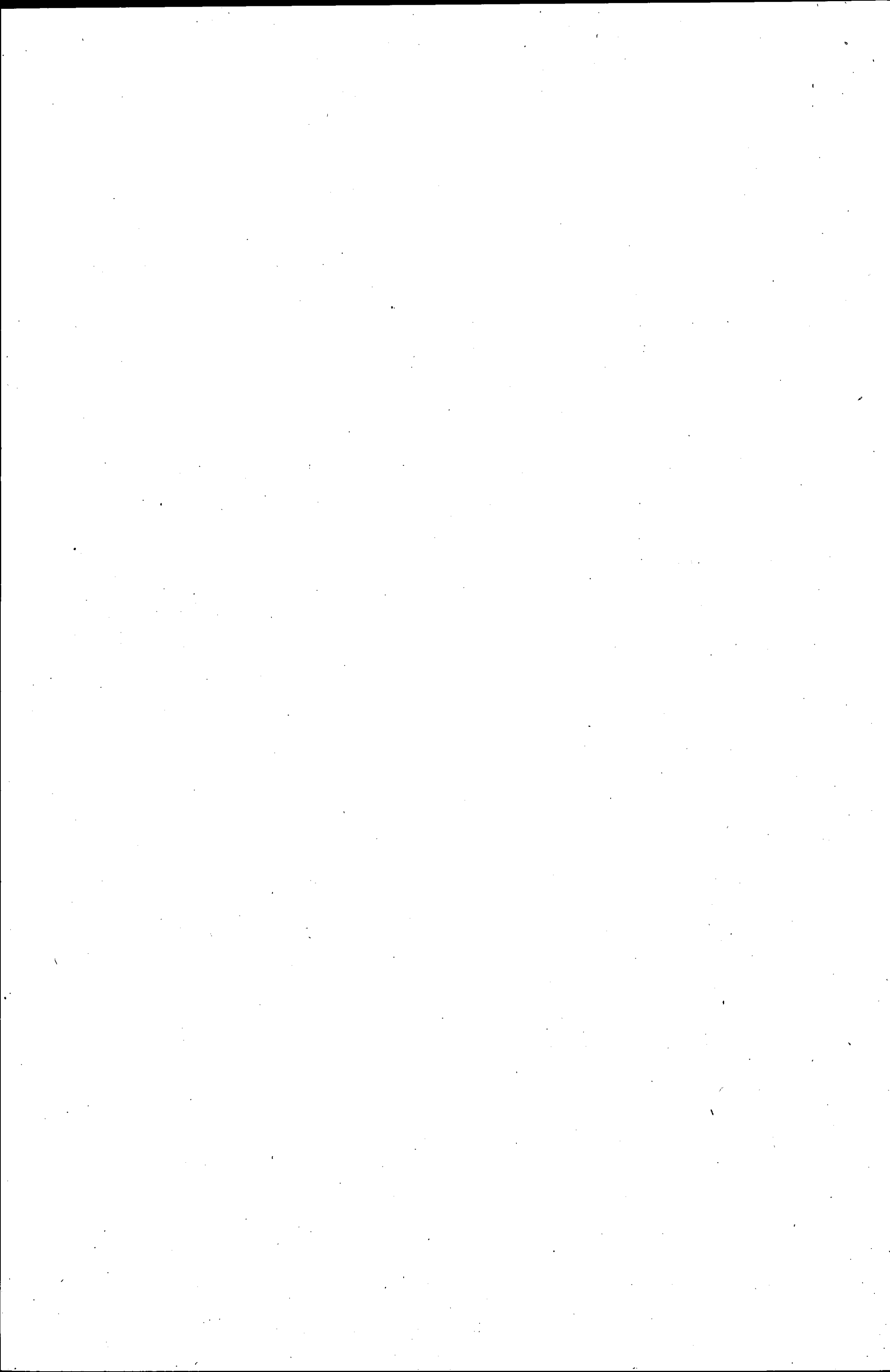
Second, there is the supply of capital which is vital to the future of the sterling area. Unless some sort of financial nexus is worked out between the dollar area and the sterling area through which capital for sound investment can flow easily from one to the other, the western economy cannot work with smoothness and efficiency. One of the most urgently needed developments is the restoration of investment in the international field, especially public investment as we knew it before the war. Much more is to be got immediately by the flow of investment than by the adoption of freer trade practices by the United States, though that also is urgently needed and is a condition of the long-term solution of the dollar gap and the problems of the sterling area. The United States has capital available. Surely its record since the war should leave no one in any doubt on that, since it has made available to the world, mostly by gift, over $40 billions since 1945. A fraction of this, in a carefully regulated flow for investment, would contribute greatly to the solution of the dollar problem of the sterling area, whilst enabling the members of the area to sustain a high rate of economic development without undue strain on their economies. Thus, in the case of Australia, it may be that the country could readily finance from its own resources a population increase of, say 200,000, or nearly 2.5%, per annum. This would permit of approximately 80,000 immigrants, but Australia is anxious to absorb at least 130,000, even more if cir-

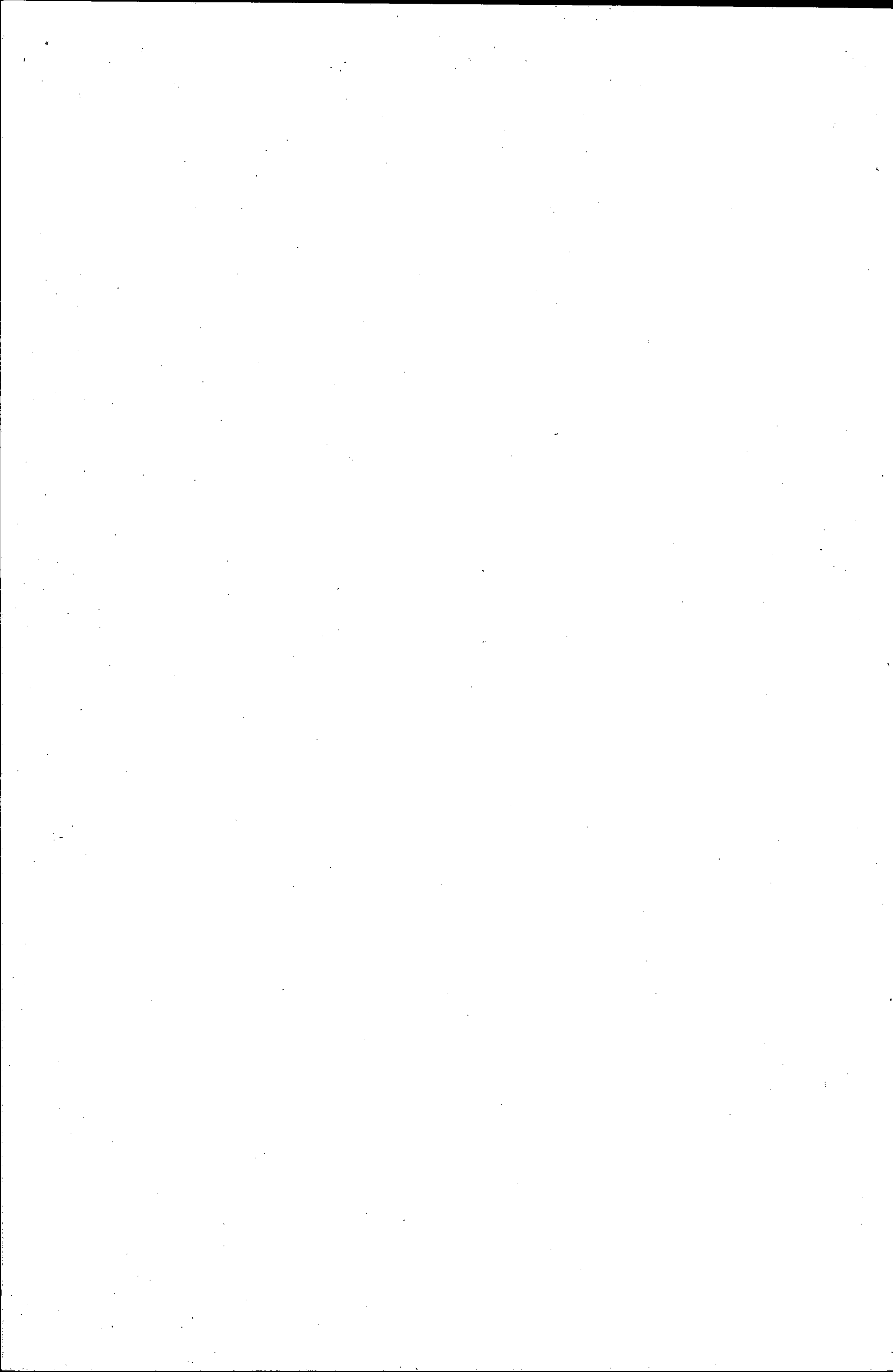
cumstances were favourable. To absorb the extra 50,000 would require a more rapid rate of development, and a greater investment programme, than would be required if the total immigration were kept down to 80,000. There are resources to be developed in Australia; Great Britain and other European countries are anxious to sustain a substantial flow of emigration; Australia enjoys political stability and has the same cultural and political heritage as the United States; she has a high standard of living and is building up good relations with her populous neighbours. Could anything be more economically sound or politically desirable than the rapid expansion of Australia on these lines? Could the United States embark upon a more profitable investment in all senses of the term? Yet, there is no recognised channel at present through which Australia can obtain the finance required as she did in the days when the United Kingdom was able to export capital on a considerable scale. Clearly, the regular flow of capital to countries like Australia from the United States would make an immediate contribution to the solution of the dollar problem, would offer some guarantees that both the planning of an ambitious development programme and the adoption of a more rigorous internal economic policy would yield good results, and would lay the foundations on which the increase in efficiency in industry generally would enable the country to balance its dollar account and take its place as a free member of the western economy. Apart from the increase in the price of gold, this is the greatest contribution America can make immediately to the improved working of the western economy as a whole, and in particular to the solution of the problems of the sterling area.

There remains the question of freer trade. I have suggested that the provision of capital and the avoidance of any deflation in world prices are more important than the adoption by the United States immediately of a progressively freer trade policy. But in the long run, and the not very long run, it will be necessary for the United States to move towards a more liberal trade policy, if she is to play her part in consolidating the western economy into one economic world. It is impossible to consider trade policy apart from investment or reasonable price stability. Indeed, all three are inter-related. Thus the flow of investment depends upon the flow of trade and the maintenance of prices depends upon the flow of investment. In this sense the promotion of freer trade is basic to a solution of the economic problems of the free world, and it is important that this should be emphasized as Canada has in discussions in both London and Washington. But in pressing this point of view it is equally important not to overlook the need to avoid a deflation of world prices and a shortage of capital. They are more important in the immediate future, and absolutely essential to the efficient working of a

free system of international trade when it does come. Nor is it necessary to be defeatist about the prospect for freer trade. Naturally, it is the point in economic policy where the forces of enlightenment meet the pressures of the lobbies at their greatest level of activity, so that criticism of proposals for freer trade are bound to draw forth fiercely expressed opposition. On the whole, however, time is on the side of those who work for freer trade by laying the foundations on which it can be prosperous. If the United States still pursues a policy of trade restriction, it should not be overlooked that this is also the meat and bread of policy in the sterling area.

The United States has definite and immediate responsibilities, in the directions I have indicated, as a supplier of capital and the guardian of the international price level, and ultimately also for developing liberal trade policies. It is in this way, by a joint effort of the members of the sterling area and the United States as the leading economic power in the western world, that the problems of the sterling area are likely to be solved. They would in fact quietly be dissolved in the progressive movement of the western economy to one currency and one economic unit; there seems little prospect of a solution on other grounds. If there is no solution, and the western world is divided into two economic units, it will then be incumbent on each country to consider its own long term interests, and to decide upon the orbit to which it wishes to be attached.





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