

MEMORANDUM OF CONVERSATION

June 25, 1947

SUBSTANCE OF SECOND MEETING OF
UNDER SECRETARY CLAYTON AND
AMBASSADOR WITH BRITISH CABINET
MEMBERS.

Peterson was delayed in traffic and entry at the meeting, and at the time of his arrival Mr. Dalton was speaking about the cost of the British Armed Forces which were being used to help the United States in the control of Germany.

Mr. Dalton referred to rubber from which dollar earnings were falling rapidly. It was the best dollar earner among colonial exports and the break in prices to 31 1/8 Straits Settlement cents (a reduction of one-third or one-fourth) was serious. It was caused by US policy regarding synthetic rubber, which under mixing regulations required consumers to use synthetic production of which now approximated 500,000 tons annually. This represented state intervention of a protection character. The Batt Report proposed 250,000 tons of synthetic, and if this was made operative the resulting additional market for 250,000 tons of natural rubber would mean \$100 million to rubber exporters, most of whom were in the UK area. Mr. Dalton knew that this matter was coming before the rubber study group at Paris shortly.

Referring to Mr. Dalton's reference to expense for bi-zonal arrangements, Mr. Clayton questioned the assertion that the UK was "putting up money to help us occupy Europe". It was a joint occupation and the British were not in a position of helping us, but in this general respect he recognized the difference in the UK position versus Continental European countries.

As for rubber, the War Department insisted on mixing requirements in the production of finished articles, mainly tires. They had been unable to figure out any other method of keeping synthetic plants going. Their present capacity was over a million tons annually and popular demand was that one-quarter be kept as going concerns in case of trouble. We were caught in a bad fix in the last war and would not soon forget the difficulties. We were trying to find a way of keeping synthetic plants going other than by the mixing law but subsidization was not feasible. (Dalton interjected that people prefer natural rubber, and received an affirmative reply). Mr. Clayton then reiterated that subsidization was not a practicable approach, because while a subsidization would produce synthetic rubber, it would not force people to use it. It was intended to get synthetic production down from 500,000 tons to 250,000 tons and the Department wanted the new law limited to two years. He believed synthetic production would be brought down to 250,000 tons and on that basis thought the US would be back to its prewar importations of natural rubber. In response

to a request for assurance that the US would soon be resuming rubber imports, Mr. Clayton said the purchase of rubber had been released from government control and private buyers were doing the importing. Mr. Dalton emphasized that rubber was a sore point and Cripps asked if we could encourage people to come into the market early, to which Mr. Clayton replied that since private people were now doing the importing, it would be difficult for the Government to do anything about the matter.

Mr. Bevin said the rubber problem impinged upon UK treatment of natives. With prices for such indigenous products falling there was trouble to augment that which already existed on a low ration of four to five ounces of rice daily. He said this was a fundamental consideration and had political implications. The UK was on a razor edge in Malaya and we should avoid making a gift to our "mutual friends". He spoke of the British Special Commissioner's work in South-East Asia (Lord Killern) and the reports from Malcolm MacDonald in Singapore. Bevin said the Communist movement was "going" in Indonesia, agents pouring in and this development was on top of other difficulties in South-East Asia. He asked if US rubber buyers could be shown the wisdom of the basic price.

Mr. Clayton would look into this but thought it would involve an agreement among buyers in conflict with our basic laws (anti-trust) but Bevin said something similar had been done with tin in which the US had cooperated, or at least abided by an agreement. Bevin said the tin people did not grumble but saw advantages in a steady and stable level for tin. Bevin favored stability in prices of fundamentally important commodities as a principle and suggested on rubber a private agreement might be worked up. Mr. Clayton reiterated that US policy was to get away from government purchase. However, he would take up the question of rubber at home, particularly (1) the shift to 250,000 tons and (2) would look into market factors and the possible resumption of private buying.

Mr. Clayton was surprised at the reported price changes (Cripps said levels were below production cost). Mr. Clayton would not overlook the political considerations which Mr. Bevin again mentioned.

Mr. Bevin as the next point sought elucidation of Mr. Clayton's belief that the UK problem must be lumped into the problem of Europe, because if that were the case, in forthcoming meetings, Mr. Bevin's approach would have to be changed. Mr. Bevin had planned (1) a steering committee (2) groups to analyze needs in relation to European production (3) groups on finance (4) groups on railway problems, their needs and organization (5) groups on motor transport (difficult because of cut-down in Germany, the biggest producer) and (6) groups regarding credits, currency, etc.

When the plans of these working parties were completed and in operation Bevin thought the only effect on the UK would be that--in time, a year or two--Europe would be in somewhat

better position to pay for British imports but since in the interim period Europe would consume all she could produce there would be little effect on the UK position except perhaps for an increase in dollar receipts from German exports.

As to Germany, Mr. Dalton mentioned the cost of the Byrnes Agreement. Originally for an eighteen-month period from January, 1947, total cost was contemplated as \$860 million of which the UK share was \$460 million which in terms of dollar drain on the UK was estimated as \$200 million. This last figure, revised because of price changes was now \$275 million. A further overall increase in costs for Germany to provide additional calories had added \$150 million to the total bill (\$75 million to the U.K.) which made the present rate of drain on the UK for Germany some \$350 million. "Pretty poor", according to Dalton.

Mr. Bevin noted that if Poland feeds Europe, Poland demands dollars in exchange because the Polish Prime Minister has a solid case as to his needs of U.S. equipment. Bevin was cultivating the Polish Prime Minister, having decided to center British policy around the new leader whom he had consulted on return from Moscow. He believed this plan would be fruitful. Similar approaches were being made in Yugoslavia where Bevin had talked. He was convinced that Yugoslavia would gradually come west. Yugoslav needs were agricultural implements, railway equipment, timber-cutting equipment, etc. which Russia could not supply. In connection with Yugoslavia mention was made of Trieste and the effect of the opening of that port on Yugoslavia's western connections. But when Bevin asked Cripps what he could give up for Yugoslavia, Cripps could offer little, primarily because of the steel shortage. This was the pattern wherein Britain got into a dollar tangle in order to "get going" on constructive political relationships. Mr. Bevin did not foresee early solution of these political difficulties. We must have patience but he was confident. Mr. Bevin said that if the U.S. took the line that the U.K. was the same as any other European country this would be unfortunate because the UK could contribute to economic revival. The UK held stocks of rubber and wool and "we, as the British Empire", could assist materially. The British did not want to go into the program and not do anything--this would sacrifice the "little bit of dignity we have left".

Mr. Clayton did not quite see how the UK position was different from that of other European countries. The whole trouble arose from a shortage of dollars but this in turn represented failure of Europe to produce. The production bottleneck should be eased in a few years--perhaps by 1951. The UK had a dollar shortage the same as other European countries and if the US could do something to ease this shortage he wondered where the difference in impact upon the UK arose. Sir Stafford Cripps responded that the UK was a natural market for European goods for which the US were not buyers. Mr. Clayton had some question on this point but Cripps mentioned timber, foodstuffs (especially perishables, dairy products and dried fruits) and said "if you want to rehabilitate Europe that market (the UK) must be rehabilitated. The dollar drain is coming through the UK".

Mr. Clayton

Mr. Clayton still could not see the difference. He thought if the UK received dollars from its trade with Europe their position would be satisfactory. Mr. Clayton thought the Marshall idea would put dollars into Europe by taking care of their essential imports, leaving more of the proceeds of their exports available for payment for goods imported from Britain.

Mr. Clayton said that in the US examination of the dollar problem it seemed to fall into two parts--(1) a short-range problem, mainly requirements of food and fuel--perhaps fiber--which might cost three and one-half to four billion dollars (2) reconstruction and development where responsibility fell on the International Bank. The Bank was getting well organized, had a good staff and US and UK controlled it. If there was a solution of the short-term European problem there would be a firm foundation for the Bank to go ahead with longer-term reconstruction and development. Mr. Clayton thought he may have given an incorrect impression that US aid would be set forth specifically in food and basic raw materials. If the UK needed food we did not mean that the US would necessarily supply it. There should be no "tied loan" principle. The US would simply look at the emergency European problem in bulk, mainly the three "f's"--food, fuel and fiber. In these observations Mr. Clayton was merely thinking aloud but it was his idea that whatever the US would do would probably be untied, just as was the British loan.

Mr. Bevin asked if the US could not bring Canada and Argentina into such a Lend-Lease conception and thus save the UK on dollars. In mentioning Lend-Lease, Mr. Bevin did not contemplate strict repetition of such a device but thought something akin to Lend-Lease would be the end result.

Sir Edward Bridges recapitulated the last point that Mr. Clayton gave--(1) short-term assistance for Europe (2) assurances from Europe as to what it would do to help itself and (3) a certain integration of "degree of closeness" of economic relations in Europe as an essential component. He said the UK did not contemplate going into a European Customs Union. Even the UK-French plans for integration were not complete and although Belgium, Netherlands, and Luxembourg were going ahead with the Customs Union they had encountered difficulties. A full blueprint for Europe would take too long for the present emergency.

Sir Edward asked how Britain would fit into the plan. If the US was thinking of help in kind from the US the effect would be only to prolong by a few months the date when the credit would be exhausted. He thought Mr. Clayton's remarks showed an understanding that as far as the UK was concerned their requirements could not be confined to goods from the US but would be needed from usual sources. He understood there was a further point, namely, that Europe should join together in giving assurances. The UK had a fear of the "European pool" idea in the Marshall Plan which he thought would bring the UK down to the level of the lowest in Europe. Sir Edward also understood the US contemplated a series of bilateral agreements with individual European countries which would take into account the differences in economic needs of the various countries and yet permit the program to be put to Congress as a unified scheme. Mr. Clayton said there was no

"pooling" idea current in Washington; it was his idea that there would be bilateral agreements within the framework of a European program of rehabilitation.

Sir Wilfrid Eady sought reassurance that the US considered the International Bank an effective mechanism for the second stage. Mr. Clayton said the primary need was to create investors' confidence in prospects of repayments of loans. Mr. Dalton noted the Bank had been slow in organization, with many changes in management and this caused much discouragement among the British. He asked if Mr. McCloy thought the Bank would go into Europe and Mr. Clayton replied affirmatively. Mr. Bevin asked how far political consideration would come into lending by the Bank. He presumed bank loaning would be dependent upon the conclusion of treaties with former enemies and that as for Allies there would be assurances under their United Nations obligations. With Europe striving to produce there would be reasonable chance of repayment.

Mr. Clayton said that the Bank's constitution required that political considerations should not enter into decisions on loans and noted that in connection with the Polish loan a delegation was making an on-the-spot investigation and undoubtedly the Bank would require an agreement regarding Polish coal (both present production and that attributable to the new machinery) before funds for re-equipment would be forthcoming. Other details of operations of the International Bank were discussed.

Mr. Dalton raised the nondiscrimination clause in the Financial Agreement. The British dollar position required them to look at their import programs where they were unwilling (and shouldn't) reduce food imports. But certain articles, for example, fruit, could be purchased from soft currency countries yet this could not be the exclusive source under the nondiscrimination clause. Fruit from the US added "very much" to the dollar problem. Tobacco was a similar case in point. He had taken tax action to cut imports and in other directions the UK "may take action". In the case of films he had taken power to act which he felt the Government must have if it were necessary later to take some action.

In connection with nondiscrimination, discussion arose regarding the present British interpretation of Clause 9 of the Financial Agreement as applied to trade between the UK and its Colonial Areas for which the UK provided a common quota in the Monetary Fund. As the Department is aware, the British consider themselves free to discriminate in favor of trade within this UK-Colonial Area. The British express belief that this interpretation would ease the impact of the nondiscrimination clause. Mr. Clayton and the Ambassador agreed and did not challenge this interpretation of Clause 9.

Mr. Clayton said with emphasis that the matter of nondiscrimination "comes so late". The loan was an act of

Congress and relief on nondiscrimination meant passage of a joint resolution where many questions would be asked and this might call for exposure or some revelation of the UK situation.

Sir Edward Bridges mentioned the clause regarding imports from countries with war-shattered economies and Mr. Douglas agreed that we and the British could take a look at various commodities and their sources to see what could be done. Mr. Dalton said the last thing he wanted was a debate in Congress on nondiscrimination and Mr. Clayton thought an approach to Congress on this subject would endanger larger plans now underfoot.

Sir Stafford Cripps mentioned steel and UK dependence on imports. Two years ago he placed contracts in the US and because of understandable difficulties there the steel was not obtained. This had handicapped UK aid to Europe, the manufacture of tractors and other productive equipment. Was there any possible way of getting steel? The British had given UK steel producers their full coal requirements and would get thirteen million tons of steel this year but their requirements were sixteen million tons. Mr. Clayton outlined the difficulties arising from shortages at home, factories on short-time because of lack of steel and internal pressure for steel but thought there "was always a possibility". The Department of State was fighting for exports every day. Mr. Clayton asked for a memorandum from Sir Stafford on their steel needs.

Mr. Bevin then asked for a somewhat more concise statement of the present US attitude toward Europe and the Marshall program. In response Mr. Clayton said that he foresaw the following phases: (1) Europe should explain why more progress has not thus far been made since the cessation of hostilities with the help already received (2) European countries should set forth in a concrete and substantial way a statement of what they proposed to do to help themselves, how long it will take and by what steps--what minimum assistance is required from the US, why it is necessary and when the load on the US would be reduced--presumably on a sliding scale. Mr. Clayton again stressed it would not be easy to sell the idea in the US. There was much in the press of what the US "has got to do" and much about American needs for export markets. Mr. Clayton knew the US need for export markets but many of his fellow citizens had other views and in order to put the program across the US must know when Europe will be able to get on its own feet. To supplement this, if possible, the US would like some proposals regarding a closer integration of European economy. He did not assume that anything in great detail could be provided in a short time and cited his conversation with Senator Milliken as an example of why a firm plan for Europe including European integration was necessary to convince Congress on the necessity of additional assistance by the US.

Mr. Bevin said integration raised an interesting point because whenever he took steps in this direction, for example with France and Belgium, Sir Stafford Cripps said he was violating ITO principles. Apparently to point out the US need for exports, he said in 1927 he had examined economic factors

in the US and given the narrowing of our imports and the wasteful character of our investments, he had predicted the American slump two years in advance. But on the point of integration he found in Europe a desire to do what Mr. Clayton sought but found Europe in effect committed by ITO not to integrate. If Mr. Clayton could make a public statement on European integration this would help. "In Europe we can't reach a customs union at once", but Mr. Bevin suggested Europe should act sensibly. He had in mind an international board to develop and utilize water-power from the Alps. He also mentioned the Teschan political problem and thought a coal mine was at the root of this and the solution would be found in joint operation of the mine and sharing of the output. But these attempts toward rebuilding came into conflict with trading rules.

Mr. Clayton mentioned the progress made in the Benlux Customs Union and said this certainly did not violate ITO rules.

Mr. Bevin then mentioned Anglo-French plans for integration--tractors to be produced in the UK, food in France and a free exchange of the two; musical instruments to be produced in France, no competitive plant set up in the UK and French instruments freely admissible into the UK even though they might be taxed from other sources. Sir Stafford Cripps said such plans needed assurance of some permanence. Mr. Clayton agreed that the principle of nondiscrimination as now understood would be violated in such proposals.

Mr. Bevin said the British might obtain agreement in principle for a Customs Union and wondered if this would be enough to comply with ITO rules. "We have in ITO an ideological plan which thwarts reconstruction" and felt a five-year plan for the first stages of integration would be necessary. The very words "Customs Union" would be objected to in France by the Communists.

Mr. Douglas thought the integration problem raised two questions. First, decisions regarding interchanges arising from new plants and enlargements of old plants (to which point Sir Stafford Cripps interjected that the British must have free entry for the products concerned). This interjection precluded Mr. Douglas from defining the second category of goods, namely, production from existing plants (Mr. Douglas intended to explore the possibility of special treatment for integration of new production and nondiscrimination in trade arising from existing plant).

Mr. Clayton said that once the bars were let down on the principle of nondiscrimination all kinds of undesirable arrangements would take place tending toward bilateralism which had been proved unsound. Sir Stafford Cripps thought the ITO Delegation might make provision for certain phases of integration and we might look into the matter jointly. Mr. Clayton, thinking aloud, said something in the nature of special interim exceptions to nondiscrimination working gradually up to a Customs Union might be presented to our people at Geneva.

After the Prime Minister indicated the meeting must break up because of the hour, Mr. Douglas added one further point to the general plan for Europe: there must be acceptance in prin-

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ciple at least of constructive measures in the field of fiscal affairs. Budgetary reform, like integration of European economy, would be most acceptable to the present Congress and would be an important factor in action by the International Bank relative to Europe. Mr. Douglas also raised with Mr. Dalton the matter of enabling legislation relative to films, which subject has been covered by separate telegram to the Department.

At the conclusion it was agreed that tabulations regarding the British financial position could be sent on to Washington for highly restricted use on the basis that the actual figures had not been "put through or checked" and might be changed in twenty-four hours. The tables had been prepared under pressure and Treasury experts looked upon them chiefly as an approach in presenting the problem.

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