

E.F. PENROSE

Economic Planning for the Peace



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BY E. F. PENROSE

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IN MEMORIAM

John Gilbert Winant

P R E F A C E

THIS work is a blend of analysis with a record of experience. It follows, therefore, that I am indebted to many persons, both in the realm of thought and in the realm of action, and there is no hope that all my debts can be acknowledged individually.

The greatest of them is to the late Ambassador John Gilbert Winant, whom I served as economic adviser in nearly nine years of international work. The dedication of this book conveys but imperfectly my sense of the magnitude of this debt. Although I shared his ideals and worked in close harmony with him, it should not, of course, be assumed that he would necessarily have agreed with all the views expressed in the following pages. It will be understood, also, that the references to him are related only to the particular theme of this book and cover only a small part of his astonishingly diversified activities in public life.

To the Institute of Advanced Study, Princeton, where the first draft plan of this study was made, I am indebted for appointing me as a member in 1947, and to Professors Winfield Riefler and Walter Stewart and the late Professor Robert Warren for profitable discussions during my stay in the Institute.

The subsequent development of the study took place after my appointment as B. Howell Griswold Jr. Professor of Geography and International Relations at the Johns Hopkins University. But for the time and facilities for research and writing which, on the initiative of the late Dr. Isaiah Bowman, were made available to me by this appointment, this book could not have been produced. Dr. Bowman, with whom I had already discussed postwar plans in 1944 in London, showed a keen interest in the progress of the manuscript up to the time of his death and was particularly helpful on questions relating to the attitude at "top levels" towards the dismemberment of Germany. I am indebted also to a number of postgraduate students in economic geography and economics for the stimulus of many discussions on postwar economic events.

In recent years my outlook on international trade and finance has been influenced by the writings of, and by conversations (which began in my prewar Geneva days) with Mr. Folke Hilgerdt, formerly

of the League of Nations, now of the United Nations Secretariat. In his *Network of World Trade* he opened up, to my mind, one of the most promising approaches yet made to international economics. My debt to him is particularly apparent in a chapter included in an earlier draft dealing with the period beyond that to which later it was decided to limit this book; nevertheless the outlook in parts of this study has been influenced by his approach to international trade.

For the laborious work of typing a succession of draft manuscripts I am indebted to Dorothy Elliott, Mary Jane Langrall, Gladys Parker, and Frances Young.

To my wife, Edith Tilton Penrose, I am indebted for reading and criticizing the successive drafts, notwithstanding her preoccupation at the same time with a manuscript of her own—which, however, absolves me from the obligation to add the customary apology for many hours of silence.

E.F.P.

August 1952

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Economic Planning for the Peace

INTRODUCTION

THE Second World War lasted six years and the end, when it came, was not, like the end of the First World War, unexpected. There was time to plan for the peace, and planning began early. Some of the plans were completed before the war ended and were quickly put into effect, saving Europe from starvation in some areas and economic breakdown in others. But the plans and preparations as a whole fell far short of what was needed to restore the world to economic health.

This study seeks to determine how it was that, notwithstanding the warnings that might have been taken from the First World War, and the time, the energy, and the resources that were given to post-war planning, economic disaster came early in Germany and was narrowly averted in 1947 and 1948 in the rest of Europe. It is not an "academic" study. It uses no technical terms and trespasses freely outside economic boundaries, assuming that it is better to fall into error in the pursuit of a trail wherever it leads than to remain impeccable by staying within narrow and conventional limits. The minds and the emotions of men and the affairs of nations are not to be subdivided into compartments corresponding to the "subjects" or "social sciences" into which it is now fashionable to divide academic studies. These pages are addressed, therefore, not only to those whose special interests lie in international economics but also to general readers who are concerned above all with the means of avoiding in the second half of the twentieth century the worldwide disorders of the first half. Economic measures are only one part of a comprehensive remedy, but in an interdependent world international economic harmony is one of the conditions of international political harmony.

The present work has its origin in two memoranda. The first, which is reproduced in Chapter VII, was written in April 1944 in the United States Embassy in London, at the suggestion of members of a visiting State Department mission on postwar questions. It described the position then reached in postwar international economic planning, pointed out the gaps that remained, and suggested means by which they might be filled. The second was written at the Institute for Advanced Study, Princeton, in the summer of 1947, just

after I had left Government service. It was an extension of the first in the light of events between 1944 and 1947 and was intended as a basis for a short book to be completed within the year.

The death of Ambassador Winant in November 1947 led to a change in these plans. Finding that the Ambassador had scarcely begun the second book which he had planned to write, and which presumably would have discussed at least part of the economic as well as the political planning in London after 1941, I decided to enlarge the scope of my study, to trace the development of postwar international economic plans from their origins and to account as nearly as I could for what, since the opening of 1944, had seemed to me to be serious errors of omission and a faulty sense of proportion in the planning.

Any writer who attempts such a study will be inescapably influenced by the position and circumstances in which he was placed during the war and immediate postwar years. This both sets limits to and at the same time largely determines the positive contribution of the study. Since I was economic adviser to Ambassador Winant during the war and early postwar years, this work inevitably reflects for most of the period a more detailed knowledge of persons and events in London than of those in Washington and Ottawa, which also played leading roles in the planning. At a number of critical points, however, I have had to reconstruct the course of events in Washington from records of personal discussions there during visits on consultation, from information derived from Ambassador Winant, from later conversations with former colleagues in government service and from the memoirs and records which have been published since the war. Nevertheless it has been impracticable to attempt as intimate an account of the personal aspects of the development of postwar plans in Washington and Ottawa as of those in London. The gaps should be put down to limited experience and not to lack of appreciation or of goodwill. Much of the inside history of Washington can be written only by those who were there during the whole of the war.

The historian of the future will be able to put together from a variety of contemporary accounts and interpretations of events a far more complete picture than any contemporary observer can hope to produce. But the stage is not yet fully set for him. Meanwhile his task will be lightened and in the end his account will come closer to reality

if some of those who observed events directly from various points of view will set down their versions while their memory of the events is still clear. Notwithstanding all that has been written there is still room for further studies of the detailed circumstances in which the important decisions on postwar questions were made. The present work offers some new evidence and interpretations based largely on experiences in London at a point through which most of the exchanges between Washington and London passed.

Since my central thesis is that the economic errors of the peace were the outcome of omissions and a faulty sense of proportion in planning for different aspects of postwar international economic activities, it is necessary, for purposes of exposition, to adopt a broad classification of these activities. For convenience I have divided them into three main categories, among which there is much overlapping but each of which embodies a distinct function and type of activity. The first may be called relief, consisting in the provision of consumer goods, some of which are essential to the preservation of life and others to the restoration or maintenance of working capacity. The second is reconstruction, which includes the restoration of stocks of raw materials, the supply of new equipment, the rebuilding of destroyed or damaged areas, and the reconversion and reorganization of such parts of agriculture, industry, transport, and finance as were deranged or retarded during the war. The third consists in permanent or standing measures of international economic organization, designed to meet the continuing needs of international economic life in times of peace.

Another category, of which I have made only slight use, is that of rehabilitation, which may be taken to consist mainly in immediate repairs to damaged or worn equipment, in the supply of spare parts to existing equipment, and in the restoration of essential services as far as practicable and mainly with existing equipment. For many if not most purposes rehabilitation may be subsumed partly under relief and partly under reconstruction. Nevertheless, the distinction is occasionally useful, especially when scarcity of resources limits the scope of reconstruction.

The period to be covered by the study and the form of organization of the material raised serious difficulties from the start. As I wrote, the events of the postwar world seemed to be confirming the criticisms made in the memorandum written in 1944: but at the same time an as-

tonishingly bold and statesmanlike measure was taking shape to meet the gaps in preparations for the postwar period. Absorbed in the unfolding of this great international plan, I extended my study beyond the war period to cover the important events of the first five years of the postwar period during which the wartime plans were tested by experience. But this swelled the manuscript to an inconvenient length for a single book and led to an uneven treatment of the two periods, in the first of which I observed events from inside government and in the second from outside.

The present study, therefore, apart from a few paragraphs in the summing up, closes roughly at the position reached in the early months of 1947, when the full effects of the gaps in postwar planning were showing themselves, when Britain was moving toward an external financial crisis, when Western and Southern and a large part of Central Europe were in sight of general economic collapse, when the European Recovery Program had not yet taken definite shape, and when the international economic outlook was bleaker than at any time since the fighting had ceased in Europe. The turn of the tide began later in the year and is touched on very briefly in a closing chapter. Thus, except for a few paragraphs in the last chapter, the present study is confined to the period in which I was able to follow events from the "inside."

The arrangement of the diverse materials which had to be included was even more difficult than the choice of the period to be covered. The first draft was an attempt at a more or less chronological approach after the manner of most of the political studies of wartime experiences, such as those of Mr. Sherwood, Mr. Stimson, and Mr. Hull. The results were more intelligible to readers already familiar with part of the ground covered than to readers with little or no previous experience of any of it. A chronological approach represents more closely than any other the conditions in which postwar plans were prepared and executed. But it confuses the general reader by frequently switching his attention abruptly from one part of its field to another, thus increasing the difficulties of tracing developments in any single subdivision.

After the study had been rewritten several times, the chapters dealing with events up to the end of the war in Europe were arranged in three broad groups divided roughly according to the classification described earlier. The first deals with long-term meas-

ures of international economic organization and is in turn divided into subgroups dealing with international finance and investment, international raw material agreements, and international commerce. The second deals with relief and is divided into subgroups dealing with food relief and with the establishment of an international relief organization. The third deals with reconstruction and is divided into subgroups dealing with reconstruction in liberated Allied countries and reconstruction—positive or negative—in ex-enemy countries. In each of the subdivisions a chronological approach has been followed.

Before the middle of 1943, postwar planning was not so sharply divided into these categories as it became later, but the drift was in that direction and ultimately, except for some overlapping between relief and reconstruction in Allied countries, these groups, and to a large extent the subgroups, correspond roughly to the groups into which the civil servants who took part in postwar international economic planning were divided. The separation of civil servants into those concerned only with long-run questions and those concerned only with short-run questions was a striking feature of the organization of economic postwar planning and itself influenced the course of the planning.

There is one exception to this scheme of organization. Chapter VII, on the Hot Springs Food and Agricultural Conference, analyzes an approach to postwar planning in which questions of the long run and questions of the short run were treated simultaneously, and the reports and resolutions dealing with them were carefully coordinated. This was the only outstanding case of its kind during the period of postwar planning.

The scheme of organization followed in the chapters on postwar planning during the war has been modified in the chapters dealing with the two years after fighting ceased in Europe. In the formulation of postwar plans during the war, political opportunities and the ideas and interests of the leading civil servants went far to determine the direction of the planning and the sequence in which the plans were made. In the application of the plans and the improvisation of new plans after the war, immediate needs and pressing economic events were the predominant influence. This contrast should not be pressed too far. During the war economic necessity influenced the planning at some points, and after the war political obstacles for some

time hindered the preparation or application of appropriate economic plans even when the need for them was demonstrated. But with these qualifications the contrast holds good, and the order of treatment and extent of discussion of the different topics has been somewhat modified in the later chapters. Long-run questions, instead of holding first place as they had done in the planning during the war, sank into the background in the face of short-run emergencies, though perhaps not as far as they should have done. Gradually the realization grew after April, 1945, that economic chaos in Germany, Britain's immediate balance-of-payments difficulties, and subsequently the impending economic breakdown in Europe, should take precedence.

Notwithstanding the stress laid in these pages on errors of omission and commission, especially the former, the aim of this study is not destructive nor iconoclastic, and the merits as well as the defects of postwar planning have been discussed. In the present state of political witch hunting in Washington it may be too much to expect that no one will attempt to misuse any statements in this book to serve partisan ends in an unscrupulous pursuit of power. Yet the motives for the criticisms of persons and policies contained in the following pages lie not in political partisanship nor, it may be hoped, in personal likes and dislikes, but partly in economic judgments and partly in beliefs about values.

In tracing the details of postwar planning and its outcome the question will recur again and again to those who wish to penetrate below the surface of events, whether or not the record justifies the hope that human societies will accumulate the knowledge and develop the wisdom, the moral sense, and the capacity to act, through which alone they can profit by past experience and avoid the repetition of old errors and the commission of new errors in the future. Twice within the span of a generation we have been plunged into world conflicts which have brought unimaginable disaster to millions of human lives. Each time the survivors have been given a reprieve and an opportunity to reconstruct the world in a new image. Each time the task of reconstruction in a more densely populated, more specialized and more interdependent world has increased in complexity, requiring greater knowledge and executive capacity, greater integrity and magnanimity. The limitations of human foresight may excuse some of the errors of the peace. But others might have been

avoided by a proper interpretation of the past. Unfortunately, it is immensely more difficult for large societies than it is for individuals or small groups to profit from past errors. The interpretation of past experience is difficult enough in itself and may be possible only for trained minds. But even when a small number of individuals agree on a reasonable interpretation, a long and difficult road must be traversed before their interpretation is accepted by the mass of their fellow countrymen, most of whom never study the past, or by the government of their country, preoccupied with day-to-day events. Too often the politician heeds past experience only so far as he can extract from it an interpretation, however spurious, which can be pressed into the support of ulterior aims of his own. The last state may then be worse than the first; it is often better to ignore the past than to misinterpret it. Moreover, an excessive anxiety to avoid a repetition of the disasters of the past may hinder preparations to avoid new disasters of a different kind in the future, as it did among those military general staffs who gave their main energies in the interwar period to preparing for a new war on the same lines as the old.

But these difficulties do not excuse the fatalistic, cynical, and defeatist attitudes which permeate American politics today. They should spur us to greater efforts to determine why the counsels of wiser men are so often discarded by or never reach the ears of those in positions of political authority, and why certain forms of supposedly democratic government are retained which give undue opportunities to selfish and obstructive minorities that place themselves in opposition to international measures. They should lead us also to inquire into the widespread belief that human nature in politics can never be changed, that he who aspires to political office must inevitably pander to the prejudices of the ignorant and the pressures of selfish interests, and that the man of culture, integrity, and intellectual attainments, with rare exceptions, is and always will be out of place in political life.

For the economic successes and failures of the peace were political successes and failures and had their origin not only in the adequacies and inadequacies of economic and political knowledge and judgment but also in the characters of the individuals who made the political decisions and of those who influenced them in their choices among alternative courses of action.

CHAPTER I

Negotiating a Text for Postwar Sermons

THE First World War ended suddenly and unexpectedly and caught the statesmen in Allied countries unprepared with plans either for relief or for reconstruction. Widespread human misery followed, much of which, with foresight, could have been prevented.

During the Second World War, government officials in London and Washington were anxious to prevent a repetition of this error, but in the earlier part of the war great difficulties stood in the way of open and concerted economic preparation for the peace. With the abrupt end of military inactivity on the Western front in the spring of 1940, popular sentiment in Great Britain was directed toward winning the war; and, since the United Kingdom was fighting against heavy odds, it could not be expected that a ready ear would be turned towards proposals for postwar measures. When Pearl Harbor awakened the American people to international realities there was a sharp revulsion in Washington political circles against any discussion of postwar matters, as the magnitude of the task of winning the war came to be realized. By this time Whitehall had begun to study postwar questions, but it was difficult to begin Anglo-American discussions of the difficult and urgent questions that might be expected to arise on a small scale as soon as any of the Allied countries was liberated and on a large scale when the war in any one theater or in all theaters came to an end.

At this stage the supreme objective was to draw a full and united war effort from all sections of people in the British Empire and the United States. It was easier to obtain unity in the war effort than unity in the larger objectives to be pursued after victory. In 1942 it seemed to many that the war position of the Allies was so unfavorable that no risks of disunity among political parties should be run by stirring up public discussion of the social and economic questions of the future peace. It was not, indeed, supposed that controversies on the sub-

ject would turn any parties or significant sections of the people against the war effort. But it was feared privately by many political leaders that controversies in the legislatures and among the public on postwar questions would distract attention from the task of bringing the war effort to its highest pitch, and would create in the outside world an appearance of disunity that would encourage the enemy. For some time these fears seemed to dominate the minds of the administration leaders in Washington, particularly since the increasing Republican minority, aided by the conservative section of the Democrats, were prone to identify constructive postwar planning with the spirit of the New Deal which had aroused their ire in domestic affairs.

The appointment of John Gilbert Winant as Ambassador to the United Kingdom in succession to an extreme isolationist, Joseph Kennedy, brought a new spirit into Anglo-American relationships through the Embassy in London and greatly influenced the course of discussions on postwar questions.

Ambassador Winant came to his post with wide interests and experience in international as well as national affairs, and in economic as well as political affairs. To him the outbreak of war was an occasion not for suspending public concern with economic and social questions but rather for reexamining the existing order to determine how far past shortcomings had contributed to present strife. He did not believe that political settlements in themselves could provide an enduring basis for peaceful international relationships, and he knew that economic settlements would require long and arduous preparation if the errors made after the First World War were not to be repeated. Although he was well aware of the political pitfalls in Washington which held back the administration, particularly after the Pearl Harbor disaster, from raising controversial issues on peacetime questions while the Allied arms were suffering reverses at the front, he took every opportunity, from an early stage in the war, to advise the State Department and sometimes the White House to take constructive action on a variety of postwar international economic matters.¹

In London, Ottawa, and Washington small groups of civil servants played a large part in the initiation as well as in the detailed prepara-

¹ Numerous incoming telegrams in the State Department files will be available to the future historian in confirmation of this.

tion of plans for the postwar period. They were made up of an effective combination of permanent officials and of temporary officials who were drawn into government service for the war period, and some of whom were outstanding economists. The union of these two types of officials in wartime was fruitful in many ways: not only were the newcomers able to fill gaps which could not be filled from the ranks of permanent officials, but the experience and the intellectual equipment of each type supplemented those of the other to the advantage of both of them. No such array of economic talent had ever before been mobilized in the service of government in the three capitals.

The first impetus toward the discussion of postwar economic questions between the U.S. and the U.K. came from the system of Lend-Lease or, as it subsequently became, Mutual Aid. This brilliant conception of President Roosevelt's was one of the greatest achievements of the war. It was designed not only to assist in the war effort but also to avoid such burdensome commitments to repay as were foisted on the United Kingdom during and after the First World War, and which were a source of discord through the interwar period. From the beginning there was not only a desire but also a determination to avoid a repetition of this experience which had contributed to the Second World War by giving a pretext for the passing of the mischievous Johnson Act which banned loans to countries that had not paid the debts contracted in the First World War.

In the summer of 1941, when Keynes visited Washington, the State Department was drafting clauses to complete the text of the agreement to be negotiated with the United Kingdom and subsequently with other Allies, which would specify the obligations arising out of Lend-Lease operations. Although most of the clauses in the agreement were concerned with the forms of mutual aid to be undertaken by the parties, the framework of postwar settlement of the balance of mutual aid had to be dealt with, at least in general terms. The article relating to this happened to be the seventh in the agreement: hence the term "Article VII," which will recur frequently in the following pages and which came into everyday use among the planners who worked on postwar international economic questions in London, Washington, Ottawa, and Canberra.

If commitments to repay or replace the balance of goods received were to be avoided an alternative form of settlement acceptable to

the United States Congress had to be devised. This article inevitably raised postwar economic questions and was the subject of long and strenuous discussions in and negotiations between London and Washington. In Washington at the outset some officials wished to demand political concessions from the United Kingdom, particularly the cession of military and air bases, and others wished to demand unilateral economic concessions. But wiser counsels were accepted in the formation of U.S. policy and it was realized that obligations must be common to both sides. The original draft was revised many times in the course of internal discussions and of negotiations with the United Kingdom. Its chief provisions were that in the settlement of obligations arising out of the Lend-Lease Act no conditions should be laid down which would obstruct commerce, but agreement should be reached on measures to reduce trade barriers and to abolish preferential duties.

But the economic position of the United Kingdom was changing and some of the effects of the change were not yet fully realized in Washington. Before the war a proposal to remove preferential duties in the United Kingdom would have led to a division of opinion mainly on political party lines. But a striking new factor had to be taken into account in 1941. The United Kingdom, unable to raise loans in the United States because of discriminatory legislation adopted by Congress, had been obliged to sell the greater part of its marketable liquid foreign assets to obtain dollars. This created a difficult postwar problem even for those British circles which before the war had opposed imperial preferences. It was left to the great British economist, John Maynard Keynes, who had been appointed as adviser to the Chancellor of the Exchequer, to state it forcibly in Washington in the summer of 1941 on a visit arranged by Ambassador Winant. With his customary vigor Mr. Keynes spoke plainly on the implications for postwar policy of the liquidation of the foreign investments of the United Kingdom to pay for orders placed in the United States during the period of the "cash and carry" policy. An appreciable proportion of U.K. imports before the war had been offset by the returns on past investments abroad. The loss of these investments, he pointed out, would force Great Britain to export considerably more after the war if the same level of imports was to be maintained. But he added, "imports do not automatically breed exports," particularly at times when an appreciable proportion

of the productive resources of the richer countries are in a state of chronic unemployment or underemployment. Consequently it was probable, said Keynes, that Britain would be obliged for some time after the war to make bilateral commercial arrangements with other countries, providing for the acceptance of British exports by countries supplying Britain with its essential imports. Exchange control would also have to be maintained for a considerable period to limit total imports and to discriminate between essential and unessential imports.

These views were disturbing to official Washington in the summer of 1941. One of the most active and well organized divisions in the State Department was the Division of Commercial Policy and Trade Agreements. The Reciprocal Trade Agreements Act and its applications in a series of commercial treaties were almost the only exceptions to a general advance of trade restrictions during the 1930's. The division was headed by Harry Hawkins, who had worked closely with Secretary Hull on commercial policy for a decade, and who combined an exact and detailed knowledge of trade policy with great ability and long experience in international trade negotiations. The outbreak of war had not dimmed his belief and that of his staff in the desirability of freer trading among nations. They held that trade restrictions and economic warfare in peacetime were a danger to international harmony not less important than political antagonism, and that as much as possible should be done even during the war to clear the way for freer trade in time of peace.

In August I was called to Washington to receive from Dean Acheson, then Assistant Secretary of State, and from Harry Hawkins and convey to Mr. Winant an account of the questions which had arisen during Mr. Keynes's visit and of the attitude of the State Department on them. An impasse appeared to have been reached between Washington and London on what at the time appeared to us to be one of the most important aspects of postwar policy. On the flight to Lisbon I discussed postwar difficulties with Professor Alvin Hansen, the distinguished economist of Harvard University, and Dr. Luther Gulick, who were visiting London for a few days to address a scientific meeting. We agreed that in any discussions with Mr. Keynes it would be wise to accept unreservedly the view that, after postwar reconstruction had been completed the chances of freer trade would be lost unless a high level of employment were

maintained. Hansen and Gulick rendered valuable service by showing Keynes that there were Americans who were equally concerned with him about the necessity of placing full employment as high as free trade among the prerequisites for the postwar economic order. However, Keynes remained unconvinced of the adequacy of any measures proposed up to that time to deal with Britain's balance-of-payments difficulties. Nor did Whitehall take an optimistic view of the ability of the United States to maintain full employment in peacetime.

In September Ambassador Winant requested the State Department to postpone discussion of Article VII, in view of urgent war questions that were absorbing all the energies of the government. The postponement enabled officials in London and Washington to reconsider the draft article. In Washington, Redvers Opie, economic adviser to Ambassador Halifax, held "off the record" discussions with Dr. Leo Pasvolsky, Secretary Hull's adviser, and Harry Hawkins. In London I engaged in similar informal conversations, first with a few of the younger economists who were close friends of Mr. Keynes, and later with Mr. Keynes.² Such informal and unobtrusive exchanges of personal views on postwar matters continued throughout the war, helping to clear the way for organized, official negotiations, removing misunderstandings, keeping a small and discreet group of officials in each capital in touch with the development of thought among their counterparts in the other and establishing a spirit of cooperation in a common Allied cause.

At the outset Keynes stressed the difficulties that would beset Britain when Lend-Lease ended. It could not be expected, he said, that increased exports sufficient to pay for those imports which had previously been offset by earnings on foreign investments would be "automatically generated by the price system." At the end of the war Britain would be more damaged and would start with a greater reconversion problem than most if not all her industrial competitors who were not ex-enemy countries. His impression was that in spite of his explanations the seriousness of the position was not appreciated in Washington.

² Throughout the rest of the war I exchanged personal views frequently with Mr. Keynes: we discussed war and postwar economic issues fully and frankly. When particularly important economic issues arose both the Ambassador and I would spend an evening in discussion with Keynes, free from interruption.

This was a strong case which needed a more comprehensive reply than it had yet received. Unfortunately, there were formidable political difficulties to be faced. The proper remedy, as it appeared to me at the time, would have been to make Lend-Lease retroactive and reimburse Britain for the investments liquidated in the United States to meet war purchases before Lend-Lease began. But I was obliged to add that there was no hope that Congress would consent to that remedy. Two points in the British case, however, had to be acknowledged without reservation: first, the grave balance-of-payments difficulties that would confront Britain at the end of the war, and second, the necessity of maintaining a high level of employment among the leading industrial countries of the world and especially in the United States. Admitting all this, however, it was doubtful whether bilateral negotiations to force suppliers abroad to buy more in Britain than they would otherwise have bought, could ever be an effective remedy. Markets and sources of supply were not always closely matched and could not be forced into correspondence without a general lowering of efficiency. Freer trade was necessary to help Britain to increase its exports after the war. Moreover, a series of exclusive bilateral bargains between the United Kingdom and the countries from which she obtained her imports would provoke retaliation from other countries, with the result that international buyers would be forced more and more to purchase goods from high-cost instead of low-cost producers and total trade would diminish. It would be difficult to solve Britain's problems within such an international economic framework.

Mr. Keynes's attitude in the second half of 1941 was, I believe, primarily a reflection of a temporary mood of despair regarding the chances of getting international agreement on a more enlightened solution than that of bilateral pressure and bargaining. A somewhat analogous situation had arisen in the early 1930's, when for a brief period he advocated tariffs as a remedy for British unemployment, but soon turned away to better plans. Then and later the case for so-called "bilateralism" on its economic merits rather than as a counsel of despair was upheld chiefly by a group of economists who, though living in Britain, were of continental European origin and training.

However, in the Treasury Mr. (later, Sir) Hubert Henderson, who had been a Cambridge economist, editor of the *Nation* and a

member of the Economic Advisory Council, continued to argue the case against Article VII on the grounds that some discrimination would be unavoidable in the conditions that would exist after war. This was of course a markedly different point of view from that of the political supporters of imperial preference, since it did not rely on political sentiment and indeed supported discriminations in favor of certain foreign as well as Empire countries when economic circumstances appeared to require them.

At that time and later I did my best to impress on Mr. Keynes and other government economists that the desire for freer and for non-discriminatory trade in the State Department should not be written off as the product of a nineteenth century *laissez-faire* attitude toward economic affairs, untouched by recent economic thought and experience. It was true that Secretary Hull and Harry Hawkins had a particular concern with trade, but this arose from the Secretary's leading role in that field for many years and Hawkins' position at the head of the division concerned with trade matters. In conversations in Washington both Acheson and Hawkins showed themselves progressive in outlook and under no illusion that freer trade alone was a panacea for all economic ills. However, it soon appeared that the contrary view had been expressed to British officials in Washington by some U.S. officials outside the State Department.

It was Keynes who, notwithstanding his controversial position in Washington earlier in the year, took the lead in the preparation of constructive alternatives to discriminatory bilateral bargaining. Impressed by the reasoned objections to exclusive bilateralism which were expressed to him informally by Mr. Meade and other British economists after his return to London, he set to work energetically on the preparation of an alternative approach to the question. This will be discussed later, but it should be noticed at this stage that Keynes's plan was well advanced by the time negotiations on Article VII were resumed. In his own mind Keynes had dropped, or was on the verge of dropping, the argument that hard bilateral bargaining would have to be resorted to; and he was replacing it by a plan for an international institution to deal with balance-of-payments questions. Thus the powerful influence of Keynes was at last thrown on the side of those within Whitehall who advised that Britain should agree to a revised draft of Article VII which still included the

provisions relating to the reduction of tariffs and the elimination of preferences.

In Washington, also, by the end of 1941 the subject was approached more broadly. There was fuller appreciation of the dependence of trade policy on internal employment policy and a clearer recognition of this in revised drafts of Article VII. The revised drafts introduced a clause placing an obligation on the parties to promote the expansion of employment and production. These drafts, regarded as satisfactory in the State Department, can be taken as evidence of the scant foundation for the view held in some parts of Washington and London that the United States position was dominated by an outworn nineteenth century doctrine of free trade as part of a system of general *laissez-faire*.

In these months political events overshadowed economic events. The war clouds over the Far East darkened and the storm broke on December 7. In the closing weeks of 1941 great political and economic decisions had to be made, and it was not until February that Ambassador Winant told me that he was informing the State Department that in his view the time had come to take up Article VII again. Negotiations were resumed and drafts and redrafts were presented by both sides, but agreement was not easily or immediately reached. The chief difficulty in the final negotiations centered on the proposed "elimination of discriminations," which attracted the attention and aroused the opposition of a section of the Conservatives in the coalition government.

The controversy became more political than economic, a matter of sentiment rather than of calculation. A section of the Conservative Party valued the system of preferential duties on Empire goods as a force making for solidarity within the British Commonwealth of Nations. They pointed with pride to the readiness with which Canada, Australia, New Zealand, and the Union of South Africa had voluntarily entered the war side by side with Great Britain and sent their young manhood across the world to fight in the deserts of Tripoli and the mountains of Greece at a time when the fortunes of war favored the enemy, when the survival of civilized society seemed doubtful, and when other countries lay inactive—conquered, acquiescent, or in a stupor. They recoiled from the suggestion that at this of all times Great Britain should join in a public declaration of policy aimed at the severance of special economic ties uniting the

Commonwealth, and it seemed to them particularly inappropriate that such a declaration should be suggested by a country which, though it had given material help, had persistently refused to enter the war until it was forced involuntarily into it by direct attack.

Those who held these views believed that they were acting directly in the interests of Great Britain and the Commonwealth. They sought no personal gain and were not moved by individual self-interest. Perhaps their most active and uncompromising member was Leopold Amery, who had great energy, high integrity, and keen political insight, but little facility in economic reasoning. The case rested essentially on sentiment and on political rather than economic considerations.

The Prime Minister has often been described as an "imperialist." In fact, however, Mr. Churchill had been brought up as a free trader: he was a minister in the Liberal government which before the First World War successfully withstood the attacks of the Conservative opposition and the protectionist campaigns of Joseph Chamberlain; and though later, when he was in the Conservative Party, he acquiesced in a certain degree of protection as a *fait accompli*, he still thought there was a general presumption on the side of free trade and felt no enthusiasm for the system of Empire preferences adopted at Ottawa. His hesitations and objections on the clause relating to discriminations arose, therefore, not from his personal views on the intrinsic merits of the subject, but from a desire to preserve unity and harmony within the coalition cabinet and to bring undivided energies to bear on the conduct of the war. He saw this as a matter of supreme importance, with all other things of no moment whatever in comparison. He felt that internal controversy on a question relevant only after victory had been won was out of place at a time when victory was as yet no more than a distant goal.

A considerable section of the Conservative Party was by no means wedded strongly to imperial preferences. From the time when Joseph Chamberlain started his campaign for a preferential system, the Conservatives have been and remain divided on the question. The impassable barrier to comprehensive proposals for a preferential system approximating "Empire Free Trade" has always been the desire in each country for domestic protection. In the United States serious misconceptions have prevailed concerning the Ottawa Conference. The records of that conference show Australia and not Great Britain

as the driving force behind the movement for an extensive preferential system. Canada temporarily occupied a position somewhat similar to that of Australia. It was Mr. Bruce, the Australian representative, and Mr. Bennett, the Canadian representative, not Mr. Baldwin, who pushed the preferential system as far as it was carried at Ottawa and would have pushed it farther but for the resistance of British Conservatives who were more interested in raising barriers against imports generally than in lowering them on Dominions products.

By 1941 the attitude of the Dominions had changed considerably. Mr. Bennett, Canadian Premier at the time of the Ottawa Conference, had disappeared from Canadian politics, and Mr. MacKenzie King, who had been leader of the opposition in 1932 and had opposed Mr. Bennett's policy at the Ottawa Conference, was Prime Minister. Australia was now particularly interested in obtaining in the postwar period a wider market for its wool in the United States. Mr. Bruce, who had become High Commissioner for Australia in London, was no longer the crusader for imperial preference that he had been in 1932. In the intervening period it had become clear that the preferential system had not borne out the enthusiastic claims that had been made for it. Moreover, Mr. Bruce was convinced of the importance of harmony in the postwar period, as well as in the war years, between the British Commonwealth and the United States. Both during the discussions in Washington on a wheat agreement and during the Article VII discussions in London, Mr. Bruce and Mr. MacDougall, his economic adviser, visited our embassy and discussed the difficulties with Ambassador Winant and me. Though they did not in any way compromise the British position, it was clear that they were extremely anxious to assist in reaching a solution satisfactory to all sides.

In still other ways the situation had changed since 1932. The Ottawa Conference and the measures which were adopted by it were a response to the disastrous Smoot-Hawley tariff which in 1930 had been accepted by President Herbert Hoover, against the emphatic advice of the country's economists. With the fall of Mr. Hoover and the Republicans the position changed. The new Secretary of State, Cordell Hull, from the beginning pursued an unwavering course toward freer trade. The instrument which he chose for reducing barriers was indeed a slow and cumbersome one, involving

a long-drawn-out series of bilateral negotiations. But it had the great advantage of not requiring ratification by Congress. For once, American representatives were able to make commitments which they were certain that they could fulfil. Moreover, the political condition of the world after Hitler seized power in 1933 would have given slender chance of success to any enterprise for simultaneous multilateral reduction of trade barriers. The aggressor countries were moving into a war economy. They desired the greatest possible supply of goods useful in war, not the greatest possible volume of production and trade to satisfy human wants. Faced with this threat, it was in the interest of the potential victims of aggression to follow the same course for their own defense. Some of the smaller neighbors or near neighbors of Germany were coerced into bilateral arrangements. Others belatedly began to prepare defensive measures. The scope for the application of the Reciprocal Trade Agreements Act was therefore limited by the political state of the world.

However, it was in the interest of some of the threatened countries to maintain a considerably greater volume of external trade under the protection of powerful naval forces than they would have been able to risk if they had been only land powers. Consequently Britain was able to enter into an important reciprocal trade agreement with the United States as late as 1938. Her policy of relying on her navy and air force instead of seeking agricultural self-sufficiency was wholly justified when war came. A considerable proportion of German labor was tied up in small-scale agriculture, partly in an attempt to approach as nearly as possible to self-sufficiency in food and partly in the belief that the rural population were more reliable supporters of the Nazi regime than the urban population. The result was that Britain's labor mobilization for direct war purposes, especially in the manufacturing industries, was far more complete than that of Germany. At the same time Britain achieved a record increase in domestic food production with the aid of an increase in agricultural machinery.

Thus on the United States side the Smoot-Hawley tariff act had been undermined at some points by Secretary Hull and on the United Kingdom side the war was beginning to demonstrate that even for defense purposes the maintenance of British external trade was sounder than the pursuit of self-sufficiency.

There remained only two economic arguments of substance against

the abandonment of imperial preferences. Mr. Keynes mentioned the first in one of the conversations I had with him during these negotiations. He was not, he said, impressed by the views of some of the British ministers who supported preferences for reasons of sentiment and who held that they were an important political link holding the Commonwealth together. The ties among the members of the Commonwealth did not depend on such economic bargains, the negotiation of which sometimes caused friction. But once the system of preferences had been established it did provide a fairly reliable market for several million pounds sterling of U.K. exports. The sudden abolition of this market would not necessarily be followed automatically by the opening of alternative markets of the same value. The proportion of U.K. exports involved was not great, but unless adequate remedies were found the British position at the end of the war would be such that even a small assured market would count.

This argument could be met in one or more of three ways: first, by providing at least equivalent concessions in other markets to offset probable losses in preferential markets; second, by a direct remedy for the U.K. balance-of-payments difficulties arising out of the liquidation of external assets for war purposes; third, by far-reaching constructive international measures to create conditions in which it would be easier to solve the problem of the U.K. balance of payments. As we shall see, the text of Article VII which was adopted opened the way to the application of the first and to some extent of the third but not of the second of these remedies. My impression was that Keynes, while not overlooking the first was mainly concentrating his attention at that time on the third, in which he hoped that his plan for an International Clearing Union would find a leading place.

The second substantial economic argument against the sudden abolition of preferences was that certain colonial territories, particularly in the West Indies, which could balance their payments abroad only by the proceeds of exports admitted at preferential rates on the U.K. market, would be crippled by the removal of the preferences. Sir Hubert Henderson, who had been a member of the Royal Commission on the West Indies, had been greatly impressed by the precarious position of these colonial areas relying chiefly on sugar exports and by the difficulties of finding alternative export crops.

There was much force in this argument but, notwithstanding all the hullabaloo about imperial preferences in Washington, then and later, the United States had for years itself granted preferences, notably to the Philippine Islands and Cuba, and it might be taken for granted that the State Department could not, even if it wished to do so—which was not certain—induce the Filipinos to accept and Congress to endorse the sudden abolition of American preferences.

Keynes, who was adviser to Sir Kingsley Wood, the Chancellor of the Exchequer, was now in favor of signing Article VII, and the opposition in the late stages arose chiefly from political circles. It seemed that all but one of the Chancellor of the Exchequer's advisers in the Treasury were in favor of acceptance. Economists in other parts of Whitehall held similar views. The provisions of the Ottawa Conference had hardly gained more approval in British economic circles than the Smoot-Hawley tariff had gained in United States economic circles, and once the draft recognized that preferences and tariffs had to be dealt with together and that they could be dealt with effectively only if high levels of employment were maintained, British economists supported an accord with the United States.

But the political opponents of Article VII maintained a stiff opposition for some time after civil servants and a number of ministers, including Mr. Eden, the Foreign Secretary, and Richard Law, the Minister of State, were prepared to agree.

Early in February Ambassador Winant spent a week-end at Chequers with the Prime Minister. Returning, he described the ministerial position to me as follows: some three-quarters of the Cabinet were opposed to having any reference to trade preferences in the Lend-Lease agreement. Of these, a few were out-and-out supporters of empire preference on principle but others, including Mr. Churchill, did not believe that preferences served any useful purpose and were ready to begin discussions immediately, outside the scope of the Lend-Lease negotiations, on preferences, tariffs and other post-war questions of economic policy. They objected, however, to carrying on such discussions within the framework of the Lend-Lease negotiations, on the ground that the association of these two subjects gave the impression that Empire ties would be bartered away or sold in exchange for goods which Britain needed to wage the war.

A smaller group, led by the Foreign Secretary, had not read this association of ideas into the United States proposal and was ready to accept a draft, prepared by the Foreign Office, which was in harmony with the U.S. position. But Mr. Amery and Sir Kingsley Wood had led a stiff opposition which prevented the acceptance of this proposal. Sir Kingsley Wood, besides being Chancellor of the Exchequer, was in a position resembling that of a "party manager" of the Conservative party and was concerned with the maintenance of unity within the party.

Thus the signature of the draft agreement was delayed and the Foreign Secretary handed an alternative draft to Ambassador Winant, who, on returning from the Foreign Office, asked me to examine it before he gave Mr. Eden his answer. So far as it went it was unobjectionable; it included an obligation on both sides to seek the reduction of trade barriers. But it made no reference to preferences or discriminations. This issue, therefore, had to be squarely faced, and it appears that there were some in Washington who would have been willing to accept such a draft in principle and who were doubtful whether it was worth while to prolong the controversy on the issue of discrimination. However, my advice to the Ambassador was that the British draft should not be accepted and that consultation with Washington before answering the Foreign Secretary was not necessary. After going over the draft carefully once more, the Ambassador agreed and communicated his answer to the Foreign Secretary, after which he dictated a telegram to the State Department informing them of the action which he had taken.

The question was now wholly at the "ministerial level." Messages passed between the President and Prime Minister and between the Secretary of the Treasury and the Chancellor of the Exchequer. Ambassador Winant talked with Mr. Churchill, Mr. Eden and Sir Kingsley Wood. Lord Halifax cabled from Washington to the Foreign Office arguing vigorously that the latest State Department draft should be accepted.

Finally agreement was reached on the following text of Article VII:

"In the final determination of the benefits to be provided to the United States of America by the Government of the United Kingdom in return for aid furnished under the Act of Congress of March 11, 1941, the terms and conditions thereof shall be such as not to burden