

British Management of the Sterling Area
1950-1958

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Abstract of Thesis

The contents of this thesis examine British management of the sterling area between 1950 and 1958, covering the period between the devaluation of sterling in 1949 and the establishment of sterling convertibility in 1958. The main body of the thesis is comprised of five chapters which analyze different aspects of the sterling area system during this period. Long term lending from the UK to the overseas sterling area is examined with the conclusion that these capital flows were not a major drain on the British economy. The mechanics of movements in British short term liabilities to the rest of the sterling area are described and their effects on the British foreign exchange reserves is found to be positive or neutral for most of the period although the basis for this erodes as the decade draws to a close. The trade pattern of the sterling area members is analyzed and the changing policies to coordinate the trade of the area are described. The possibility that the existence of the sterling area inhibited the freedom of policy choices faced by the British authorities is explored with the conclusion that the major opportunities for a new direction in British external economic policy were abandoned for reasons other than the sterling area system. Finally, some possible alternatives to the sterling area system are analyzed and the thesis concludes that these were not plausible alternatives given the historical context in which economic policy decisions were made. The general conclusion of the thesis is that the sterling area system as it functioned in the 1950s was not the major burden or destabilizing factor for the British economy that contemporary observers and some current research have suggested.

PLEASE NOTE: References prefixed by PRO are from the Public Records Office, Kew, London. References prefixed BoE are from the Bank of England Archives.

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Chapter I Introduction

Doubts about the merit of British foreign economic policy have generated a voluminous literature aimed at resolving the conflict between domestic and external economic goals and untangling the inter-relation of economic policy and overseas political ambitions. The literature on the nineteenth century has focussed on the rise and demise of Empire and the burdens this placed on the British economy, focussing especially on British trade and capital exports¹. These same issues have arisen in the context of the relative economic decline of Britain in the twentieth century.

To a large extent, British external economic policy in the 1950s was determined by the evolution of Britain's premier role in the international economy a century earlier. Thus, the importance of London as an international financial centre and many of the traditional economic ties with overseas countries were products of Britain's earlier status. Without this history, the position of the UK in the 1950s would have been very different. Nevertheless, the apparent problems of this period were also in many respects the product of the economic climate of that decade.

The period under review covers the years from the general devaluations in 1949 to the introduction of

¹Of the more recent literature, see e.g., S. Pollard, Britain's Prime and Britain's Decline; The British Economy 1870-1914, Edward Arnold, 1989. M.W. Kirby, The Decline of British Economic Power Since 1870, George Allen and Unwin, 1981.

external current account convertibility at the end of 1958. This was a unique period of adjustment and realignment of the international monetary system. Despite the Bretton Woods agreements which had been designed to create international economic stability, an increasing imbalance emerged between the recovering continental Europe and the deteriorating balance of payments of the USA. This trend was to ultimately bring an end to the Bretton Woods plans for the configuration of the international economy. In this context of global transition and imbalance, the role of the UK in the international economy was also undergoing a fundamental change from its pre-war position as the most important economic ally of the USA and as a pivot between Europe and America to a diminished role as the weakest of a group of middle power Western European economies. This transition was the result of relatively slow growth in output, productivity and competitiveness that manifested itself in recurring balance of payments crises through the 1950s.

I.A. The Debate on the Sterling Area

The role of the sterling area system is an aspect of this adjustment that provoked some research in the 1950s and 1960s but which has largely been relegated to generalizations in more recent literature. At the end of the 1950s and through the 1960s the growing awareness of the limits to international liquidity, of the disadvantages of national currencies as units of international reserves

and of the relative economic decline of Britain in the twentieth century provoked general literature on the reform of the international monetary system and specific studies of the role of sterling as an international currency. The literature on the sterling area from this period falls naturally into two groups. The first group engaged in a general critique of British economic policy since the Second World War in order to attribute blame for the apparent relative decline of the British economy². For writers in this group, sterling area policy played a significant part in explaining that decline. The second group of writers was concerned more specifically with the problem of sterling as an international currency or with analysing the sterling area itself³. Through most of the 1970s interest in the postwar sterling area was suspended as the international monetary system found its new shape but since 1980 scholars have begun to return to the issues of the 1950s and 1960s with the benefit of historical perspective.

²e.g. A. Shonfield, British Economic Policy Since the War, Penguin, 1958. J.M. Livingstone, Britain in the World Economy, Pelican, 1966. J. Cooper, A Suitable Case for Treatment: What to do about the Balance of Payments, Penguin, 1968. L.J. Williams, Britain and the World Economy, Fontana, 1971.

³A.R. Conan, The Sterling Area, Macmillan, 1952. A.C.L. Day, The Future of Sterling, Oxford, 1954. P.W. Bell, The Sterling Area in the Postwar World; Internal Mechanism and Cohesion 1946-52, Oxford, 1956. J. Polk, Sterling: Its Meaning in World Finance, Council on Foreign Relations, 1956. Conan, The Rationale of the Sterling Area, Macmillan, 1961 and The Problem of Sterling, Macmillan, 1966. F. Hirsch, The Pound Sterling: A Polemic, Victor Gollancz, 1965. B.J. Cohen, The Future of Sterling as an International Currency, Macmillan, 1971. S. Strange, Sterling and British Policy; A Political Study of an International Currency in Decline, Oxford, 1971.

The sterling area system was generally focused around three types of relations; the sterling balances, international trade and long term capital flows. This provides a convenient framework in which to survey the existing literature. Perhaps the most surprising aspect of this literature is the unanimity of opinion as to the burdens and risks of the system for the UK and the necessity for reform⁴. Without being based on any more detailed research than that of Bell's study of the mechanics of the sterling area between 1946-1952, the assumption that the sterling area system posed an unnecessary burden on the British economy has been adopted by most of the subsequent writers on the decline of the British economy.

On the problem of the sterling balances and the stability of the sterling area system, there was general agreement that the ratio of reserves to short term liabilities (as represented by the sterling balances) was inadequate and that this contributed to the weakness of sterling through potential runs on the central reserves⁵. A prominent exception to this consensus was A.R. Conan who argued that the ratio of reserves to liabilities commonly

⁴For other reviews of opinions on the sterling area see e.g., Conan, The Rationale of the Sterling Area, M. FG. Scott, "What Should Be Done About the Sterling Area?", Oxford University Bulletin of Statistics, Vol. 21, No. 4, November 1959.

⁵Bell, The Sterling Area, p. 414-417., Day, Future, p. 60-61., Williams, Britain, p. 179., A.P. Thirlwall, The Balance of Payments: The UK Experience, Macmillan, 1956., p. 148-9. G. Maynard, "Sterling and International Monetary Reform" in P. Streeten and H. Corbet eds., Commonwealth Policy in a Global Context, Frank Cass, 1971. p. 145.

used to describe British solvency was inappropriate. A better picture of Britain's international position, he argued, would include all British overseas assets and not just the foreign exchange reserves in the Exchange Equalization Account⁶. On this basis, Conan calculated that the UK had regained its international creditor status during the 1950s⁷. The Radcliffe Committee shared this belief but still concluded that "the relationship between reserves and liabilities was clearly far from satisfactory throughout the post war period and remains so"⁸.

The sterling balances were related to British long term investment in the sterling area in three ways that were not fully consistent. First, it was alleged that British overseas investment was financed through short term lending to the UK (especially by the Colonies) in the form of sterling balances⁹. Thus, "the United Kingdom was in the unhealthy position of borrowing short and lending long"¹⁰. This implied both exploitation of the Colonies¹¹ and a precarious British international banking position¹².

⁶Conan, Rationale, p.13-14.

⁷Ibid., p.123-128.

⁸Report of the Committee on the Working of the Monetary System, Cmnd. 827, HMSO, 1959. Henceforth cited as Report of the Radcliffe Committee.

⁹Bell, The Sterling Area, p. 368, Polk, Sterling, p.234.

¹⁰Bell, The Sterling Area, p. 368.

¹¹A. Hazlewood, "Colonial External Finance Since the War", Review of Economic Studies, Vol. XXI, No. 54. Dec. 1954. pp. 31-52.

¹²Cooper, A Suitable Case, p. 221.

Secondly, it was asserted that the UK was forced to continue the policy of investing freely in the RSA or risk a run down of sterling balances by the RSA to replace the British investment¹³. Alternatively, it was argued that the accumulation of the sterling balances was largely due to the large long term capital flows from Britain which offset the current deficits of the rest of the sterling area (RSA) with the UK¹⁴. In this argument, Britain's sterling liabilities would be lower if the UK had not pursued a policy of free capital flows to the RSA. This must be balanced against the fact that in this event, UK overseas assets would not be as great.

Underlying these arguments there was a general presumption that large overseas investment in the sterling area was a burden on the British economy¹⁵. Among these writers, Andrew Shonfield made the most searing and influential condemnation of the sterling area system. For him, the two greatest obstacles to Britain's economic growth in the post war period were excessive overseas military expenditure and overseas investment¹⁶. On the second, Shonfield argued "that the British economy is robbed of necessary nourishment, that its growth is stunted, as a result of this too vigorous pursuit of

¹³Strange Sterling, p.191-92, Shonfield, British Economic Policy, p. 128, Cooper, A Suitable Case, p.221.

¹⁴Conan (1966), p. 81.

¹⁵Strange, Sterling, p. 150-51, Shonfield, British Economic Policy, p. 108.

¹⁶Shonfield, British Economic Policy, p.123.

overseas investment"¹⁷. The Radcliffe Committee looked at the possibility of capital controls because such investment was competitive with domestic investment and undermined the effort to rebuild the reserves¹⁸. The Report concluded, however, that overseas investment was an essential part of the UK's commitment to Commonwealth development and that such investment generated demand for British exports and expanded supplies of primary products¹⁹ so "there would certainly be no automatic gain to the reserves equal to the fall in overseas investment"²⁰.

The Radcliffe Committee concluded, therefore, that

although there have been occasions when the functioning of the sterling area has thrown an added strain on the reserves and when the capital requirements of the area have added to the total load on the reserves of the United Kingdom, we are satisfied that it is in the interest of this country to maintain existing arrangements²¹.

On the trade relations of the sterling area, it was generally agreed that discrimination was to the advantage of the UK rather than the RSA since the RSA was forced to restrict its manufactured imports from cheaper markets²². The UK, in contrast, was able to have free access to the sterling area raw materials and benefited from greater

¹⁷Ibid., p. 108.

¹⁸Report of the Radcliffe Committee, p.265.

¹⁹Ibid., p.266.

²⁰Ibid.

²¹Ibid., p.240.

²²"The Sterling Area I: History and Mechanism", Planning, Vol XVIII, no. 331, 1951. p. 63., Day, The Future, 102-3., Bell, The Sterling Area, 407.

manufacturing exports to the RSA. However, Susan Strange argued that the discriminatory exchange controls had 'featherbedded' British exporters in soft RSA markets rather than forcing them to face the competition in the faster growing markets of Europe and North America²³. Conversely, others noted that the strength of the trade relationships of the sterling area weakened through the 1950s as the RSA became less reliant on the British market for their exports²⁴. The complementarity of trade relations had also declined as RSA trade surpluses with the NSA could no longer be relied on to balance UK deficits with the NSA²⁵.

An important theme, especially in more recent literature, has been that the sterling area inhibited British policy. Thus, the UK was prohibited from allowing a devaluation of sterling to improve the British balance of payments because this would hurt the RSA who held their reserves in sterling²⁶. According to this scenario, the British government must have feared that such a move might lead to the collapse of the system in circumstances which

²³Strange, Sterling, p.70.

²⁴Day, The Future, p. 75., Bell, The Sterling Area, p. 401-7., Cooper, A Suitable Case, p. 239-40.

²⁵G. Maynard, "Sterling and International Monetary Reform", p. 142.

²⁶Hirsch, The Pound Sterling, p.39. Strange, Sterling, p.300, Cohen, The Future, p.144, Cooper, A Suitable Case, p.88., Pollard, The Wasting, p. 34, Williams, Britain, p.179., S. Brittan, Steering the Economy: The Role of the Treasury, Pelican, 1971. p. 446. S. Newton and D. Porter, Modernization Frustrated: The Politics of Industrial Decline in Britain Since 1900, Unwin Hyman, 1988. p. 130-31.

were not to the British advantage. As a result of the restrictive policies necessary to protect the value of the pound, it was argued that domestic industrial growth was inhibited, with serious long term consequences for the British economy. As early as 1954, A.C.L. Day warned that the financial benefits to the City that the system generated should not be exaggerated since "Britain's wealth depends primarily on the competitive strength of her manufacturing industry, and only secondarily on the profits of international banking and merchanting"²⁷. Thus, he argued that the interests of domestic industry should not be sacrificed to the international status of the pound and the operation of the sterling area. Shonfield also argued that the real rationale for continuing the sterling area system was the ambition to strengthen the pound as an international currency²⁸. He asserted that these ambitions were founded on reasons of prestige rather than economic benefit because he calculated that the net earnings of the City that were related to sterling's international status amounted to only perhaps £40m p.a.²⁹. For these reasons, it was argued, British support of the sterling area system was economically misguided.

²⁷Day, The Future, p.154. See also Williams, Britain, p. 180.

²⁸Shonfield, British Economic Policy, p.150.

²⁹Ibid., p.160. B.J. Cohen in The Future of Sterling came to the same figure as an estimate of the net amount of the City's earnings arising from the use of sterling as an international currency. p.116. W.M. Clarke suggests this is an underestimate. The City's Invisible Earnings, Institute of Economic Affairs, 1958. p. 101-2.

The argument that a quest for prestige was the motive for the UK's adherence to the sterling area system was made also by Susan Strange. Her thesis was that the problems of the British balance of payments in the 1960s were due to the unsteady transition of sterling from a primary transactions and reserve currency to a less prominent international role. Thus, her book stressed the political aspects of currency management. In this story, the sterling area represented the economic vestiges of Empire and "the retreat from Empire has been, in monetary as in military policy, a slow and grudging one"³⁰. The existence of the sterling area disguised the fact that sterling's reserve role was over by 1958. Strange concluded that the most damaging aspect of the sterling area was that

while the monetary arrangements between sterling area countries in this post-war period may have reinforced, and thus helped to prolong British influence outside Europe, they also served to lull the British themselves into a false sense of immunity from the ultimately inescapable winds of change³¹.

Thus, the literature of this earlier generation of writers, which extended over twenty years, ranged from a catalogue of aspects through which the sterling area could potentially be a burden to Britain, to arguments that the very fact that these burdens were not borne in the 1950s undermined the British economy in the longer term.

The idea that the interests of industry were sacrificed to the financial houses in London who benefited

³⁰Strange, Sterling, p.75.

³¹Ibid., p.69.

from the international use of sterling has insinuated its way firmly into the recent history of the economic decline of Britain³². Like Shonfield, they contend that low levels of domestic investment inhibited the growth of the UK economy. Thus, Stephen Blank, drawing heavily on quotations from Shonfield and Strange as evidence, argued with respect to British sterling policy that "the result of the government's commitment to maintain Britain's international position was continuing domestic economic stagnation"³³. Sam Aaronovitch argued that for the British government,

the priorities were unmistakable; to 'put the pound first', to deal with the balance of payments by deflating the economy whenever a threat existed. In this sense, the state was occupied with a policy that directly damaged the growth of accumulation within the UK itself³⁴.

Also, Sidney Pollard argued that in order not to "disappoint those who used the City of London as their banking centre, devaluation was ruled out repeatedly and

³²See Hobsbawm, Industry and Empire, Pelican, 1968 for an application of this to the pre-1914 period. For post 1945, see Stephen Blank, "Britain: the Politics of Foreign Economic Policy, the Domestic Economy and the Problem of Pluralistic Stagnation", International Organisation, Vol. 31, No. 4, Autumn 1977. pp. 673-727. A. Glyn and B. Sutcliffe, "The Rivalry of Financial and Industrial Capital" in D. Coates and J. Hillard eds. The Economic Decline of Modern Britain: the Debate Between Left and Right, Wheatsheaf, 1986. D. Coates, "The Character and Origin of Britain's Economic Decline" reprinted in Coates and Hillard, The Economic Decline. Also Williams, Britain, p. 180.

³³Blank, "Britain: the Politics of Foreign Economic Policy", p. 715.

³⁴S. Aaronovitch, "The Relative Decline of the UK" in Aaronovitch et al eds., The Political Economy of British Capitalism: A Marxist Analysis, McGraw-Hill, 1981., p. 68.

much more harmful measures to the economy preferred instead"³⁵. Thus, he found the sterling area "a specific point of vulnerability for Britain"³⁶

In a 1983 article Bernard Stafford surveyed the alternative view. He noted that there is little empirical evidence to prove that the ratio of investment to output is directly related to faster rates of economic growth³⁷. He also surveyed the international comparative studies which imply that the 'stop-go' cycle in British policy in the 1950s and 1960s was not extraordinary and that greater fluctuations of output were associated with faster growth rates elsewhere in Europe³⁸.

It is clearly beyond the scope of this thesis to explain the relative decline of the British economy in the twentieth century. The purpose of this survey has been to show that over the past thirty years there has been a broadly based consensus that the external position of the British economy has inhibited domestic growth. The sterling area system fits into this scenario in that it was the mechanism through which large investment flows were sent abroad, large short term liabilities were accumulated

³⁵S. Pollard, The Wasting of the British Economy, Croom Helm, 1982. p. 34.

³⁶Ibid.

³⁷B. Stafford, "Theories of Decline", Socialist Economic Review 1983, reprinted in Coates and Hillard eds, The Economic Decline of Modern Britain, 1986. p. 346.

³⁸Ibid., p.348. Stafford gives more weight to the strength of the British Labour movement in relative British economic decline.

and trade discrimination was pursued. Sterling area management was not, however, synonymous with the pursuit of re-establishing sterling as an international currency. Indeed, it has been argued that the sterling area weakened sterling and that the existence of the sterling area made a regional rather than a global role for sterling necessary³⁹. Nevertheless, the sterling area is most commonly judged to have been a net burden to the British economy.

Although interest in the role of the sterling area in the 1950s has played a part in the more recent literature on the economic decline of Britain, this has not been accompanied by more detailed research on the functioning of the system. As a result, the arguments about the sterling area written in the 1980s bear a close resemblance to those of thirty years earlier. It is the purpose of this thesis to fill this gap in understanding of the details of the sterling area system by taking advantage of the release of British government documents to give more insight into the formulation of sterling area policy.

I.B. The Evolution of the Postwar Sterling Area

The evolution of the sterling area reflected the changing role of sterling in the international economy. Due to the pre-eminence of the UK in trade, shipping and finance in the nineteenth century, sterling was widely

³⁹See e.g. J. Polk, Sterling: Its Meaning in World Finance, 1956.

accepted as the primary currency both for denominating international transactions and for national reserves. As a result, the nineteenth century gold standard was, in effect, a sterling exchange standard. After the First World War, Britain's pre-eminence as an economic power faltered and sterling's role in the international economy shrank as a result.

By 1928, Britain's sterling liabilities to foreign governments and traders amounted to four times the level of reserves⁴⁰. In the sterling crisis of 1930-31 the conversion of these balances virtually exhausted British reserves and contributed to the forced abandonment of the gold standard in September 1931. The group of countries which continued to peg their exchange rates to the now fluctuating pound became known as the sterling bloc. This regional group included the Dominions (except Canada) and Colonies, Egypt, Iraq and British protectorates in the Middle East as well as Portugal, Thailand, Denmark, Norway, Sweden, Finland and Latvia⁴¹.

Unlike the post-war sterling area, the sterling bloc was not formalized by a common exchange control system or by pooling of reserves and all sterling assets were fully convertible to other currencies and gold. The members did not share a common trade policy or coordinate monetary and

⁴⁰I.M. Drummond, The Floating Pound and the Sterling Area, 1931-39, Cambridge University Press, 1981. p.5.

⁴¹The League of Nations included Argentina and Japan as unofficial members of the interwar sterling bloc. League of Nations, International Currency Experience, 1944. p.47.

fiscal policies or meet to discuss their common interests. The Empire members and Canada shared a discriminatory trade system but the Treasury repeatedly rejected proposals to share policy determination with the Empire countries⁴² and indeed failed to keep them informed of British policy which would affect the sterling exchange rate. In common with the post-war sterling area, however, the stability of exchange rates among members was financed by plentiful credit from London.

With the onset of the Second World War, inter-war international monetary and trade relations were suspended and some of the sterling bloc countries broke their fixed exchange rates with sterling. As part of the war effort, all British payments to non-residents in foreign exchange or gold were subject to approval by the Treasury although on 3 September 1939 this restriction was amended to specifically exclude all countries which agreed to keep their currency reserves in London and to enforce exchange control in common with the UK. This formalized the sterling area into a legally defined group of 'scheduled territories' listed in the Exchange Control Act of 1947. The scheduled territories included the Commonwealth (except Canada), the Colonies, Burma, Iceland, Ireland, Iraq (from 1952), Jordan, Libya and the Persian Gulf Territories⁴³.

The imposition of exchange controls in 1939 was the first of two developments that led to the formalization of

⁴²Drummond, The Floating Pound, p.24.

⁴³Egypt was a member of the sterling area until 1947.

the sterling area after the war. The second was the accumulation by the UK of substantial sterling liabilities to some members of the sterling area. The distribution of sterling balances from 1945-1950 is presented in Table I.A.

Table I.A.
Sterling Balances of the Sterling Area

£m	1945	1946	1947	1948	1950
Australia, New Zealand,					
S. Afr.	305	266	255	379	491
India, Pakistan, Ceylon	1358	1314	1218	957	790
Caribbean Area	54	58	54	57	58
African Colonies	205	217	253	314	346
Middle East	-	1	1	8	8
Far East	142	193	198	195	201
Other	284	286	260	255	282
Total	2348	2335	2239	2165	2176

Notes: Source, Bank of England Statistical Abstract, No.1, 1970.

India accumulated most of these wartime assets. In an exchange of letters between the Chancellor of the Exchequer and the Secretary of State for India in 1940 it was agreed that the UK should pay for the reorganisation of the Indian Army and the cost of British armed forces in India as well as the costs of extra Indian forces drafted especially for the war effort. These expenditures by Britain were made in the form of sterling liabilities to India which could be claimed after the War. The rate of accumulation of these liabilities accelerated after India was chosen as the arsenal and headquarters of the British Near and Middle East Command in 1940 and by subsequent Indian price inflation. By 1945, India had accumulated £1,321m worth of sterling balances from a pre-war total of only £40m⁴⁴.

⁴⁴R.S. Sayers, Financial Policy 1939-1945, HMSO, 1956. p.259.

Similar wartime expenditure in other parts of the sterling area accounted for the accumulation of liabilities in these countries.

The post-war sterling area system was defined by three characteristics. Members pegged their exchange rates to sterling, maintained a common exchange control against the rest of the world while enjoying free current and capital transactions with the UK and, thirdly, maintained national reserves in sterling which required pooling of foreign exchange earnings. For the most part the members also shared a historical political and/or economic allegiance to Britain although this was not a defining requirement of membership.

The sterling area exchange controls on transactions with the rest of the world were fairly complex. Their main purpose was to restrict convertibility of sterling into dollars in the context of the post-war dollar shortage and to conserve foreign exchange. Payments of residents of the sterling area to non-residents were subject to the discretion of the monetary authority of each member, or delegated to 'authorized dealers' which were generally large commercial banks ultimately responsible to the central monetary authority. The exchange controls applied to non-residents varied considerably, giving rise to the allegation that in the early 1950s there were fifty-seven varieties of sterling⁴⁵. By 1950, the world was essentially divided into four areas as shown in Table I.B..

⁴⁵Strange, Sterling and British Policy, p.65.

Transfers of sterling within each area were generally allowed without specific permission. The exception to this was the bilateral group. Sterling payments to account of these countries were allowed automatically only between sterling area residents and the specific bilateral country. Transfers among bilateral countries were allowed only by 'administrative transferability'

Table I.B.
The Sterling Account System
April 1952

<u>Sterling Area</u>	<u>American A/C</u>	<u>Transferable A/C</u>	<u>Bilateral A/C</u>
Australia	USA	Austria	Argentina
New Zealand	Bolivia	Chile	Belgium
South Africa	Central America	Czechoslovakia	Brazil
India	Venezuela	Denmark	China
Pakistan	Ecuador	Egypt	Formosa
Ceylon	Phillipines	Ethiopia	France
Burma	Cuba	Finland	E. Germany
Iceland	Colombia	W. Germany	Hungary
Iraq	Dominica	Greece	Iran
Jordan		Italy	Israel
Libya		Netherlands	Japan
Persian Gulf		Norway	Lebanon
Territories		Poland	Paraguay
British Colonies		Spain	Peru
		Sweden	Portugal
		Thailand	Roumania
		USSR	Switzerland
			Syria
			Tangier
			Turkey
			Uruguay
			Yugoslavia

which required the express permission of the Bank of England. Generally, these countries ran balance of payments surpluses with the sterling area and were unwilling to accumulate sterling beyond a certain level, so their sterling transactions were most closely controlled. With the development of the EPU, administrative transferability for bilateral OEEC countries became

virtually automatic after 1950.

A second group of countries were designated as members of the Transferable Account Area. Payments of sterling from one transferable sterling account to another were allowed freely, as were payments between transferable account and sterling area account. Transfers were not permitted from transferable account to bilateral or American accounts. The American account countries were members of the dollar area who were free to exchange their sterling earnings for dollars and vice versa or to use sterling in payment to transferable account or to the sterling area.

This division of the uses of sterling into various special accounts with varying degrees of restriction was designed to inhibit the convertibility of sterling into dollars while maximizing the usefulness of sterling in international transactions. Thus, no sterling was freely convertible to dollars except that earned by American account countries. Residents of the sterling area could obtain dollars only with permission of their monetary authorities.

Capital account transactions were similarly restricted. British direct investment outside the sterling area was subject to Capital Issues Committee control. Permission was granted only where the investment promised to generate foreign exchange earnings, exploit technology or generally help the sterling area balance of payments. Foreign investment in the sterling area was also restricted

since the repatriation of capital was limited to the amount of the initial investment.

The proceeds of non-resident sales of sterling securities were allowed to be reinvested only in other quoted sterling securities. In practice there developed a market in 'security sterling' to allow non-residents to repatriate the proceeds of their investments. The proceeds of a sale of a sterling security could thus be exchanged for dollars in New York at a discount on the official exchange rate and prospective buyers of sterling securities would use the market to acquire security sterling for their purchases of securities. Residents of the sterling area were allowed to sell non-sterling securities freely to each other but purchases of non-sterling securities from non-residents for sterling was prohibited in order to prevent conversion of resident sterling through security trading. This last provision led to the development of the largest leaks in the sterling area exchange control system.

Due to Hong Kong's entrepot trade and Kuwait's oil production, these two members of the sterling area operated free markets in sterling against dollars which were tolerated by the British authorities. As they were still members of the sterling area, UK residents could use resident sterling to purchase dollar securities freely from Hong Kong and Kuwait residents. The Hong Kong or Kuwait trader could then exchange this sterling for dollars on the free market to purchase more dollar securities. Thus,

resident sterling was exchanged for non-resident securities. The so-called Hong Kong and Kuwait Gaps were finally closed in 1957 when British purchases of non-sterling securities from overseas residents of the sterling area were prohibited. In general, however, the ring of exchange control was fairly consistent and remained a defining characteristic of sterling area membership.

The third defining characteristic of the sterling area was the pooling of foreign exchange reserves. As part of the exchange control system, private residents were required to surrender foreign exchange earned from their transactions with the non-sterling area in return for balances in their national currency. These foreign exchange earnings were used partly to settle RSA deficits with the UK⁴⁶. The excess was sold by the members' monetary authorities to the Bank of England in return for sterling assets in the form of Treasury Bills, or government securities. The monetary authorities of the RSA could then draw foreign exchange from the central reserves at any time. The purpose of the 'dollar pool', as it was known, was to conserve the amount of foreign exchange needed to support the sterling area. This was based on the principle that the pooled foreign exchange assets of the area as a whole would be less than if each member had to keep a cushion of reserves of its own. Thus, the 'idle' surpluses of members were available to cover the non-

⁴⁶Thus the UK could earn foreign exchange from its surpluses with the rest of the sterling area (RSA).

sterling deficits of others. This principle is sometimes forgotten in analyses of the sterling area which seek to argue that the reserves of the system were not adequate to cover all potential claims of the members. The main purpose of reserve pooling and the sterling area system as a whole was to coordinate these claims in the interests of all members and so allow a smaller volume of foreign exchange to insure against fluctuations of the system vis a vis the rest of the world. As long as it was in the interest of each member to remain part of the dollar pool, the system was fairly secure. Given that the British Colonies were the most persistent contributors to the dollar pool, this security seemed assured at least until the end of the 1950s when Colonies began to achieve independence.

Related to the dollar pooling aspect of the post-war sterling area was the problem of the sterling balances. At the end of the War, these liabilities amounted to five times the level of British foreign exchange reserves so they could obviously not be liquidated immediately. As part of the American Loan agreement of 1946, the UK had agreed to deal with the overhang of liabilities by a combination of blocking, funding and cancellation. In the event, such a solution was not possible. Dealing with all sterling balance holders collectively was considered inappropriate by the British authorities because of the different ways the balances had been accumulated and the political problems of treating all holders equally. While

to the Americans the sterling balances represented war debts which should be written off, the British felt obliged to honour their debts to their allies in the Commonwealth. In July 1947 partial blocking arrangements were negotiated with India and Iraq followed by similar arrangements with Ceylon and Pakistan⁴⁷. Despite these agreements the sterling balances of India, Pakistan and Ceylon together were run down by £428m from the end of 1947 to the end of 1949. There was an offsetting increase in the sterling balances of Australia, New Zealand and South Africa, mostly due to speculative short term capital inflows into these countries especially after the sterling devaluation of 1949. It was widely believed that Australia would revalue the Australian pound to a par with sterling but these expectations proved unfounded. By the first quarter of 1950, the level of sterling area sterling balances was £2,541m or slightly more than the 1945 level. The central reserves, meanwhile, amounted to only £900m. This excess of short term liabilities to the sterling area over the central reserves became one of the major preoccupations of British sterling area policy.

These then were the characteristics of the sterling area in the 1950s. It was a fixed exchange rate system, bound by common exchange controls against the rest of the world while the members enjoyed relatively free current and capital flows within the area. The pooling of foreign

⁴⁷P.W. Bell provides a useful summary of these agreements at the end of his Chapter 2 of P.W. Bell, The Sterling Area in the Postwar World, 1956. pp.39-42.

exchange reserves generated sterling balances and the need for periodic discriminatory trade controls to protect the central reserves. Britain was the centre of the system and managed it by supplying long term capital investment, accepting unlimited short term sterling liabilities and purchasing sterling area exports without restriction.

I.C. The Sterling Area and the Theory of Currency Areas

In the 1960s, academic interest in the theory of optimum currency areas was sparked by a brief article by R.A. Mundell⁴⁸. More recently, the costs and benefits of monetary integration have received greater attention in the context of plans for European monetary union⁴⁹. In part, the issues of the sterling area system would seem to fit into part of this debate and it is worth exploring the theoretical discussion of currency areas to establish the extent to which this is so for the 1950s.

First, the sterling area was not a currency union. All members had their own national currencies, although the degree of independence varied. In the case of the Colonies, national currencies were virtually

⁴⁸R.A. Mundell, "A Theory of Optimal Currency Areas", American Economic Review, Vol. 51, September 1961, pp.657-65.

⁴⁹See e.g., H.G. Johnson and A.K. Swoboda eds., The Economics of Common Currencies; Proceedings of the Madrid Conference on Optimal Currency Areas, George Allen and Unwin, 1973. R.Z. Aliber ed., The Reconstruction of International Monetary Arrangements, St. Martins, New York, 1987. D.E. Fair and C. de Boisieu eds., International Monetary and Financial Integration - The European Dimension, Netherlands, 1988.

interchangeable with sterling because Colonial monetary systems were based on 100% sterling reserves. The properties of the sterling area system do, however, approximate a currency area defined by W.M. Corden as "an area within which exchange rates bear a permanently fixed relationship to each other" and where there is a "permanent absence of all exchange controls, whether for current or capital transactions, within the area"⁵⁰. The members of the sterling area operated firmly fixed exchange rates with each other, denominated their trade in sterling and for the most part enjoyed free payments on current and capital account. The exceptions to these general rules were some trade restrictions within the area (e.g. Australia imposed quantitative restrictions on sterling area imports after 1952) and some capital controls (e.g. in 1956 South Africa imposed controls on capital flows to the UK in response to the increases in the British Bank Rate).

Despite these exceptions, the sterling area had many of the prerequisites for a successful currency area described in the theoretical literature⁵¹. Thus, it is argued that open economies will benefit from fixed exchange

⁵⁰W.M. Corden quoted in E. Tower and T.D. Willett, The Theory of Optimum Currency Areas and Exchange-Rate Flexibility, Special Papers in International Economics, No. 11, 1976. p. 2.

⁵¹The criteria for an optimal currency area are surveyed in Y. Ishiyama, "The Theory of Optimal Currency Areas: A Survey", IMF Staff Papers, Vol. 22, 1975. pp. 344-383, H.R. Heller, "Exchange Rate Flexibility and Currency Areas", Zeitschrift für Wirtschaft-und Sozialwissenschaften, 1979. pp 115-135, and E. Tower and T.D. Willett, The Theory of Optimum Currency Areas and Exchange-Rate Flexibility, Special Papers in International Economics, No. 11, 1976.

rates since the stability of the domestic price level will be more affected by fluctuations in the exchange rate than closed economies⁵². Also, aggregate demand policies are a cheaper means of balance of payments adjustment when the marginal propensity to import is high than when it is low so that the opportunity cost of the loss of devaluation as a policy option is not as great in open economies⁵³. A second criterion is a high degree of capital market integration to allow capital flows to finance imbalances between members of the currency area⁵⁴. A third criterion is the degree of diversification of production⁵⁵. Countries with more diversified production will suffer less pressure on their exchange rate from a fall in demand for one of their tradeable goods than an economy which only produces a few products. A diversified economy will thus find the fixed exchange rates of a currency area less costly. A fourth criterion is a high degree of policy coordination or integration among members of a currency area since the pursuit of widely differing inflation, unemployment and growth targets will tend to drive the

⁵²Heller, "Exchange Rate Flexibility", p. 118. Ishiyama, "Theory of Optimum Currency Areas", p. 350. Tower and Willett, Theory of Optimum Currency Areas, p. 13-14.

⁵³Ibid. See also Tower and Willett, Theory of Optimum Currency Areas, p. 42.

⁵⁴Heller, "Exchange Rate Flexibility", p. 120. Ishiyama, "Theory of Optimum Currency Areas", p. 355-6.

⁵⁵Heller, "Exchange Rate Flexibility", p. 119. Ishiyama, "Theory of Optimum Currency Areas", p. 353-4. Tower and Willett, Theory of Optimum Currency Areas, p. 49-50.

members' exchange rates apart⁵⁶.

In the context of the sterling area, most members had relatively open economies, measured in the value of foreign trade to GNP and they shared a high volume of trade among members relative to trade with the rest of the world. This will be shown in Chapter III. Secondly, there was relatively free movement of capital within the area and there was a high degree of financial market integration in both short and long term securities so there was ample facility for capital flows to smooth short term balance of payments disequilibria among members. The possible costs to the UK economy of this financial integration will be addressed in Chapter II and Chapter IV. On product diversification, the members diverged. Thus, if the theoretical considerations hold, it was more advantageous for the diversified British economy to be part of a currency area than the less developed overseas members whose exports were concentrated in a few primary products. Against this interpretation is the fact that the smaller members of the sterling area also tended to have more 'open' economies which would benefit more from association with a currency area. Finally, one of the essential criteria of optimal currency areas is the coordination of economic policy. This was the object of a series of Commonwealth Economic Conferences and Finance Ministers' Meetings which were the formal fora for the management of

⁵⁶Ishiyama, "Theory of Optimum Currency Areas", p. 357-9. Tower and Willett, Theory of Optimum Currency Areas, p. 15-16.

the sterling area. Through these conferences, Britain tried to coordinate first a common external trade policy and later an internal deflationary policy for all members. The degree to which these attempts were successful will be considered in Chapter III.

The experience of the sterling area diverges from the literature on currency areas in that the latter deals with the situation of a country making a positive decision whether or not to join such a system. This reflects the emphasis on the theoretical potential for European union rather than a historical/empirical analysis⁵⁷. To the pros and cons of currency areas in the case of the sterling area in the 1950s must be added the dismantling costs of the existing system that had emerged gradually and the relative cost of practical alternatives. This will be addressed in Chapter VI. Also, the sterling area differed from most of the scenarios in the literature in that the exchange rate between the area and the rest of the world was fixed rather than floating⁵⁸. Thus, the adjustment of the sterling area as a whole was made less flexible and the need for adequate central foreign exchange reserves was an over-riding preoccupation of the management of the system.

With the achievement of most of the criteria discussed

⁵⁷Heller notes that the bias in the literature has been "entirely theoretical in nature", "Exchange Rate Flexibility", p.117. With a decade of experience of the European Exchange Rate Mechanism under study, this bias is weakening.

⁵⁸Alternatively, it could be argued that the sterling-dollar exchange rate was variable until February 1955 through the fluctuating transferable sterling market.

in the literature, the sterling area should have reaped the theoretical benefits of a currency area. These include economizing on reserves⁵⁹, eliminating speculative capital flows between members⁶⁰ and increasing the usefulness of money as a medium of exchange and a store of value, thus taking advantage of economies of scale and reduced transactions costs⁶¹. More fundamentally, a currency area must be judged on the extent to which it promotes the economic goals of its members. In the case of the UK in the 1950s these were price stability, full employment, balance of payments stability and growth. The goals of the rest of the sterling area focused more on growth and development. The final chapter of the thesis will return to an assessment of the sterling area as a currency area.

While the theory on currency areas gives some broader context to the study of the sterling area, the main thrust of this thesis is to provide an up to date and more complete account of the economic relations among the members of the sterling area and to draw some conclusions about the impact of the system on other aspects of British policy and on the range of alternatives dismissed along the way.

The thesis is built around the three key relationships of the sterling area system. Chapter II examines the

⁵⁹Tower and Willett, Theory of Optimum Currency Areas, p. 12-13. Ishiyama, "Theory of Optimum Currency Areas", p. 363.

⁶⁰Ishiyama, "Theory of Optimum Currency Areas", p. 362.

⁶¹Ishiyama, "Theory of Optimum Currency Areas", p. 362. Tower and Willett, Theory of Optimum Currency Areas, p. 6-8.

mechanics of movements in the sterling balances and their implications for the British economy and British policy. Chapter III examines the trade relationships of the sterling area and British attempts to coordinate policy. Chapter IV analyzes the long term investment flows from Britain to the rest of the sterling area. The next two chapters are more policy oriented. The first determines how the sterling area inhibited British policy in other spheres and the second examines the alternatives to the sterling area and the process toward convertibility. The final chapter draws the evidence together and concludes that the role of the sterling area in British policy in the 1950s was both more complex and less important than previous accounts have argued.

Chapter II The Sterling Balances Problem

Britain's accumulation of enormous sterling liabilities to the Commonwealth and Colonies profoundly affected the post-war configuration of the sterling area system. In 1945, these liabilities amounted to £3.6b, 65% of which was owed to sterling area members as defined in 1950¹. Immediately after the war Britain failed to come to any lasting agreements with her sterling area creditors despite American pressure to settle the problem. The reasons for this are described fully elsewhere². It suffices for the present chapter to note that there were complicated political reasons against unilateral action by the UK either to cancel her debts or fund them. Under the terms of the 1947 Anglo-American Financial Agreement, the UK was under an obligation to fund, block or cancel the balances and in August 1947 a partial blocking arrangement was concluded with India, followed by similar arrangements with Pakistan and Ceylon in February and June 1948. By 1950, despite a substantial rundown by India, Pakistan and Ceylon (£568m between 1945 and 1949), British sterling liabilities to the sterling area still amounted to £2.6b or more than twice the level of UK foreign exchange

¹UK External Liabilities and Claims in Sterling: 1945-62 (Old Series), Bank of England, 1968. I am deliberately excluding Egypt from this analysis. Egypt left the sterling area in 1947, in part due to her large sterling assets.

² See for example, L.S. Pressnell, External Economic Policy Since the War, Volume I, HMSO, 1986.

reserves in this year³. Because of the apparently fragile ratio of reserves to liabilities, the problem of the sterling balances was the most constant preoccupation of British sterling area policy throughout the 1950s.

Most of this chapter will be concerned with identifying what comprised the sterling balances, the mechanics of their movements and their effect on the central reserves. The conclusion that is drawn is that movements in the RSA sterling balances did not pose a major destabilizing burden on the central reserves. Changes in the ratio of reserves to liabilities were more directly related to changes in the British economy vis a vis the non-sterling area due to the way sterling area sterling balances were accumulated and run down.

The analysis will also address the possible effects of the sterling balances system on the Colonial holders of these balances. There was a significant contemporary debate over whether the Colonies were exploited by the sterling area system and in particular by the accumulation of sterling balances. This will be analyzed by looking at the British attempts to accelerate Colonial development through liquidating their sterling balances. The failure of this policy suggests that the liquid part of the Colonial sterling balances was relatively small and the resistance to development originated in the conservative fiscal and monetary

³UK External Liabilities, Bank of England, 1968.

policies of the Colonial governments themselves.

II.A. Identifying the Sterling Balances

An analysis of the sterling balances by country or even by type of fund should be a fairly straightforward procedure. In fact, however, no published series exists of a complete breakdown by holder or by type of fund for this period. The preference in published sources has been for regional groupings which include individual members of the RSA whose balances followed very different paths⁴. The paucity of published data is due in part to the reluctance of the Bank of England and the Treasury to draw public attention to the size of the liabilities relative to reserves and also to avoid making details of individual members' holdings public in case this should precipitate a spending spree⁵. The Bank of England, furthermore, was reluctant to reveal detailed figures which they received from RSA commercial and central banks to the Treasury for reasons of customer confidentiality. As part of the Monthly Report on External Finance, however, figures for most sterling area members were calculated for meetings of the Overseas Negotiations Committee. The complete quarterly series is presented in Appendix I.

⁴See e.g. Bank of England 1968 series or Memorandum on the Sterling Assets of the British Colonies, Colonial Office Paper 298, HMSO, 1953.

⁵Note from H. Brittain to T.L. Rowan HMT 11 May, 1953. PRO T236/3352.

The first important distinction to be made in an analysis of the sterling balances is between the three major geographical categories of holders; Colonies, Independent Sterling Area (ISA) and Non-Sterling Area (NSA). Figure II.A. shows the relative sizes of sterling area and non-sterling holders and Figure II.B. shows movements in Colonial and independent sterling area balances.

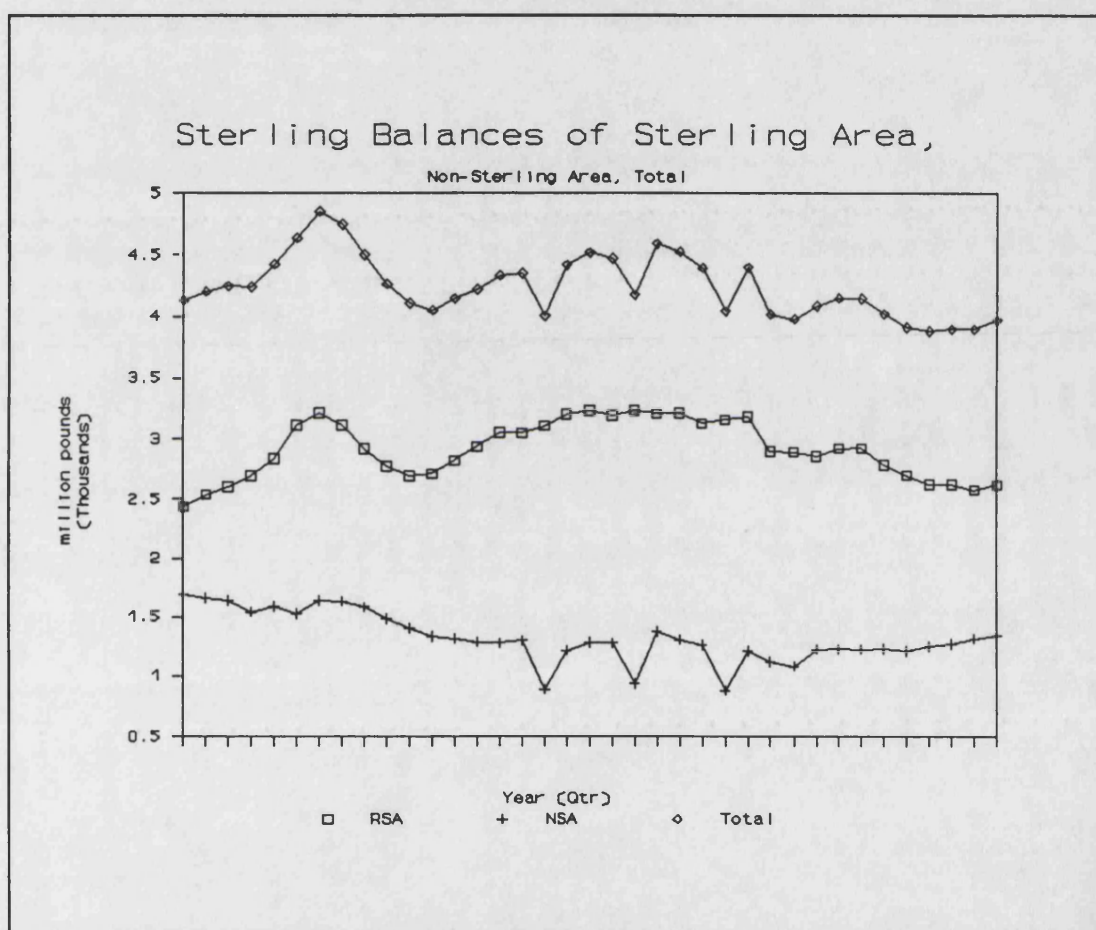


Figure II.A.

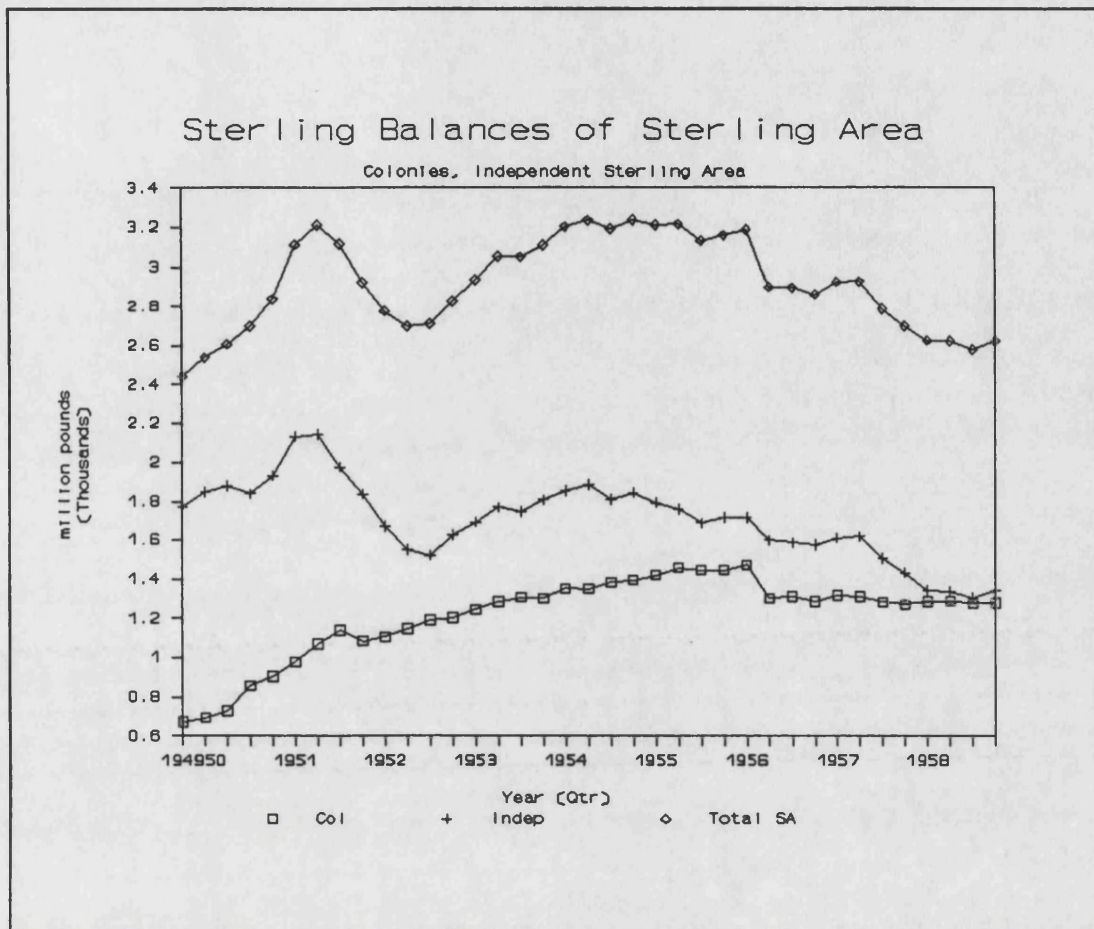


Figure II.B.

II.A.i. Colonial Sterling Balances

The value of Colonial sterling balances almost doubled between 1950 and 1958 from £673m to £1.28b. As a result of the Korean War boom between 1950 and 1952, Colonial sterling balances increased by £400m in these three years. After this rapid increase, the level of Colonial balances recovered and grew fairly steadily by about £100m p.a. until the second quarter of 1956. The drop in Colonial balances in 1956 was due to the slump in many raw material prices which followed a boom in industrial raw material prices in 1955. From the second quarter of 1956, Malaya and the African Colonies especially suffered from declines in the world prices for rubber, tin, cocoa and copper⁶. After a fall in this quarter of some £170m the level of Colonial sterling balances remained fairly constant, declining slightly towards the end of the period. By the end of 1958, Colonial sterling balances accounted for about half of sterling area sterling balances compared with 27% at the end of 1949.

A complete breakdown of Colonial sterling balances by holder and type of fund is not available in published sources. An estimation of the distribution by classes of funds and by colony was, however, constructed by J.G. Littler in 1956 for

⁶Commonwealth and Sterling Area Statistical Abstract, No 78, 1957., HMSO, Dec. 1958.

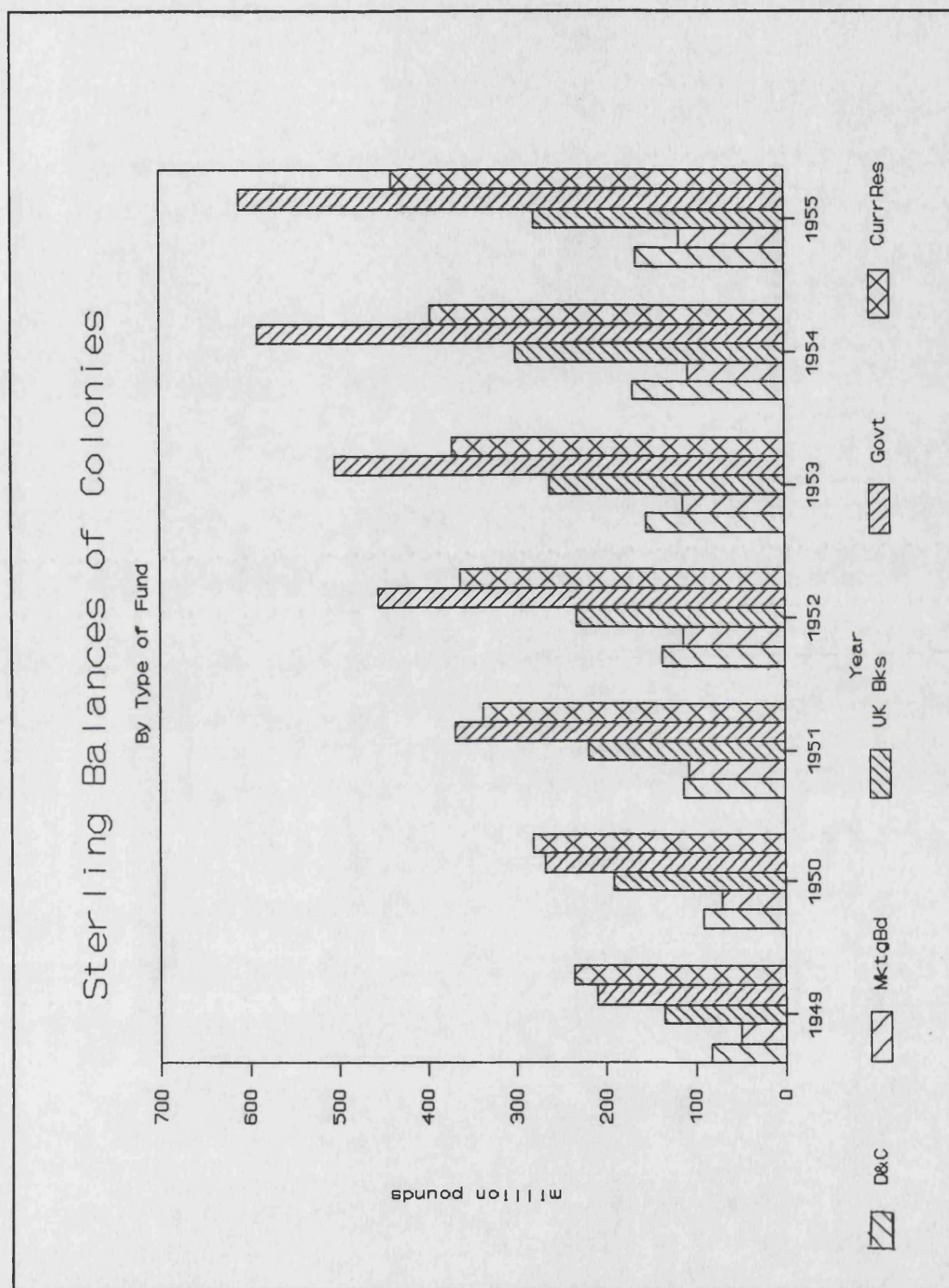


Figure III.C. D&C = Dominion and Colonial Securities

the years 1949-1955⁷. The series published for 1956-1958 by

⁷"The Pattern of Colonial Sterling Assets and UK Sterling Liabilities to the Colonies" by J.G. Littler, 2 March 1956. PRO T236/4253.

the Colonial Office in the Digest of Colonial Statistics is flawed by changes in the composition of the territories included and by the grouping together of Colonies into territorial groups rather than individual members⁸. Using these two sources of data, however, a general picture of the composition and distribution of the Colonial balances can be determined. Figure II.C. shows the components of total Colonial sterling balances for 1949-55 and Figure II.D. shows the balances of these Colonies excluding the Gold Coast (Ghana), Malaya, Singapore and Northern Rhodesia and Nyasaland for 1956-58.

The largest component of Colonial sterling balances in 1950 was currency reserves. Colonial monetary systems were based on 100% sterling backing for the local money supply. In fact, most Colonies kept 110% reserves to allow for changes in the value of their investments which were managed by currency boards in London or by Crown Agents for the Colonies. Because of this statutory link to sterling, currency reserves tended to grow directly with Colonial money supplies and therefore with the size of Colonial economies. With the raw material boom of 1950-52, therefore, currency reserves grew from £236m at the end of 1949 to £363m by the end of 1952⁹, an increase

⁸Digest of Colonial Statistics, Colonial Office, HMSO, London.

⁹Littler, Treasury Paper, 2 March 1956. PRO T236/3562.

of 54% in three years. Those Colonies whose currency reserves grew fastest were, not surprisingly, those that benefited most from the Korean War boom. These included Malaya, whose tin and rubber trade generated an increase in currency reserves of £22m between 1950 and 1952 and Nigeria with an increase of £25m. As a proportion of total Colonial sterling balances, currency reserves declined from 36% at the end of 1949 to 32% in 1958.

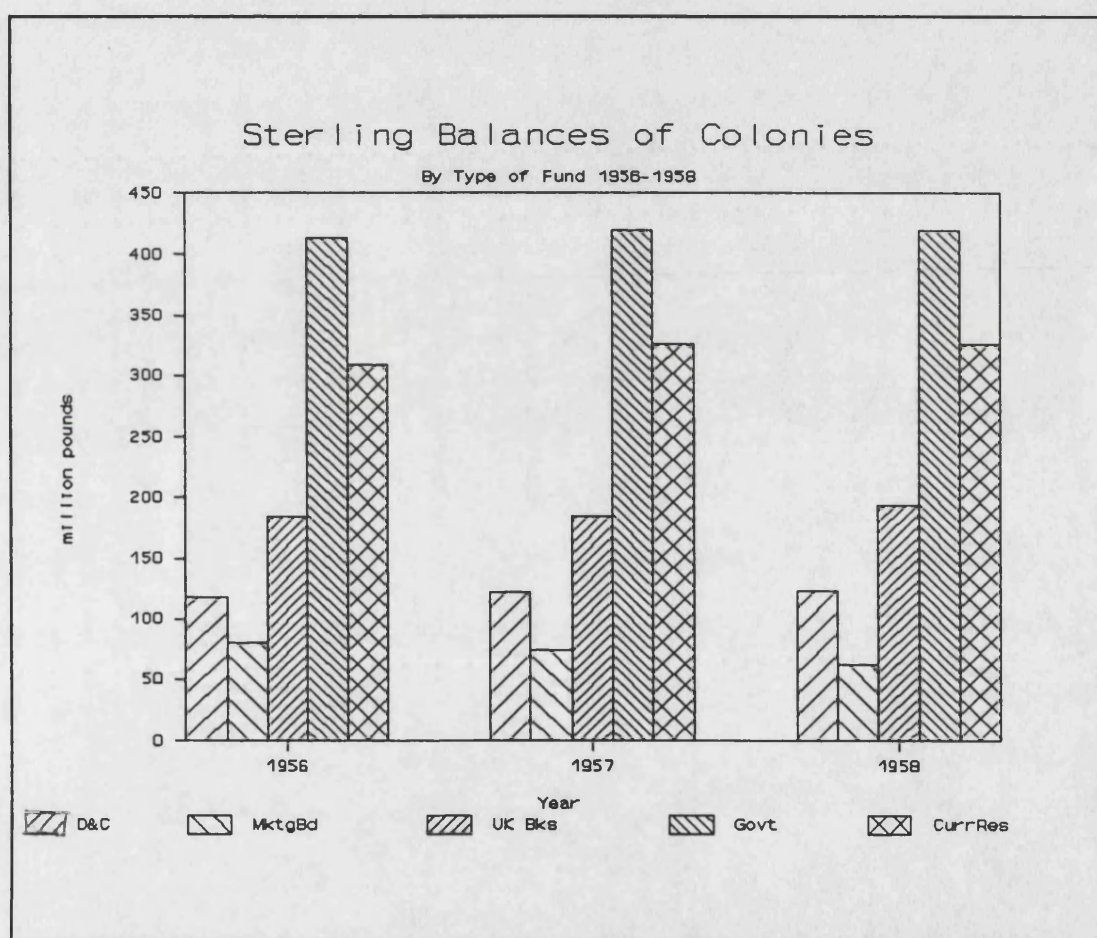


Figure III.D.

Government reserves accounted for 32% of Colonial sterling balances in 1950 but grew to 42% by the end of 1955

declining to 33% by 1958. These in turn were divided into general reserves and special funds. General reserves were mainly the result of budget surpluses due to substantial government taxation of exports combined with a conservative spending policy. In Nigeria, for example, government taxation between 1948 and 1962 averaged 35% of the fob revenue of cocoa, 48% of palm oil, 42% of palm kernels and 52% of groundnuts¹⁰. In turn, the government ran budget surpluses averaging almost £5m p.a. from 1950-58 or 10% of government revenue¹¹. By 1955 Nigeria had accumulated government reserves (including special funds) amounting to a total of £107.4m or twice as much as annual government expenditure compared with only £30.1m at the end of 1949¹². The Gold Coast and Singapore were in a similarly liquid position. Malta and Uganda had reserves three times their annual expenditure, Brunei twelve times and Hong Kong 150%¹³. For the Colonies as a whole, government general reserves grew from £60.4m at the end of 1949 to £346.6m at the end of 1955.

The motives behind this dramatic accumulation of government assets are uncertain. Part of the Colonial

¹⁰S.O. Olayide, D. Olatubosun, S.M. Essang, Nigerian Foreign Trade and Economic Growth 1948-64, University Press Ltd., Ibadan, 1982. p. 83.

¹¹ibid., p. 84.

¹²"The Pattern of Colonial Sterling Assets and UK Sterling Liabilities to the Colonies" by J.G. Littler, 2 March 1956. PRO T236/4253.

¹³ibid.

governments' conservative reserve policy was attributed to potential instability in revenue due to fluctuations in raw material prices and undeveloped local money markets¹⁴. In 1953 a Working Party of Bank of England and Treasury officials endorsed the Colonial policy of accumulating four to six months' revenue in reserve each year for these reasons¹⁵. In fact, however, the fears of the Colonial governments of a collapse in revenue were not realized and general reserves continued to increase in every year of the period. That this very conservative approach to expenditure persisted to the end of the 1950's, while the Colonial governments had not been obliged in any year to run down these large reserves, suggests some accumulation for accumulation's sake as well as a response to a real risk of fluctuations in the international economy.

As well as general reserves, the Colonial governments controlled a series of special funds. These included statutory sinking funds for government loans, post office savings bank funds, pension funds, renewal funds, development funds and various other reserves for specific purposes. There was a considerable increase in this category of government balances, the total rising from £150m in 1949 to £264m by

¹⁴Working Party on Colonial Sterling Assets, Report on the Financial Aspects of the Assets, 4 Sept. 1953. PRO T236/3562.

¹⁵ibid.

1955¹⁶. The largest categories were post office savings bank funds (£78m in 1955), sinking funds (£38m in 1955) and development funds (£68m in 1955)¹⁷. The savings bank funds increased with export earnings and therefore with the fortunes of the market for raw materials. The growth in sinking funds reflected the increasing volume of loans from the UK.

Most development funds were established in 1951 with the proceeds of the raw material boom and they continued to accumulate at least through 1955. The distribution of government funds specifically ear-marked for development is presented in Table II.A. Colonial development may have been

Table II.A.
Colonial Government Development Funds

£M	1949	1950	1951	1952	1953	1954
Gold Coast	0	0	8.0	10.5	13.6	24.0
Uganda	1.3	0.7	0.5	4.5	10.9	10.0
Singapore	0	0	0	0	5.8	9.0
Hong Kong	0	0	0	4.5	4.5	8.0
Nigeria	0	0	1.0	7.7	6.9	8.0
Cyprus	0	0	1.8	2.2	2.6	3.5
Tanganyika	0.7	1.8	3.0	3.9	2.1	2.5
Kenya	1.0	2.3	4.2	8.5	7.0	2.0
Bermuda	0	0	0.2	0.3	0.5	0.9
Zanzibar	0	0	0.1	0.1	0.2	0.3
Total	3.0	5.2	18.8	43.2	54.1	68.2

Source: "The Pattern of Colonial Sterling Assets and UK Sterling Liabilities to the Colonies" by J.G. Littler 2 March, 1956. PRO T236/4253.

retarded at the beginning of the period by shortages of capital goods supplies and technical assistance from the UK. This excuse, however, should have weakened as the decade

¹⁶Littler, 'The Pattern', 2 March 1956. PRO T236/4253.

¹⁷ibid.

progressed and the supply problems associated with rearmament worked their way through the British economy. The reason why the Colonies accumulated such surpluses rather than spending them on development will be discussed later in this chapter.

The two remaining categories of Colonial sterling balances also grew in response to the trade fortunes of the Colonies. Funds with British banks operating in the Colonies accounted for 23% of Colonial sterling balances in 1950 and 19% by 1958¹⁸. These were comprised of the reserves and working balances of these banks, held in London primarily as British Treasury Bills. They were determined, then, by levels of deposits, liquidity policy and working balances required for trade. In this way they were linked to British banking practice and the fortunes of Colonial trade.

The final category of Colonial sterling balances was marketing board assets which accounted for 7.5% of Colonial sterling balances in 1949, 8% in 1955 and 6% by 1958. Raw material marketing boards were most prominent in the West African Colonies of the Gold Coast and Nigeria where they accounted for about 25% of these Colonies' sterling balances. Cocoa marketing boards were set up in the Gold Coast and Nigeria in 1947 and Nigerian palm oil, groundnut and cotton marketing boards followed in 1949. The purpose of the boards was to stabilize producer prices given the volatile international market for these products. The boards fixed

¹⁸Colonial Digest of Statistics, 1959.

producer prices, prescribed grades for production, appointed buying agents and sold the product on the international market.

The sterling assets of these boards are shown in Figure II.E.¹⁹. They absorbed most of the profits of the raw

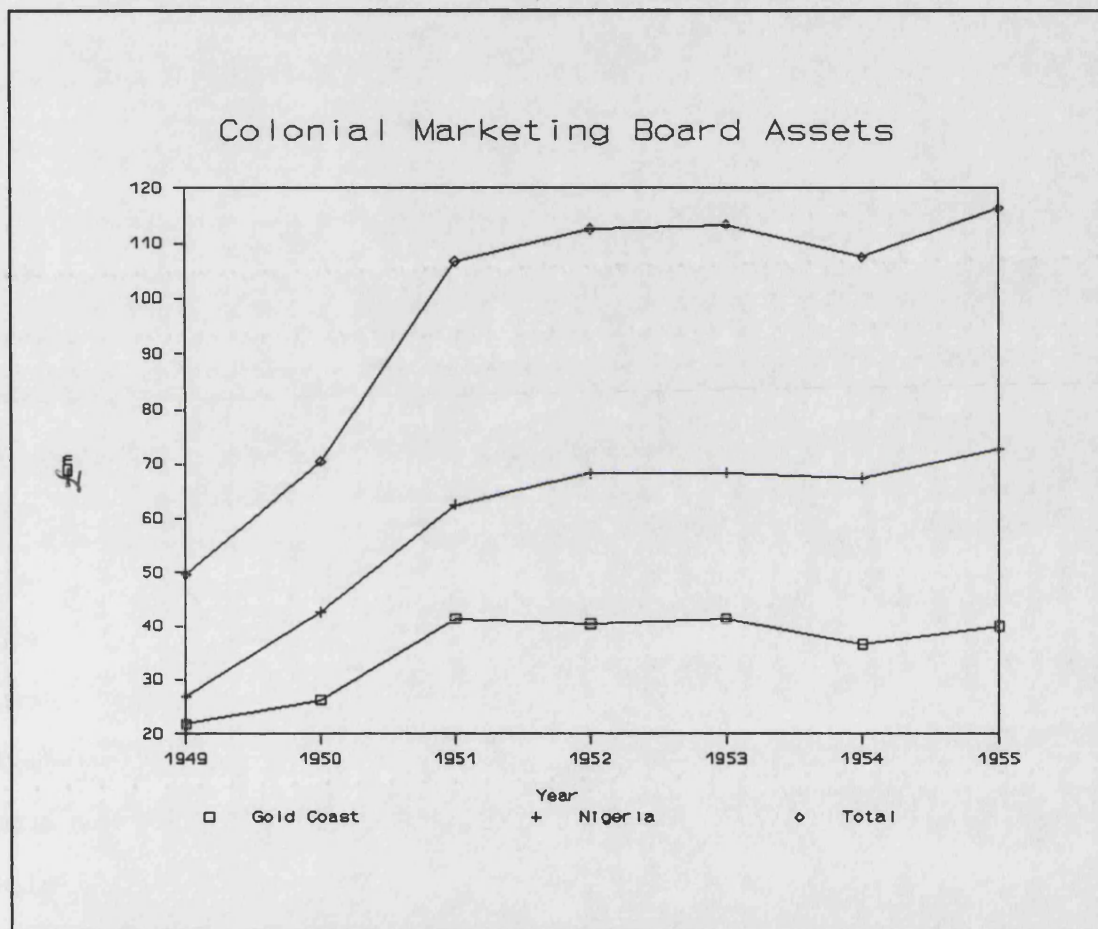


Figure II.E.

material boom of 1950-51 and largely maintained these assets

¹⁹The figures include some miscellaneous official funds but are primarily marketing board assets.

through to the end of the 1950's. The amount of assets owned by Colonial marketing boards was the same in 1957 as in 1952, immediately after the Korean war boom. The marketing boards themselves, then, appear to have been subject to the same cautious spending policy as Colonial governments.

When the marketing boards were set up, it was established that the profits generated by their transactions would be allocated primarily for price stabilization and secondarily for development and research related to improving the production or distribution of their product. By 1952, all of the Nigerian marketing boards had given responsibility for managing their development projects to the Nigerian Regional Development Board²⁰. According to a formula accepted by each Nigerian marketing board, they allocated 22.5% of their surplus for that year for development projects and 7.5% for research projects managed by the Regional Development Board. The remaining 70% of the profits were designated for individual product price stabilization funds²¹. In 1950 the Nigerian Palm Oil Produce Marketing Board furthermore guaranteed a minimum £800,000 contribution in any year. The Gold Coast Cocoa Marketing Board did not follow such a formal development programme, instead it periodically provided loans

²⁰The Nigerian Groundnut Marketing Board and Oil Palm Produce Marketing Board allocated their development funds to the Regional Development Board from 1949.

²¹The Nigerian Cotton Marketing Board did not allocate a fixed sum to the Regional Product Development Boards. Instead it took part in cotton-related projects on an ad hoc basis.

to the Colonial Government for particular development projects. The development funds allocated by the marketing boards from 1950-1958 are shown in Table II.B. In 1954 the product-specific marketing boards of Nigeria were absorbed into three regional marketing boards which loaned

Table II.B.
West African Marketing Boards
Contribution to Development

£M	1950	1951	1952	1953	1954	1955	1956	1957	1958
Nigeria									
Groundnut	2.8	1.7	1.6	1.2	1.4				
Oil Palm	1.7	3.2	2.1	0.8	0.8				
Cocoa	0.5	0.6	0.4	0.1	1.7				
Cotton	0.4	0.3	0.2	0.7	0.3				
Eastern Region						1.2	0.2	2.2	1.6
Western Region						6.8	4.8	0.8	1.3
Northern Region						2.1	0.5	1.2	0.3
Total	5.4	5.8	4.3	2.8	4.2	10.1	5.5	4.2	3.2
Gold Coast									
Cocoa	2.2	3.5	4.0	2.4	2.0	0.3			

Source: Annual Reports of the Nigerian Groundnut Marketing Board, Oil Palm Produce Marketing Board, Cocoa Marketing Board, Cotton Marketing Board, Eastern Region Marketing Board, Western Region Marketing Board, Northern Region Marketing Board and the Gold Coast Cocoa Marketing Board.

substantial sums directly to the Nigerian government and to regional development corporations. In 1955 the new regional boards accepted an obligation to contribute a total of £14m to the Nigerian government's loan programme for large scale development schemes. Over the nine years, these Nigerian marketing boards contributed over £45m to local development and amassed general reserves of £73.4m.

The limiting factor in the marketing boards' contribution to development seems to have been that the annual allocations

were related to annual surpluses and not to the level of reserves. Thus, the contribution to development in 1950 amounted to 10.6% of reserves but in 1958, when prices were falling, the contribution amounted to only 4.0% of reserves.

After 1951, the Gold Coast Cocoa Marketing Board stopped adding to its price stabilization fund (it was stable at £51m until 1957) and took up substantial amounts of local government securities including over £6m worth of local railroad and harbour development securities in 1954-55 and £2m worth of a general Development loan in 1956. The Gold Coast contribution to local development in Table II.B. excludes the contents of their own Rehabilitation Scheme Fund which spent about £10m on Swollen Shoot disease over the period. From 1950-1958 the Gold Coast Cocoa Marketing Board spent over £14m directly on development and accumulated a stabilization fund of £45m of which £33.7m was invested in British government securities.

Altogether, Colonial sterling balances represented an increasing proportion of total sterling area sterling balances, rising from 30% at the end of the war in 1945 to 54% by 1958. About half of the Colonial balances were held in East and West Africa where marketing boards exaggerated the effects of the raw material boom on sterling holdings. The Gold Coast and Nigeria alone held 30% of Colonial sterling assets in 1956. The share held by the Malayan area increased slightly to one quarter by 1958 while the West Indies and Hong

Kong each held a constant proportion of about 10%. The geographical distribution of the Colonial sterling balances was thus fairly constant and tended to reflect the pattern of concentration of the raw materials boom of the early 1950s through to the end of the period.

II.A.ii. The Sterling Balances of the Independent Sterling Area

The sterling assets of the independent sterling area (ISA) declined by one third between 1950-58 to £1.3b. About 90% of ISA sterling balances were held as government reserves or by central banks. The rest were held as funds of UK banks operating overseas²².

India, which had accumulated the largest wartime balances, was still the largest sterling asset holder in 1950, accounting for £804m or 42% of ISA balances²³. By the end of 1956, however, Indian sterling balances accounted for only 26% of the ISA total or £412m²⁴. By this time Indian sterling balances were already below the amount considered by the Indian authorities to be a working minimum²⁵. The main determinant of the level of Indian balances in the 1950's, as

²²"Sterling Balances Part I: Amount and Characteristics" Appendix II by L.P. Thompson-McCausland, 30 January, 1956. BoE OV44/30

²³Report on External Finance, BoE EID3/98-106.

²⁴Ibid.

²⁵"Commonwealth Government Borrowing in the UK in Relation to Sterling Balances" 6 May, 1957. PRO BT213/96

with Pakistan and Ceylon, tended to be development expenditure. In 1956-58, heavy spending on development pulled sterling balances for these three countries down £598m or to one quarter of the 1955 level.

Australia was the next largest independent sterling asset holder in 1950, holding 26% of ISA balances in that year. As in India, the level of sterling balances in 1956 was considered by the Australian authorities to be below the minimum desired level. The Australian Prime Minister made several public statements during 1954 and 1955 which indicated that £200m was then considered an absolute minimum sterling reserve²⁶ but in the first quarter of 1956, the volume of Australian sterling assets had fallen to £174m. The level of sterling balances held by Australia and New Zealand tended to follow the vagaries of the balance of payments situation. In this sense the balances of these countries most closely represent working foreign exchange reserves. None of the 'old dominions' were large wartime accumulators. In 1945 South Africa, Australia and New Zealand together held £305m or 22% of the balances held by India, Pakistan and Ceylon in that year²⁷.

Increases in Middle Eastern sterling balances partly offset the decreases in other ISA holdings. Through the mid

²⁶ibid.

²⁷The sterling balances of India and Pakistan were divided in 1948.

1950s the oil producing territories became rich, earning sterling in amounts that their development plans had difficulty absorbing. Between 1950 and 1956 Iraq's sterling assets more than doubled from £52m to £127m²⁸. The sterling assets of the Persian Gulf Protectorates, which included Kuwait, increased from a mere £3m at the end of 1951 to £260m by the end of 1958, becoming the second largest independent sterling holder after Australia.

The general picture of sterling area sterling balances is of a gradual increase in total volume to 1955 except for the slump of 1952. There followed a gradual decline to 1958 although the balances recovered their 1955 level by 1962²⁹. Within this apparent stability, however, was a significant regional shift. The major wartime creditors, India, Pakistan and Ceylon, operated at a fairly stable reduced level until 1952 and again until 1956 when their assets came close to exhaustion. The older dominions of Australia, South Africa and New Zealand were not major wartime creditors but had built up their assets by 1950 to 26% of the total. Their balances fluctuated around a declining trend, never recovering from the drop associated with the slump of 1952. Colonial sterling balances offset this decline in the ISA since the collapse of raw material prices in 1952 was not associated with a quick

²⁸"Middle East Sterling Area Territories" 28 March 1956 OV44/31 and "UK Sterling Liabilities" 21 February, 1952. BoE ADM14/30

²⁹ibid.

spending of sterling assets as was the case in the ISA.

II.A.iii. The Sterling Balances of the Non-Sterling Area

The final category of sterling balance holders was the non-sterling area (NSA). These balances differed in both volume and character from those of the rest of the sterling area. NSA balances were held mostly by private holders after 1953 and tended to be the working balances of traders. Britain exercised no control over these assets and they were assumed, therefore, to be linked most closely with the volume of trade in sterling and to confidence in the pound. The NSA balances declined only £97m between 1950 and 1958 although this disguises speculative runs in 1952 and 1955-57³⁰.

What the data suggest is that through the early part of the 1950's, more specifically through the boom and bust of 1950-52, RSA sterling balances were transformed from the extraordinary wartime accumulations of the post-war era to the natural product of the functioning of the sterling system given the legacy of British Colonial policy which persisted in encouraging conservative economic policies through the 1950's.

Having established what the sterling balances consisted of and the significance of their geographical distribution, it remains to identify the mechanics of movements in the balances and their possible effect on the British economy.

³⁰UK External Liabilities, Bank of England, 1968. Unless otherwise specified the term 'sterling balances' will refer to RSA balances only.

II.B. The Mechanics of the Sterling Balances System

Movements in sterling balances were linked to the relative balance of payments position of the RSA with Britain on the one hand and the with NSA on the other. The RSA would run a deficit with the UK supported by a surplus with the rest of the world while the UK used its surplus with the RSA to offset its deficit with the rest of the world. The result was that the sterling area as a whole was in overall balance with the rest of the world. This idyllic situation was not, however, how the system functioned in the 1950's, when the sterling area as a whole was more often than not in deficit with the NSA. What is important for the analysis to follow, however, is that the UK did run a surplus on current and long term capital account with the RSA in every year and the RSA did run a surplus with the NSA.

In November 1955, the Governor of the Bank of England wrote to Sir Edward Bridges

It is felt, I think, both in the Treasury and the Bank that it is time we had a really thorough "New Look" at our sterling area arrangements to see whether the structure which has proved appropriate to the war period and the post-war transitional period does not now need some radical change³¹.

In response, a Treasury-Bank Working Party on the Sterling Area was set up. Not surprisingly, no 'radical change' in policy emerged but the mechanics of the sterling balances system did come under examination.

³¹Letter from C.F. Cobbold to Sir Edward Bridges, 18 November 1955. BoE OV44/30.

As the Bank of England representative on the Working Party, L.P. Thompson-McCausland embarked on a four part study of how the sterling area sterling balances moved relative to the central reserves and offered a series of policy options for the future management of the system. This was the most complete study of the sterling balances undertaken by the British authorities in the 1950s. In Part I, he prepared a descriptive paper on "The Technical Position of Sterling as it Affects the Sterling Area"³². In this, he distinguished between the trading and banking roles of sterling for sterling area members. The distinction was somewhat unclear but seems to have been made between sterling balances that had been accumulated by selling or "depositing" foreign exchange in London and movements in sterling balances that did not result in equal movements in reserves, which were attributed to sterling's trading role. The distinction was, strictly speaking, a false one since all sterling balance movements were the result of foreign transactions of the RSA and were in this sense the result of 'trading'. The distinction seems to have been made to better point out the logic of Thompson-McCausland's policy recommendations which will be discussed below.

From the point of view of the RSA, Thompson-McCausland noted that sterling had not lost its usefulness for commercial

³²"The Technical Position of Sterling as it Affects the Sterling Area" 24 November 1955, circulated to the Working Party on 13 December 1955. BoE OV44/30.

purposes, especially since the re-opening of London commodity markets. As a central banking reserve, however, sterling appeared increasingly vulnerable. The usefulness of sterling in this capacity depended on the stability of its value (hence the importance of a fixed exchange rate) and its availability, which made any blocking arrangements for sterling balances inappropriate. The threat to sterling as a reserve currency was that mistrust and friction would cause a seepage of resources out of the UK reserves and into independent gold and dollar pots in the RSA.

From the point of view of the UK, the trading role of sterling appeared secure since the UK was in consistent current surplus with the RSA. However, this surplus was offset by substantial long term investment by the UK in the RSA rather than by a decrease in UK liabilities to the RSA. Thompson-McCausland warned that large targets for current account surpluses were not enough if they were swallowed up into ever larger capital flows. This call for limiting investment in the sterling area was to become a theme in the Bank's analysis of the sterling balances problem.

The interests of the UK in sterling's banking role occupied most of Thompson-McCausland's paper. He noted that reserves and liabilities up to the time of writing in 1955 had tended to move co-cyclically which indicated in his terms that the movements were due to 'banking' transactions of the RSA. That is, the accumulation of sterling assets matched

'deposits' of foreign exchange in the central reserves. The freedom of the RSA to exchange their sterling assets for hard currency meant that "the reserves have been used more in their true quality as banking reserves for the sterling area than as emergency funds to cover the UK's own troubles"³³. The reserves loss due to RSA banking movements which resulted in declines in sterling balances did not, therefore, reflect a fundamental problem in the UK economy. What was damaging were changes in the ratio of liabilities to reserves, i.e. increases in sterling liabilities greater than increases in reserves. Thompson-McCausland dubbed this ratio the "position" of the British economy with respect to the rest of the world.

Part II of the Bank's study of the sterling balances, entitled "The Significance of Movements in the Balances" was more technical³⁴. The distinction between 'trading' transactions (i.e. those associated with the current and investment account of the balance of payments) and 'banking' transactions was retained. Since the RSA was always in deficit with the UK and in surplus with the rest of the world, settlement with the UK was made by sales of the foreign exchange earned from the NSA and supplemented by a rundown in sterling balances when the RSA was in overall deficit. When

³³Ibid.

³⁴"The Sterling Balances Part II: The Significance of Movements in the Balances", by L.P. Thompson-McCausland, 19 March 1956. BoE OV44/31.

the RSA was in overall balance, the UK earned the foreign exchange revenue of the RSA as payment for the RSA deficit with the UK and there would be no change in sterling balances. The 'banking' part of the movements came when the RSA was in overall surplus. The deficit with the UK would be paid in foreign exchange and the rest of the surplus with the NSA would be 'deposited' in London in return for sterling assets.

One element of this analysis deserves notice at this point. As Thompson-McCausland pointed out, the UK earned foreign exchange through its normal current and investment account surplus with the RSA. He went on to claim that this meant that the idea of a 'pooling arrangement' or 'central reserves' was not appropriate to the sterling area system. At a meeting of the Sterling Area Working Party on 25 April 1956, he argued that the terms 'pooling' or 'central sterling area reserves' should not appear in the final report of the Working Party³⁵. According to Thompson-McCausland's analysis, however, the UK reserves benefitted from the 'deposits', or pooling, of surplus foreign exchange earnings by the RSA. Furthermore, Thompson-McCausland's analysis assumed that the RSA settled with the UK in foreign exchange first and ran down sterling balances only to cover the residual. This was the case only given the agreement of RSA monetary authorities not

³⁵Minutes of the fourth meeting of the Sterling Area Working Party, 25 April 1956. BoE OV44/31.

to retain substantial separate foreign exchange reserves, that is, only given the concepts of central reserves and foreign exchange pooling.

The distinction that Thompson-McCausland was trying to establish was the assymetry between increases and decreases in sterling area sterling balances. This assymetry in turn depended on the RSA running a surplus with the NSA and a deficit with the UK. An increase in sterling balances occurred when the RSA was in overall surplus and represented a 'banking' transaction. Thus, foreign exchange earnings were exchanged for sterling assets and the reserves and sterling balances moved up together. In this case there was no change in the 'position' of the UK economy (the ratio of reserves to liabilities). Any visible change in the 'position' was due to the UK's own balance of payments with the NSA. Running down of sterling balances occurred when the RSA deficit with the UK was greater than the surplus with the rest of the world. In this case the RSA exchanged its foreign exchange earnings for sterling, thus contributing to the central reserves and also liquidated existing sterling assets to pay their debt to the UK. When sterling balances were run down, therefore, the reserves increased more or decreased less than otherwise because the RSA was contributing. The UK's sterling liabilities were reduced and the 'position' of the UK economy improved as long as the UK deficit with the rest of the world did not exceed the sum of the RSA surplus with the non-

sterling area and the rundown in sterling balances.

The moral of Thompson-McCausland's analysis of sterling balance movements was that the UK should try to reduce sterling balances and improve the UK 'position' by running larger balance of payments surpluses with the RSA. Again, he emphasised that aiming for a current account surplus was not enough since the substantial long term capital flows from the UK to the RSA worked against a reduction in sterling liabilities³⁶. In Part IV of his study, 'General Conclusions', he attributed most of the deterioration in the 'position' of the economy to UK investment in the sterling area. He calculated long term investment amounted to £818m from 1950 to 1955 which offset a surplus on UK current account with the RSA of £618m, leaving the 'position' £200m worse despite an increase of £144m in reserves³⁷.

How far Thompson-McCausland's analysis of the mechanics of the sterling area reflected reality can be determined by examining balance of payments figures for the RSA and the UK. These are presented in Table II.C.

It is evident in Table II.C. that the RSA balance of payments did follow Thompson-McCausland's pattern of a surplus with the NSA and a deficit with the UK throughout the period. Also, changes in sterling balances are equal to the sums of

³⁶Ibid.

³⁷The Sterling Balances Part IV: General Conclusions, L.P. Thompson-McCausland, 27 March, 1956. BoE OV44/31.

Table II.C.
The Sterling Balances and the Balance of Payments
of the Overseas Sterling Area

fm	1950	1951	1952	1953	1954	1955	1956	1957
RSA								
Balance with NSA								
Gold Sales in UK 98		77	71	78	138	176	220	223
Other	368	165	111	219	36	-33	-61	-98
Total	466	242	182	297	174	143	159	125
Balance with UK								
Current a/c	-283	-320	-348	-152	-267	-214	-306	-360
Long Term Cap.	208	165	161	201	201	129	190	295
Misc. Capital			-10	-10	10	-30	10	30
Balancing Item			-79	-80	8	-73	-76	-246
Total	-75	-155	-276	-41	-48	-188	-182	-281
Sterling Balances	391	87	-94	256	126	-45	-23	-156
UK Reserves	575	-344	-175	240	87	-229	42	13

Notes: Source, UK Balance of Payments 1946-1957, HMSO, 1959. The figures for changes in sterling area sterling balances do not correspond with more complete data used elsewhere in this chapter. In 1950 and 1951 the figure for long term capital includes the balancing item and miscellaneous capital.

the RSA balances of payments with the NSA and the UK after allowing for Errors and Omissions in a balancing item. Little can be deduced from the absolute value of the balancing item since it represents the net value of various flows of indeterminate magnitude in both directions. Consistent with Thompson-McCausland's analysis, rundowns in sterling balances cannot be obviously associated with similar movements in reserves. In 1952 the reserves were adversely affected by NSA sterling balance withdrawal amounting to £247m and a deficit of the UK with the NSA of £140m. In 1955, again, the UK deficit with the NSA of £341m and the decline in NSA sterling balances by £51m show that the movement in RSA balances were not a

major cause of reserve drawings in this year.

Table II.C. shows clearly the contrast between the experience of 1950-54 and that after 1955. The system depended mostly on Colonial foreign exchange earnings from 1950-1954, which are reflected in large "other" surpluses with the NSA in Table II.C. From 1955 the system depended mostly on South African gold sales. Until 1955 (except for the slump of 1952) the balance of payments surplus of some RSA countries more than covered the deficits of others. This is reflected in the increase of Colonial sterling balances offsetting the decreases of most of the ISA. For the last three years under review, the Colonies fell into deficit with the NSA and an overall surplus with the NSA was only achieved through sales of South African gold in the UK. These sales provided a surplus above the foreign exchange needed by the RSA but this surplus was not enough to cover deficits with the UK. The result was net declines in sterling balances. Because there was an overall surplus on NSA account, however, the net declines in sterling balances represent sterling drawn to settle with the UK rather than a net drain on reserves.

The central reserve pooling that Thompson-McCausland was so eager to dispense with, therefore, accurately describes the system that operated among the overseas sterling area members and that cushioned the net effect on the central reserves. Thus, sterling area members that ran surpluses with the NSA (the Colonies to 1955 and South Africa and the Middle East

thereafter) provided the foreign exchange to meet the 'withdrawals' of deficit members. There was no threat to the sterling balances system as long as the RSA as a whole maintained a balance or surplus with the NSA since this meant that the RSA was generating enough foreign exchange for their own purposes.

The difference between the system before and after 1955 was that, unlike the Colonies, South Africa had virtually no sterling balances. By selling gold, South Africa was just meeting her balance of payments needs rather than accumulating 'deposits' for use by others and herself in the future. In this sense the future of the sterling balances system was more precariously dependent on UK surpluses with South Africa than when the Colonies had supported it. By 1955 the Colonies were beginning to make net withdrawals and the system needed new depositors. Still, the Colonial sterling balances after 1955 proved less liquid than those of the ISA in the early 1950s since they were tied to conservative Colonial government policy and statutory currency reserves. As a result, the withdrawals were not as dramatic and the impact of this change in the structure of the sterling balances system in 1955 did not make itself felt until the 1960s. This analysis of what was happening within the RSA and the changing character of the sterling balances system was not captured in Thompson-McCausland's study. He did, however, warn that the pattern would change after 1955 with the end of the certainty of

Colonial surpluses to support the system³⁸.

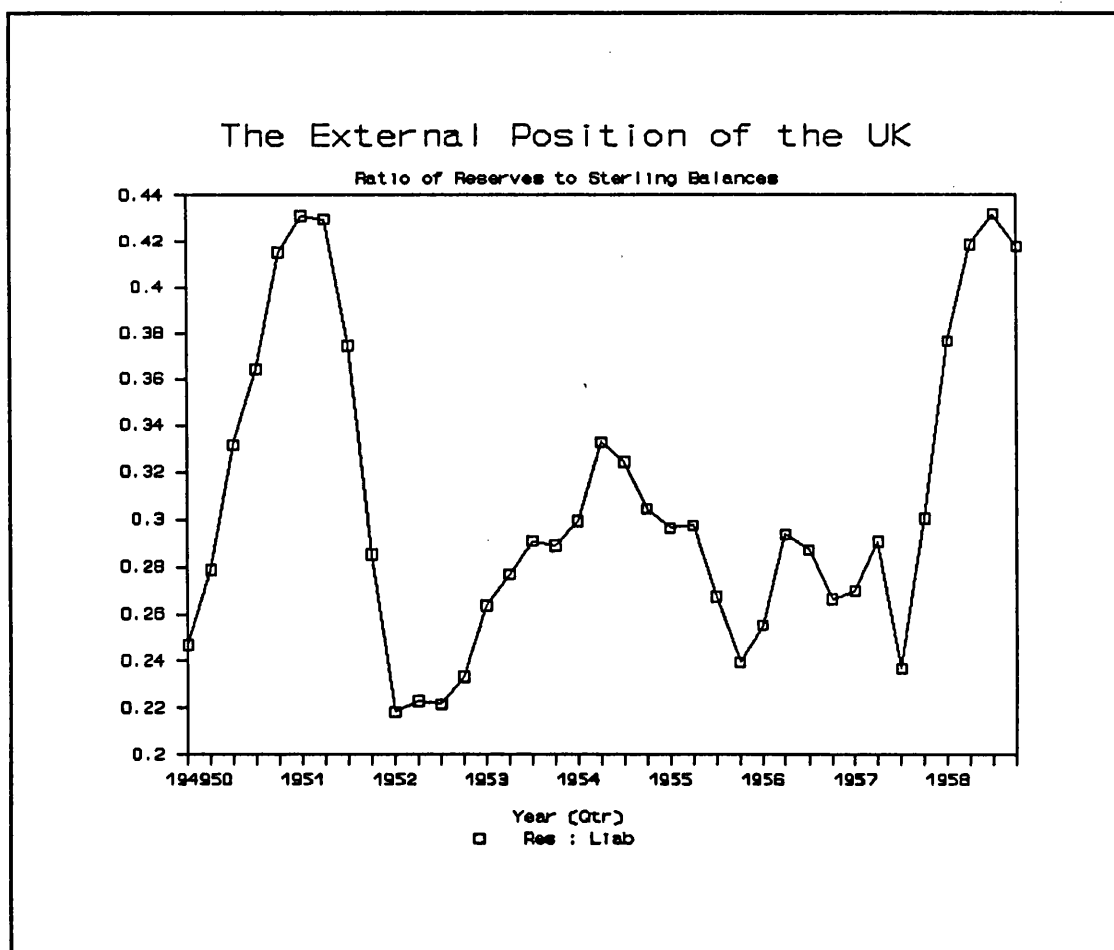


Figure II.F.

Figure II.F. shows movements in the 'position' of the UK economy. There was initially an improvement in the external position as a result of the Korean War boom due to increases in the reserves outstripping increases in sterling balances. This reflected the still fairly healthy balance of the UK with the non-sterling area through 1950. During the course of

³⁸The Sterling Balances Part IV: General Conclusions, 27 March 1956. BoE OV44/31. His policy proposals in the wake of these warnings will be discussed later.

1951, however, the UK balance with the non-sterling area fell into severe deficit and the external 'position' deteriorated sharply despite reductions in sterling balances. The position improved fairly steadily for the next two years during which time the sterling balances increased relatively slowly and the reserves improved. In 1955 there was the second reserves crisis of the 1950s which was reflected in a deterioration of the external position although it recovered by the first quarter of 1956. The only dramatic negative change for the rest of the period was in the third quarter of 1957 in response to the speculative crisis of that year. During 1958 the level of reserves increased due to the UK's healthy balance of payments and sterling balances declined which was reflected in a vast improvement in the external position. Due to the general stability of the level of sterling balances after 1952, changes in the external position of the UK tended to reflect changes in the UK balance with the non-sterling area and speculative runs on the reserves.

Table II.D.
Sterling as a Percentage of ISA Reserves

%	1950	1951	1952	1953	1954	1955	1956	1957	1958
Australia	82	66	65	70	64	49	58	65	55
South Africa	24	22	23	8	19	7	8	-	-
New Zealand	64	61	62	73	69	61	72	63	66
Ceylon	89	73	78	67	73	67	56	53	47
India	73	69	69	67	67	68	56	44	33
Pakistan	78	79	52	57	59	62	53	50	44
Iraq	95	80	81	86	91	84	80	71	66

Notes: Source: IMF, International Financial Statistics for gold and dollar reserves; Monthly Report on External Finance, BoE EID3/97-104 for sterling reserves.

Table II.D. shows another changing aspect of the sterling area reserves system and confirms Thompson-McCausland's assessment of the erosion of sterling as a reserve currency. Thus, the proportion of sterling in the reserves of the largest independent sterling area countries was generally declining through the 1950s. Table II.E. helps show that identified increases in gold and dollar reserves were not the main contributor to the declining proportion of sterling in ISA reserves. Between 1950 and 1958 the ISA accumulated £54m worth of independent dollar reserves and £115m of gold which amounted to only 10% of their cumulative surplus with the NSA and therefore of their contribution to the central

Table II.E.
Gold and Dollar Reserves of Sterling Area Countries

\$USm	1950	1951	1952	1953	1954	1955	1956	1957	1958
Australia									
\$	19	39	47	59	48	75	84	85	79
Gold	88	112	112	117	138	144	107	126	162
New Zealand									
\$	3	5	3	2	2	2	2	2	2
Gold	29	32	33	33	33	33	33	33	33
South Africa									
\$	44	7	24	38	33	53	53	38	30
Gold	197	190	170	176	199	212	114	217	211
India									
\$	56	62	65	99	87	73	76	82	77
Gold	247	247	247	247	247	247	247	247	247
Pakistan									
\$	11	13	14	10	4	6	20	13	6
Gold	-	27	27	38	38	48	49	49	49
Ceylon									
\$	8	19	14	17	19	33	41	34	34
Gold	-	-	-	-	-	-	-	-	-
Iraq									
\$	3	13	14	14	10	15	17	20	18
Gold	-	-	-	-	-	8	14	20	34

Notes: Source, International Financial Statistics, IMF, 1960.

reserves. A more significant shift was the decline of sterling balances while gold and dollar balances remained constant or increased slightly. This was the case, for example, with India whose gold reserves of £247m were a statutory part of her currency reserves. The level of Indian sterling reserves was fairly constant at just under £700m until the second quarter of 1956 when increased spending on the second five year plan began. By the end of 1958, Indian sterling reserves were drawn down to £156m due to unexpected costs in the Plan and this accounts for the quick decline of sterling as a proportion of reserves in Table II.D. South Africa, which held no sterling reserves after 1956, was a unique member of the sterling area in that she was never expected to hold substantial sterling reserves since she was a gold producer.

The case of Australia is the most striking instance of the general trend toward diversified reserves. In June 1953 J. Flett at the Treasury reported a conversation with Leslie Bury, the Australian alternate representative to the IBRD and IMF. In this talk

Mr. Bury, 'off the record' said quite frankly that at the time they had started to build up this [dollar] account in New York they were influenced by a desire to show the Americans that while the sterling area as a whole seemed to be on the verge of bankruptcy, Australia at least had some dollars to her own name. This he thought had influenced the IMF in agreeing to a further Australian drawing and might improve their chance of refinancing their New York loans. Mr. Bury added that it was too much for us to expect that every sterling area country would rigourously observe the rules of the

club in their entirety³⁹.

Between July 1955 and December 1957 Australia sold £8.9m of gold against dollars and less than £0.1m against sterling. This was reflected in an increase in Australian dollar reserves of \$10m in these three years. At the same time, however, Australia's sterling reserves increased by £120m.

The British attitude to independent gold and dollar reserves was settled at the fourth meeting of the Sterling Area Working Party in 1956⁴⁰. No strict formula for a correct maximum level of these reserves was considered appropriate since they had been accumulated in a variety of circumstances and were used for various purposes. It was agreed that the British side should not take the initiative in discussing these independent reserves as this might cast doubt on the strength of sterling. Finally, the Working Party concluded that, while the RSA should be encouraged to use the reserves to meet current deficits, the best way to limit the growth of these reserves was to follow policies which strengthened general confidence in sterling and therefore its usefulness as a reserve currency.

After spending months tracing the movements of the sterling balances, L.P. Thompson McCausland offered several policy recommendations based on his conviction that the best

³⁹Note by J. Flett, 3 June 1953. BoE OV13/60.

⁴⁰Minutes of the fourth meeting of the Sterling Area Working Party, 25 April 1956. BoE OV44/32.

way to improve the liquidity position of the UK economy was to reduce liabilities rather than aim at increasing the reserves⁴¹. The first suggestion was that lending to the RSA and the Colonies should be reduced to allow Britain's current surpluses to reduce liabilities. The second recommendation was to arrange a deal with the IMF to allow drawings on the British quota when sterling balances were run down. This would offset the direct effect of drawings of NSA sterling balances on the reserves and the indirect effect of RSA sterling balances on the reserves through confidence in sterling⁴². Finally, the Middle East should be encouraged to continue to denominate their transactions in sterling since these members promised to replace the Colonies as accumulators of sterling balances. He also argued in his concluding paper that his analysis had emphasized the need to maintain a fixed exchange rate and that the focus of policy should be the 'position' of the British economy as he defined it, not just the current account of the balance of payments.

The proposal to negotiate a special facility to draw on the IMF to offset declines in sterling balance was considered by the Working Party but rejected because of the complications it would cause for UK drawings for other purposes.

The proposal to limit capital flows to the RSA was

⁴¹The Sterling Balances Part IV: General Conclusions, 27 March. BoE OV44/31.

⁴²Ibid.

included in the final Sterling Area Working Party Report⁴³. The Working Party accepted the need to limit capital flows to the RSA both to allow for decreases in sterling balances and also because this investment claimed resources that might otherwise be used to generate exports directly⁴⁴. The Report argued, however, that overseas investment linked the sterling area and the Commonwealth together, that the UK had made a political commitment at the Commonwealth Economic Conferences of 1952 and 1954 to continue such investment and finally that the Colonies as dependents of the UK had a right to development. British government capital was a small proportion of the total and direct controls on private investment in the RSA would disrupt sterling area relations. The over-riding difficulty seems to have been summed up in the statement that "the political difficulties would be most serious if it appeared that as a result of our policies a substantial check was being imposed on sound economic development in the Commonwealth"⁴⁵. Instead, the Report recommended using general fiscal and monetary policy to reduce the flow of investment abroad.

L.P. Thompson-McCausland's lengthy analysis alerted the British authorities to fact that the functioning of the

⁴³"Problems of the Sterling Area", Report of the Sterling Area Working Party, 25 June 1956. BoE OV44/32.

⁴⁴Ibid.

⁴⁵Ibid. The British policy on overseas investment in the sterling area is discussed in Chapter IV.

sterling balances system was changing in the 1950's and this was associated with the end of sterling's role as an international currency. However, although the Sterling Area Working Party Report presented an updated and more detailed description of how the sterling area worked, its most important function seems to have been to establish that no significant change in British policy was necessary or appropriate.

II.C. The Sterling Balances and Development

The link between development and the sterling balances was historically a logical one. At the end of the Second World War India and Pakistan, who were the largest holders of sterling assets, considered them to be development reserves⁴⁶. By the time the Colonies became the major overseas holders of sterling securities, the British government was committed to a continuing flow of long term capital to the Colonies in the form of grants and London market issues. The Bank of England and the Treasury perceived this situation of lending long to the Colonies and borrowing short to be unsustainable in the long run. The link between sterling balances and development in this later stage, then, derived from a perception that Britain was in a precarious banking position.

The first attempt to link sterling balances and

⁴⁶Report of a statement by the Indian Prime Minister in Telegram from UK High Commissioner in India to Commonwealth Relations Office, 22 March, 1951. PRO T236/2753.

development began in 1949 in the context of the continuing Tripartite Discussions in Washington⁴⁷ and the development planning of India, Pakistan and Ceylon. The British expected to be asked in Washington about their progress in funding or blocking the sterling balances as required by Article X of the 1946 American Loan Agreement. At the first meeting of the Treasury-Bank of England Working Party on Sterling Balances in October 1949, Herbert Brittain suggested persuading the Americans to provide dollar aid to members of the sterling area against cancellation of perhaps twice the corresponding amount of sterling balances⁴⁸. This proposal was fleshed out during subsequent meetings. India, Pakistan and Ceylon, as the largest sterling holders, were singled out as the targets of the proposal and it was hoped that other sterling area countries would agree to this special treatment of these countries on the grounds of their more urgent need for development⁴⁹. The Bank of England, through their representative L.P. Thompson-McCausland, argued that a solution to the sterling balances problem should not be dependent on American contributions to South East Asian

⁴⁷These discussions arose out of paragraph 13 of the Communiqué of the Tripartite Economic Discussions between the UK, USA and Canada in September, 1949.

⁴⁸Working Party on Sterling Balances Minutes 4 October, 1949. PRO T236/2639.

⁴⁹Minutes of the third meeting of the Working Party, 25 October, 1949. PRO T236/2639. It was hoped that the Americans would accept this logic as well considering the strategic importance of these countries to the West.

development plans since this implied at least an eighteen month delay to get through Congress if the commitment were ever extracted from the Americans. He suggested that the major sterling balance holders should be approached immediately to arrange a strict funding and release schedule on the assumption that American aid would be forthcoming and if it were not then the funding arrangement could be rescheduled⁵⁰.

Finally, in March 1950 the Working Party on the Sterling Area⁵¹ and the Working Party on South East Asian Development submitted a joint report to the Cabinet⁵². This detailed the proposal which was later to be submitted to the Americans in an ammended form. Along the lines of the Bank's proposal, the sterling balances were to be dealt with in two stages. Stage I called for negotiations with the ISA on a funding arrangement which would assume that some American aid would follow. It was recognized that India, especially, was unlikely to engage in any funding negotiations without at least the near promise of getting some direct benefit in return. Stage II of the plan was to begin talks immediately with the Americans to arrange dollar aid for South East Asian sterling balance holders. These countries would in turn send

⁵⁰Minutes of the Working Party 10 March, 1950. PRO T236/2639.

⁵¹The name of the Working Party on the Sterling Balances was changed on Feb. 8, 1950. PRO T236/2698.

⁵²"Sterling Balances and South East Asia" 14 March 1950. PRO T236/2639.

the sterling equivalent to Washington to be transferred to the British Treasury who would put this sterling against the National Debt. In this way, the writers of the joint report hoped to achieve a cancellation of perhaps £60m p.a. of sterling liabilities over several years⁵³. On the 6 of April the British Ambassador in Washington was instructed to start a tentative approach to the Americans along these lines. Two days later the ISA governments were informed that the British would be discussing sterling balances in the context of development but no details of the plan were revealed. Finally, on April 17 the details of the British proposal were given to Dean Acheson, the American Secretary of State but the Americans delayed over replying to the proposal through the rest of April. On April 23 the Americans leaked the proposals to the press which provoked angry responses from India, Pakistan and Ceylon who resented not being consulted on negotiations for cancellation of their assets⁵⁴. Finally, on 5 May 1950 Acheson spoke to T.L. Rowan of the Treasury in Washington and rejected the British attempt to link sterling balances with South East Asian development⁵⁵.

⁵³ibid.

⁵⁴Financial Times, 24 April, 1950. This was no doubt a deliberate attempt by the Americans to bury the proposals. PRO T236/2691. Telegrams from India and Pakistan, Note: "The Views of the Government of India on the Tripartite Talks, 27 April, 1950. PRO T236/2691.

⁵⁵Telegram T.L Rowan to the Foreign Office, 6 May, 1950. PRO T236/2691.

Stage II of the plan was thus abandoned and Stage I would soon follow it. First, the Indians made it obvious that they were unlikely to agree to any funding scheme that was not linked to development aid. This was probably the greatest obstacle to any funding arrangement at this time. All the other obstacles had existed when the plan had been devised and had not been considered insurmountable. One consideration was that funding was not suitable for many kinds of sterling balances such as commercial bank reserves and currency reserves which had to be kept in fairly liquid form. Also, under Article VI of the 1946 American Loan Agreement, Britain could not request a waiver of interest payments in any year unless she reduced releases of sterling balances. If sterling releases were set in advance, this limited the flexibility of the British to request a waiver in the future.

This first attempt to link sterling balances to development, then, ended in failure. Instead, the Colombo Plan was finalised in the Autumn of 1950. India, Pakistan and Ceylon agreed to six year development plans, part of which were financed by agreed drawings on their sterling balances. Thus India was to draw £35m p.a. amounting to 15% of their planned expenditure, Pakistan £4m p.a. and Ceylon £3m p.a. Although a step forward for South East Asian development, this was not successful as a sterling balance solution since it covered only a quarter of India's sterling balances. Releases of £42m p.a. under the Colombo Plan seem a rather poor

alternative to the hoped for cancellation of £60m p.a. under the scheme involving the Americans.

The next major attempt to link the sterling balances problem with development was suggested in the context of the huge accumulation of sterling assets by the Colonies during the boom of 1950-1. In December 1951, Mr. Whitehead, Finance Minister in Southern Rhodesia, suggested that the raw material needs of the sterling area as a whole should be identified and an organisation set up to coordinate the development of these raw materials funded in part by an effort "to mobilize a large part of the sterling balances in London which are at present idle, including a portion of the commercial balances and also public funds such as part of the reserves of the various Colonial currency boards or central banks of Commonwealth Countries."⁵⁶. This idea of pooling sterling balances for development was taken up by C.F. Cobbold, Governor of the Bank of England, who moulded it into a plan for a Commonwealth Development Fund to spice up the upcoming Commonwealth Finance Ministers' Conference⁵⁷. The UK would contribute from the funds already set aside for development (e.g. the Commonwealth Development Corporation) while the RSA would contribute their 'excess' sterling balances. Canada and the USA would be asked to provide dollars for necessary dollar imports. The

⁵⁶Telegram from UK High Commissioner in Southern Rhodesia to Commonwealth Relations Office 20 December, 1951 BoE OV44/50.

⁵⁷Paper by Governor Cobbold 25 December, 1951. BoE OV44/50.

prospects for additional development capital, therefore, again depended on American aid. Cobbold wrote that this would immobilise a large part of the sterling balances and at the same time meet RSA wishes for development⁵⁸. This seems to assume that the Fund would be spent at a slower rate than each member would otherwise have run down their sterling balances⁵⁹.

The Governor's plan came up against stiff opposition within the Bank of England. L.P. Thompson-McCausland pointed out that RSA countries would want to spend their sterling balances on their own development rather than that of other members and the decision on where the funds should go would introduce a divisive element into sterling area relations⁶⁰. J. Fisher made explicit the Fund's underlying purpose of blocking agreed amounts of sterling against dollar aid and pointed out the difficulties of getting the USA and Canada to agree to contribute⁶¹. Fisher did not, however, extend this to point out that the plan was the same in this essential feature as the failed attempt two years earlier to get the UK to provide dollars against cancellations of sterling balances

⁵⁸ibid.

⁵⁹It is R.N. Kershaw who finally points out that the sterling balances would be spent rather than blocked if the plan were a success. Note by R.N. Kershaw, Jan. 2, 1952. BoE OV44/50.

⁶⁰L.P. Thompson-McCausland note "Governor's Draft", 2 January, 1952. BoE OV44/50.

⁶¹J. Fisher note 2 January, 1952. BoE OV44/50.

by India and Pakistan. Fisher cut through the altruistic tone of the Governor's proposal to expose that "the UK interest is to stimulate primary production from dollar loans and then tap the resulting increase in dollar exports (by the Colonies) by selling capital goods for industrial and welfare development to the Empire for sterling"⁶². The focus of development from the British point of view was thus on raw materials while the RSA were more interested in welfare and industrial development. This was yet another area of potential conflict.

Cobbold absorbed this advice and the plan was revised. The Fund was changed to a Commonwealth Board of industrial and financial experts who would decide what products were needed in the sterling area and where to develop them as well as advising on financial and commercial aspects of proposals⁶³. The Governor's plan thus came to visualize a much more intimate and formal association of interests among sterling area members which implied a complete adjustment in the character of the system. The sterling balances aspect was included in a later draft which added that the member governments would also set aside or 'segregate' part of their sterling balances for ten year development plans in their own areas⁶⁴. The plan was finally sent to the Treasury in

⁶²ibid.

⁶³Note by Governor for Commonwealth Working Party 25 January, 1952. BoE OV44/50.

⁶⁴Governor's note for Treasury, draft. 27 January, 1952. BoE OV44/50.

February 1952 where it seems to have received a cool reception since it did not surface in discussions with the Commonwealth representatives⁶⁵. Even in its revised form the Governor's plan did not avoid the difficulties which had been raised earlier in the Bank. The new plan rested on the rather naive belief that the RSA would not recognize this attempt to block their sterling balances and that sterling area members would agree to the political and economic compromises required by centralized direction of development for the area as a whole. This put too much faith in the common interest of the RSA members among themselves as well as with the UK. Given these obstacles, it is extremely unlikely that the IBRD or the USA would have become involved to the extent of supplying additional funds so any net benefit to RSA development would have been unlikely.

The idea of somehow pooling sterling assets to direct them at development, however, did not die at this stage. Four years later Parliament debated a proposal to establish a Commonwealth Development Agency or Bank⁶⁶ which was based on the principle that by pooling 'excess' sterling reserves available for development, the RSA would have a better chance of attracting credit abroad. The debate prompted the Secretary of State for the Colonies to circulate such a

⁶⁵The Governor did discuss the plan informally with the New Zealand representative, Mr. Holland, who supported it as a possible way for New Zealand to join IBRD and IMF. BoE OV44/50.

⁶⁶Report on the debate on 30 November, 1956. BoE OV44/56.

proposal to the various Commonwealth High Commissioners. Not too surprisingly, the responses were that such a pooling of reserves into a centrally administered organisation was neither desirable nor practicable⁶⁷.

The idea lived on in the Treasury until April 1958 when it was revived by T.L. Rowan as a possible fillip to the upcoming Montreal Commonwealth Conference⁶⁸. By the time the Treasury had taken up the idea of pooling balances to get control of them, however, the Bank of England had dropped it. In a 'personal' letter to the Chancellor of the Exchequer Heathcoat Amory, Governor Cobbold tried to temper Rowan's enthusiasm by alerting his superior that "I see that suggestions for a Commonwealth Development Bank are coming to the fore again...I ought just to emphasize that, while the suggestion has obvious presentational attractions, it bristles with practical difficulties"⁶⁹.

It is not easy with hindsight to distinguish even the 'presentational attractions'. It is curious that this type of plan, which had few foreseeable benefits for the RSA and several drawbacks, such as the loss of control of their foreign assets and a certain source of dispute between members, was repeatedly brought out as an exciting long term

⁶⁷Telegrams BoE OV44/56.

⁶⁸Report of a conversation between T.L. Rowan and Governor Cobbold 23 April, 1958. BoE OV44/56.

⁶⁹Letter from Cobbold to Amory 29 April 1958. BoE OV44/56.

concept to revive the flagging Commonwealth economic conferences. It is perhaps a deeper comment on the quality of sterling area relations that Britain could offer no other new incentive to hold the attentions of the RSA. Indeed, by the mid-1950s it seemed the sterling area members had little to discuss beyond repeated calls from Britain for short term restrictions in times of crisis and calls from the RSA for development capital.

The final set of policy initiatives to be discussed was the possibility of changing aspects of Colonial monetary systems to remove sterling balances from the UK liabilities account and to release them for Colonial development.

When the Colonies were accumulating millions of pounds worth of sterling assets every year at the beginning of the 1950s, there emerged a general public feeling that the sterling balances system (and the Colonial currency reserves system, especially) exploited the underdeveloped Colonies. This view was expounded most vociferously by Arthur Hazlewood and opposed by Ida Greaves⁷⁰. Hazlewood's general objection was that the Colonial system, and the accumulation of Colonial sterling balances in particular, represented forced Colonial lending by the Colonies to the UK at the expense of their own development. Ida Greaves' contention reflected the official opinion that the Colonial sterling balances were accumulated

⁷⁰See e.g. the debate in The Economic Journal, Dec. 1952, Dec. 1953 and Sept. 1954.

for specific long term commitments rather than being 'idle' balances. They guaranteed the value of local currency in relation to sterling and enhanced the creditworthiness of the Colonies. The sterling balances were thus important to the longer term stability and growth of the Colonies.

The possibility of mobilizing the Colonial sterling balances for development arose in response to the apparently precarious banking position of the UK lending long to the Colonies and borrowing short term. A second factor was the growing resistance of the London capital market to new Colonial stock issues. In November 1951, the Cabinet suggested that some consideration should be given to the use of sterling balances for local investment to reduce calls on the London market⁷¹. The Colonial Office immediately composed a note to the Treasury protesting that very little of the Colonial balances were 'disposable' or available for other investment and that the Colonies would still need every penny that the London market could provide given their urgent need for capital, even if more existing assets were invested locally⁷². The note concluded with two limited suggestions for investigation. The first was the investment of Colonial sterling balances in each other's Colonial issues and the

⁷¹Cabinet Minutes 20 November, 1951. PRO T236/3351.

⁷²Note from Poynton in the Colonial Office to Johnston at HMT 21, November, 1951. PRO T236/3351.

second was a decrease in the statutory currency reserve⁷³.

Three weeks later the Colonial Office suggested a Working Party should be set up of Treasury, Bank of England, Crown Agents and Colonial Office representatives to look at Colonial sterling balances and the related issue of the absorptive capacity of the London market for Colonial loans⁷⁴. The second part of the Working Party agenda was dropped by the Treasury to avoid having to deal with Colonial Office pressure to ensure a priority on the London market for Colonial issues⁷⁵. In the end the Working Party was postponed (perhaps due to preoccupation with the 1951-52 reserves crisis) and was not revived until a year later.

In March 1953 the Bank of England took the initiative and suggested that it was time for a further look at the possibility of greater local investment of Colonial sterling balances⁷⁶. The Working Party on Colonial Sterling Assets was set up in May and reported in September. After two years of being on the agenda, the conclusions of the Working Party on the question of local investment of sterling balances are somewhat disappointing. The Working Party produced two reports dealing with 'The Economic Significance of the Assets'

⁷³ibid.

⁷⁴Note Poynton to Johnston, 10 December, 1951. PRO T236/3351.

⁷⁵Treasury Note 28 November, 1951. PRO T236/3351.

⁷⁶Note Cobbold to E. Bridges, 6 March, 1953. PRO T236/3351.

and 'The Financial Aspects of the Assets'⁷⁷. Despite its promising title, the Economic Significance report contained few new insights. Its major conclusion was that the current charge that the UK was exploiting the Colonies by forcing them to accumulate assets⁷⁸ was unfounded since the sterling balances were not blocked and the Colonial governments themselves were responsible for amassing reserves for future development. Nevertheless, the report went on to suggest that the Colonies should perhaps start spending their reserves since these charges were politically damaging to the UK. Other arguments for an orderly run down of sterling balances were that large sterling balances weakened confidence in sterling and that development spending should start while the Colonies were still under British guidance to lessen the impact of future 'irresponsible spending' by new governments. Finally, the report argued that Colonial development spending would enhance the Colonies as a market for British goods. The report concluded that no major change in British policy was necessary because sterling balances were unlikely to continue to increase in 1953 and 1954 since raw material prices were falling and development spending was expected to increase. In this, the Working Party underestimated the conservative nature

⁷⁷Working Party on Colonial Assets "Report on the Economic Significance of the Assets" 11 Sept., 1953 and "Report on the Financial Aspects of the Assets" 4 Sept., 1953. PRO T236/3562.

⁷⁸See e.g. A. Hazlewood, "Sterling Balances and the Colonial Currency System" Economic Journal Vol LXII No. 248, Dec. 1952. pp. 942-45.

of marketing board and Colonial government policy. In fact, as noted above, Colonial sterling balances continued to grow, by 7% in 1953 and 11% in 1954.

The Report on the Financial Aspects of the Assets⁷⁹ is not much more satisfactory. The major implication of the report is that little could be done to ease the pressure on the London Market or to increase the amount of development capital available for the Colonies. The report reiterated the conclusion that the Colonies should be encouraged to invest part of their sterling balances in their own development and then went on to offer suggestions for which funds should be targetted. The Report first recommended no change in the Colonial policy of keeping four to six months' revenue in reserve every year although by the end of 1952, the basis for the data used for the report, government reserves had reached 39% of Colonial sterling balances. The investment policy of the marketing boards was also deemed sound. At the end of 1952 89% of these funds were invested in British government securities - none was invested in Colonial issues⁸⁰. In any case marketing board assets amounted to only 10% of Colonial sterling balances.

The final two recommendations of the report advocated more positive (if limited) action. The first was that the

⁷⁹Working Party on Colonial Assets "Report on the Financial Aspects of the Assets", 4 Sept. 1953. PRO T236/3562.

⁸⁰"West and East African Currency Boards: Make-up of Assets", 7 April 1954. BoE OV67/2.

Colonies should be encouraged to make use of the existing statutory right to invest up to one third of post office savings bank funds in new local public issues. In 1951 (the latest figures available to the Working Party) only 6% of post office savings bank funds were invested in local issues⁸¹. This suggestion, while on the one hand only asserting the status quo, also pertained to only 5% of Colonial sterling balances. Even if all Colonies had invested their savings bank funds locally, this would only have released £22m.

The final recommendation of the report, however, was more promising. In accordance with the original Colonial Office suggestion in 1951, it was decided that the Colonies should consider reducing the sterling backing of local currencies. The working party suggested a maximum 20% fiduciary element (the actual proportions were to be determined by the Colonial authorities themselves) which would release these sterling funds for local investment. This promised to release up to £70m of British liabilities for local investment or about 6% of Colonial balances in 1953.

Altogether, the recommendations of the report amounted to relatively little in terms of easing the pressure of accumulating Colonial assets. Nor, as stated above, did they promise any net easing on the London market or a significant increase in funds available for development purposes.

⁸¹Colonial Office Note "Investment of Post Office Savings Bank Funds" 20 June, 1953. BoE OV44/83.

Liquidating sterling assets, whether currency reserves or savings bank funds, required selling British securities on the market and taking capital out. This pressure of sales on the market would have partly offset any reduction in the frequency of issues of new Colonial stocks. Indeed, it was recognized that there was no guarantee that the Colonial demands on the market would have been smaller or less frequent⁸². Also, a reduction in currency funds managed by the Crown Agents would have reduced their purchasing power for new Colonial issues for which they were the major buyer. The net impact of these initiatives on the volume of development funds available to the Colonies was, therefore, ambiguous.

The attempts to link sterling balances to development must be regarded as failures. They did not go far in increasing development resources or in reducing sterling balances. This failure was sealed by the general refusal of the Colonial governments to entertain the suggestion of a fiduciary element in the currency reserves. In September 1954, the Governors of the Colonies were finally canvassed about their willingness to reduce their currency reserves but the response was unenthusiastic⁸³. This may have been for several reasons. In 1951, the Colonial authorities were advised by the Crown Agents that any reduction in the sterling backing of their local currency would have negative effects on

⁸²Financial Aspects Report PRO T236/3562.

⁸³Despatch to Governors 10 September, 1954. PRO T236/3562.

their international credit rating⁸⁴. As the London market tightened up, the Colonies were increasingly looking elsewhere to satisfy their capital needs and their international credit standing was an important determinant of their access both to the London market and to other foreign investors.

A second possible motive for the Colonies' reluctance to spend their sterling balances while repeatedly complaining of being starved for capital is a more strategic one. It certainly did not make sense to give the UK an excuse to start limiting capital flows to the Colonies (whether official or otherwise) by releasing sterling assets for local investment. Many Colonies who were rich in sterling were approaching independence in 1953 (e.g. Gold Coast, Malaya) so their special claim on the British government and on the London market would be over soon enough. This, of course rests on the assumption that those making the decision to hang on to all of their Colony's sterling assets while maximizing their access to the London market either believed that they would still be in a position to spend the balances after independence or were amassing them in trust for the future independent regimes. The motives of the Colonial governments are confused by this ambiguity. What is not ambiguous is that the Colonial authorities wanted to maintain the Colonial currency system. There was no precipitous rundown of sterling

⁸⁴Conference of the Technique of Development Finance, Tenth Meeting, 14 June 1951. PRO CAOG9/149.

balances when Malaya and Ghana achieved independence in 1957 which suggests that their large sterling reserves were not as liquid as the British authorities feared. This reinforces Ida Greaves' assessment that the sterling balances were tied to long term commitments (such as sinking funds) and that the Colonial currency reserve system was considered important as evidence of economic stability to attract foreign investment.

This ends the discussion of the attempt to solve the sterling balances problem by linking it to sterling area development. The enthusiasm with which the British authorities clung to this type of package solution to two main problems in the sterling area system was thwarted by a lack of necessary cooperation from the United States or from the RSA. In the end the British had nothing to offer the RSA as an inducement to decrease their claims on the UK once it became clear that the Americans would not offer direct dollar support to the sterling area system. The efforts to change the Colonial sterling balances system to release some of the balances for expenditure on development was inhibited by the limited amounts that could be released and by Colonial resistance to erosion of their currency reserves.

II.D. Conclusions

The sterling balances in the 1950's have been shown not to have been the dangerous and volatile factor in the British external economy that many contemporary observers believed. Changes in sterling balances did not have a detrimental effect

on the reserves as long as the RSA had a surplus with the NSA and the UK had a surplus with the RSA. Indeed, the increases in sterling balances until 1956 strengthened the reserves.

The danger of the system lay in the possibility that the ISA would choose to diversify their own reserves by exchanging their sterling balances for dollars or gold. During the 1950s there was evidence of the beginning of such a trend but the method of diversifying reserves was to retain part of each year's dollar earnings and running down sterling balances to settle with the UK. This type of settlement did not draw on the reserves and did strengthen the 'position' of the British economy.

The year 1955 marked a change in the character of the sterling balances system. In this year the diversification of Australian reserves accelerated, the Colonies' accumulation of sterling balances finally reached its peak and the RSA surplus with the NSA (a main determinant of the stability of the system) came to rely on Middle Eastern surpluses and South African gold sales. Given the nature of the Colonial balances and the conservative policies of the Colonial governments and of the independent regimes which succeeded them in the later 1950s, this weakness in the sterling balances system did not manifest itself until nearly a decade later.

Appendix to Chapter II

STERLING BALANCES

Monthly Report on External Finance BoE EID/98-106

Pak not incl funds with Fed Res Bk of India

WAfr not incl I of Waf Mktg Bds until III 1950

EAfr incl Aden fr II 1952

Rhd&Nya is NRhd & Nyas until II 1954

Malaya is Mal&Sing from IV 1957

Ln

	Austr	NZ	SAfr	India	Pak	Ceylon
IV 1949	381	50	57	822	100	53
I 1950	435	57	78	830	98	49
II	472	69	79	803	100	51
III	451	59	68	794	87	55
IV	499	57	78	804	97	68
I 1951	592	83	88	823	146	75
II	626	104	73	796	159	72
III	531	93	42	771	159	74
IV	403	66	59	730	150	76
I 1952	290	57	61	679	142	72
II	235	55	61	663	101	63
III	220	54	52	682	59	58
IV	293	59	57	694	57	52
I 1953	337	84	39	693	66	47
II	378	103	22	681	65	41
III	365	95	9	675	64	40
IV	404	95	19	697	65	35
I 1954	413	118	15	708	67	40
II	384	127	30	696	59	48
III	333	101	33	687	52	49
IV	332	78	54	691	60	52
I 1955	296	85	39	685	66	60
II	264	97	22	677	66	62
III	217	77	15	679	62	64
IV	214	54	21	687	73	67
I 1956	174	71	14	680	92	67
II	191	112	14	528	90	57
III	206	102	18	475	80	54
IV	259	88	24	412	77	52
I 1957	323	99	12	412	79	48
II	378	123	3	360	69	36
III	375	99	-5	290	59	37
IV	387	60	-4	254	62	39
I 1958	359	59	-19	221	58	38
II	329	69	-9	183	52	29
III	293	72	-7	155	40	32
IV	295	79	5	156	43	30

	Iraq	Jordan	PGulf	Libya	Burma	Eire	
I 1949	49	0	0	0	46	210	
I 1950	49	5	0	0	44	202	
II	50	5	0	0	51	200	
III	50	15	0	0	55	205	
IV	52	15	0	0	51	211	
I 1951	53	15	0	0	56	202	
II	52	15	0	0	63	184	
III	47	15	0	0	66	178	
IV	51	14	3	1	62	179	
I 1952	51	13	15	1	64	177	
II	48	13	18	6	67	176	
III	55	14	16	6	68	186	
IV	60	14	15	6	71	196	
I 1953	65	13	16	5	79	197	
II	74	14	52	6	89	194	
III	75	15	45	6	82	202	
IV	83	15	38	7	73	209	
I 1954	87	15	37	9	69	207	
II	91	16	52	10	59	198	
III	94	17	58	10	48	206	
IV	103	19	70	11	40	209	
I 1955	103	20	64	10	36	202	
II	113	21	93	10	28	185	
III	117	22	106	11	23	179	
IV	116	22	136	11	26	173	
I 1956	120	24	143	13	37	174	
II	124	24	157	13	39	156	
III	129	25	164	14	43	163	
IV	127	27	169	15	46	171	
I 1957	124	26	157	16	39	174	
II	108	29	185	16	37	172	
III	103	30	189	15	36	180	
IV	96	29	203	15	31	174	
I 1958	91	31	206	16	28	179	
II	90	31	245	15	37	179	
III	90	33	256	17	41	187	
IV	101	33	260	18	40	193	

†

	Rhd&Nya	Iceland	Total Indep	WAfr	Ghana
I 1949		1	1769	156	
I 1950		1	1848	168	
II		1	1881	169	
III		1	1840	252	
IV		1	1933	253	
I 1951		1	2134	283	
II		0	2144	309	
III		0	1976	333	
IV	43	1	1838	329	
I 1952	50	0	1672	339	
II	46	0	1552	350	
III	52	0	1522	357	
IV	50	1	1625	351	
I 1953	50	0	1691	384	
II	49	0	1768	399	
III	72	0	1745	407	
IV	68	0	1808	400	
I 1954	68	0	1853	431	
II	116	0	1886	462	
III	121	1	1810	475	
IV	125	1	1845	488	
I 1955	117	1	1794	500	
II	121	1	1760	510	
III	115	0	1687	513	
IV	114	0	1714	507	
I 1956	105	0	1714	502	
II	94	0	1599	472	
III	113	0	1586	467	
IV	109	0	1576	452	
I 1957	100	1	1610	461	
II	100	1	1617	460	
III	100	0	1508	451	
IV	87	-1	1432	274	160
I 1958	76	-1	1342	268	171
II	89	-1	1338	268	174
III	97	-1	1305	264	169
IV	91	0	1344	259	167

‡

	Malaya+ Borneo	HK		BWI	Malta	BornTerr
I 1949	106		68 I 1949	68	47	
I 1950	109		67 I 1950	72	46	
II	111		81 II	75	47	
III	136		92 III	77	46	
IV	164		94 IV	78	47	
I 1951	190	101	I 1951	79	47	
II	226	112	II	79	47	
III	257	121	III	79	46	
IV	252	116	IV	81	47	
I 1952	256	123	I 1952	84	47	
II	260	125	II	87	48	
III	278	122	III	92	49	
IV	283	120	IV	91	51	
I 1953	285	113	I 1953	95	52	
II	289	121	II	105	53	
III	286	122	III	113	53	
IV	282	133	IV	107	54	
I 1954	291	132	I 1954	115	55	
II	295	128	II	121	56	
III	308	134	III	123	57	
IV	305	135	IV	123	56	
I 1955	325	136	I 1955	129	59	
II	332	153	II	135	61	
III	351	135	III	124	60	
IV	364	132	IV	119	60	
I 1956	380	134	I 1956	127	62	
II	311	125	II	118	55	
III	322	135	III	116	55	
IV	314	135	IV	111	55	
I 1957	325	131	I 1957	118	57	
II	312	135	II	130	57	
III	305	126	III	134	59	
IV	306	132	IV	125	60	80
I 1958	314	136	I 1958	126	61	87
II	313	143	II	129	63	86
III	318	144	III	124	63	86
IV	321	146	IV	125	63	86

‡

	WAfr + Ghana	EAfr	SRhd	Malaya	Other
I 1949	156	108	49	106	71
I 1950	168	114	46	109	71
II	169	125	52	111	67
III	252	131	55	136	71
IV	253	139	53	164	77
I 1951	283	148	46	190	85
II	309	153	55	226	90
III	333	159	52	257	94
IV	329	164	44	252	51
I 1952	339	172	32	256	54
II	350	193	39	260	46
III	357	204	40	278	50
IV	351	209	40	283	57
I 1953	384	214	46	285	56
II	399	215	51	289	53
III	407	217	53	286	56
IV	400	220	45	282	61
I 1954	431	222	43	291	63
II	462	227		295	62
III	475	225		308	62
IV	488	217		305	70
I 1955	500	212		325	68
II	510	207		332	60
III	513	203		351	60
IV	507	197		364	68
I 1956	502	195		380	73
II	472	163		311	57
III	467	158		322	56
IV	452	158		314	61
I 1957	461	160		325	63
II	460	159		312	56
III	451	152		305	55
IV	434	150		226	63
I 1958	439	147		227	63
II	442	141		227	56
III	433	139		232	55
IV	426	136		235	63

†

	Col Total	fA Total	NSA Total	Grand Total	Central Reserves	Res:Liab
I 1949	673	2442	1693	4135	603	0.25
I 1950	693	2541	1664	4205	709	0.28
II	727	2608	1641	4249	865	0.33
III	860	2700	1544	4244	984	0.36
IV	905	2838	1590	4428	1179	0.42
I 1951	979	3113	1528	4641	1342	0.43
II	1071	3215	1640	4855	1381	0.43
III	1141	3117	1636	4753	1168	0.37
IV	1084	2922	1586	4508	834	0.29
I 1952	1107	2779	1488	4267	607	0.22
II	1148	2700	1409	4109	602	0.22
III	1192	2714	1338	4052	602	0.22
IV	1202	2827	1321	4148	659	0.23
I 1953	1245	2936	1288	4224	774	0.26
II	1286	3054	1284	4338	845	0.28
III	1307	3052	1304	4356	888	0.29
IV	1302	3110	894	4004	899	0.29
I 1954	1352	3205	1217	4422	959	0.30
II	1351	3237	1285	4522	1078	0.33
III	1384	3194	1280	4474	1036	0.32
IV	1394	3239	940	4179	986	0.30
I 1955	1419	3213	1380	4593	953	0.30
II	1458	3218	1311	4529	957	0.30
III	1446	3133	1265	4398	838	0.27
IV	1447	3161	884	4045	757	0.24
I 1956	1473	3187	1215	4402	813	0.26
II	1301	2900	1121	4021	852	0.29
III	1309	2895	1086	3981	831	0.29
IV	1286	2862	1228	4090	762	0.27
I 1957	1315	2925	1231	4156	789	0.27
II	1309	2926	1228	4154	850	0.29
III	1282	2790	1234	4024	661	0.24
IV	1270	2702	1213	3915	812	0.30
I 1958	1286	2628	1256	3884	989	0.38
II	1287	2625	1277	3902	1099	0.42
III	1276	2581	1321	3902	1114	0.43
IV	1280	2624	1349	3973	1096	0.42

‡

Chapter III. Sterling Area Trade Relations

The trade policy of the sterling area system was a central part of Britain's management of the sterling area in the 1950s. By manipulating sterling area trade flows the UK hoped to ease the effects of the international dollar crisis, run down Britain's sterling liabilities in the least painful way and provide the UK with a surplus to support its traditional deficit with the non-sterling area (NSA). During the 1950s, however, these hopes were not realized. The international dollar crisis receded, although Britain's foreign exchange reserves remained low, and the British surplus with the RSA dwindled as the decade progressed. It did not prove possible to coordinate a longer term sterling area trade policy and the sterling area did not turn out to be a dependable market to offset declines in British competitiveness elsewhere. By the mid-1950s Britain's trade policy focused increasingly on her own problems and less on those of the sterling area as a whole.

In the early 1950s, Britain's efforts to balance sterling area trade with the rest of the world were based on the pursuit of a triangular balance between the UK, the rest of the sterling area (RSA) and the non-sterling area (NSA). In this way the UK could support a persistent trade deficit with the NSA through the sterling area system. In the 1930's, protectionism had weakened Britain's competitive edge in Europe and North America while, with the help of Imperial

Preference, British exports were increasingly concentrated on what were to become sterling area markets. Excluding Canada, the rest of the Empire bought 34.5% of British exports in 1930 and 41.5% in 1938¹. Increased imports from Europe, especially of manufactures, tended in turn to push Britain into deficit with more developed countries². Given this pre-war pattern, sterling area trade with the rest of the world could be balanced in the post-war period if RSA members were able to earn an export surplus with the NSA and the UK earned a surplus with the RSA. The RSA surplus with the NSA would cover their deficit with the UK and hard currency would flow from the RSA to London to finance the UK deficit with the NSA.

For this pattern to work two requirements had to be met. First, there had to be a continuing strong demand for sterling area raw material exports in the NSA. The second requirement was that the RSA should satisfy their demand for manufactured imports by importing from the UK rather than the NSA. Close historical ties between the RSA and UK traders and the shortage of hard currency in the sterling area system to buy NSA exports combined to guarantee the second requirement immediately after the end of the war. Postwar reconstruction, followed by the Korean War boom sustained a high demand for sterling area raw material exports which satisfied the first

¹D.H. Aldcroft and H.W. Richardson, The British Economy 1870-1939, Macmillan, 1969. p. 70.

²Ibid. p. 71.

requirement. By 1955, however, the RSA fell into a trade deficit with the NSA and relied on gold sales to maintain the balance of payments surplus with the NSA. As the decade progressed British exports were not adequate in supply or quality to meet the import needs of the RSA. By the end of the 1950s the independent members of the sterling area were becoming less willing to pool what hard currency they earned or to continue to hold their claims on the central reserves in sterling³. As a result of these developments the UK was unable to sustain a coordinated trade policy with the RSA. Instead, the UK urged the RSA countries to adopt deflationary domestic policies to improve their balance of trade with the NSA.

This chapter will review the pattern of sterling area trade and the policy devised by British officials. The first section will show that the trade pattern of the sterling area was essentially a series of bilateral relationships between the UK and the various members of the RSA. The second section will establish that Imperial Preference was not a sterling area policy and therefore quantitative the use of import restrictions and demand management will be the focus of this analysis. The next five sections will review the imposition of import restrictions and their subsequent relaxation. The chapter concludes with an analysis of the costs of the sterling area to British export competitiveness.

³See Chapter II, The Sterling Balances Problem

III.A. Was There a Sterling Area Trade System?

Table III.A. shows the pattern of trade between the UK, the RSA and the NSA. These figures show that a complementary triangular balancing system did not exist in the 1950's.

Table III.A.
The Balance of Trade of the UK and RSA

£m	1950	1951	1952	1953	1954	1955	1956	1957	1958
UK									
X to NSA	1238	1460	1500	1460	1490	1660	1950	2080	2000
M fr NSA	1434	2220	1710	1570	1680	2020	2090	2180	2060
Balance	-196	-760	-210	-110	-190	-360	-140	-100	-60
X to RSA	1016	1280	1330	1210	1330	1410	1460	1460	1430
M fr RSA	956	1250	1240	1320	1330	1410	1370	1390	1280
Balance	60	30	90	-110	0	0	90	70	150
RSA									
X to UK	956	1250	1240	1320	1330	1410	1370	1390	1280
M fr UK	1016	1280	1330	1210	1330	1410	1460	1460	1430
Balance	-60	-30	-90	110	0	0	-90	-70	-150
X to NSA	1524	1990	1550	1440	1440	1630	1770	1940	1700
M fr NSA	1394	1780	1580	1320	1410	1700	1840	2090	2190
Balance	130	210	-30	120	30	-70	-70	-150	-490
£A									
X to NSA	2762	3450	3050	2900	2930	3290	3720	4020	3700
M fr NSA	2828	4000	3290	2890	3090	3720	3930	4270	4250
Balance	-66	-550	-240	10	-160	-430	-210	-250	-550

Notes: Exports (X) and Imports (M) f.o.b. RSA = sterling area other than UK. NSA = non-sterling area. Source: International Monetary Fund, Balance of Payments Yearbook for 1951-58. UK Balance of Payments 1947-57, HMSO, 1959 and OEEC, Direction of International Trade, Area Summary, for 1950.

The UK did earn export surpluses with the sterling area in every year after the war until 1953 and then again from 1956 to the end of the period. Even in those years in which the UK was in surplus with the sterling area, however, this was not enough to offset the UK trade deficit with the rest of the

world except for 1958. Nor was the RSA balance with the rest of the world consistently healthy enough to pull the sterling area as a whole into balance. The RSA trade suplus with the NSA gradually diminished into deficits from 1955 onward.

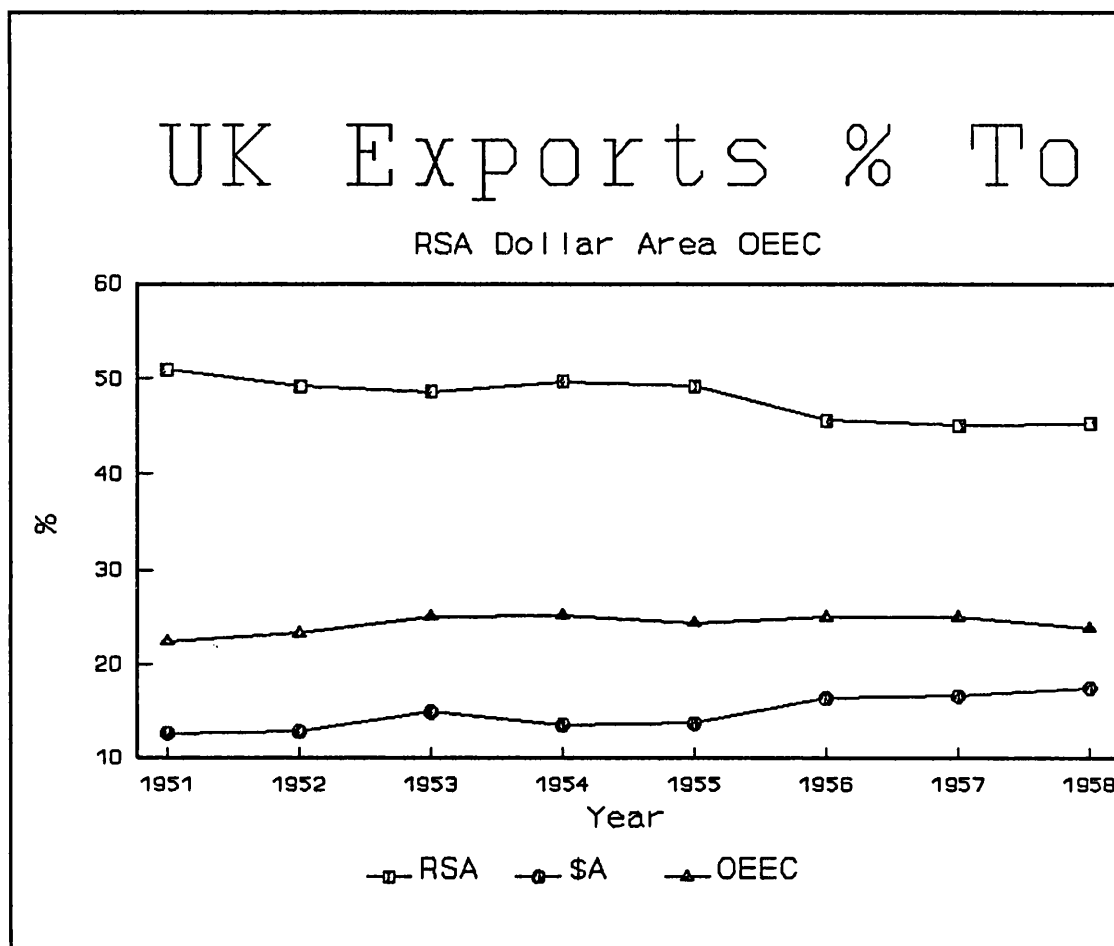


Figure III.A.

Figures III.A. and III.B. show British trade with the RSA, the Dollar Area and non-sterling OEEC as proportions of total British trade. The percentage of exports directed at the sterling area was somewhat higher than imports from the area but both followed a generally declining trend through the period except for slight revivals in 1953-55. Exports to the

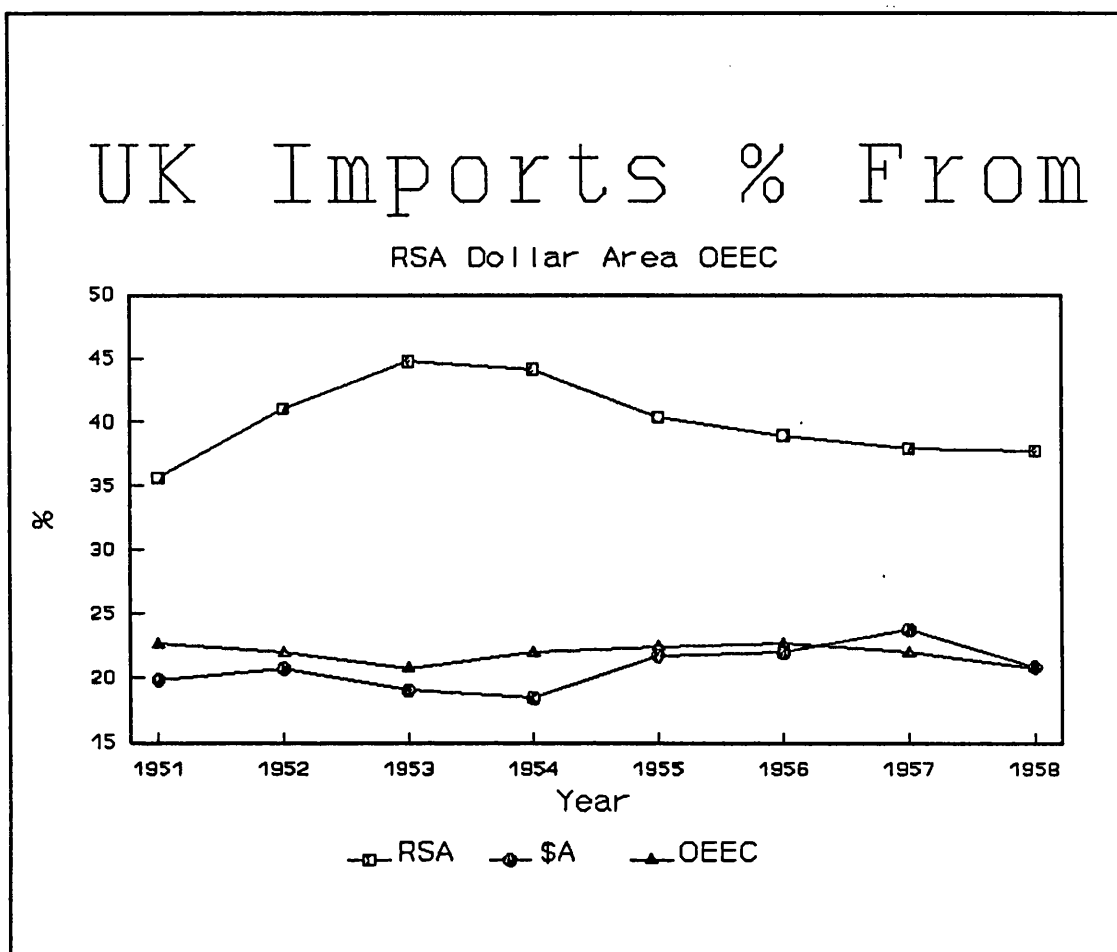


Figure III.B.

dollar area grew from 12.6% to 17.5% of total exports while the export share of the OEEC was more stable arriving at 24% by 1958. In 1954-5 when exports to the dollar area fell due to the American recession it was the sterling area which was the fastest growing substitute market rather than Europe. By 1958 the sterling area was still the UK's greatest market group absorbing over 45% of British exports.

The story for the UK's imports is slightly different. The dollar area was a greater source of imports than it was a market for exports and the sterling area took a smaller role

as a result. Still, dollar area exports took up only about 20% of the UK's import bill while the raw material exports of the sterling area took up about 40%. Non-sterling OEEC accounted for about 21% of Britain's imports.

It is commonly noted in support of the contention that complementary trade was a fundamental feature of the sterling area system, that sterling area members conducted half of their trade with each other. Figures III.A. and B. verify this for the UK. Table III.B. shows trade with the sterling

Table III.B.
Trade of Members of the Sterling Area with Other
Members as a Percent of Total Exports and Imports

0%-34%		35%-45%		46%-55%		56%-65%		65%+	
Exp	Imp	Exp	Imp	Exp	Imp	Exp	Imp	Exp	Imp
Icel	Icel								
Iraq									
		Pak		Iraq					
				Pak					
				India					
				Col	Col				
				Austr				Austr	
				Ceylon				Ceylon	
				S. Afr	S. Afr				
						Burma	Burma		
								Irel	Irel
								N.Z.	N.Z.
H.K.	H.K.								
Malaya									
		Malaya							
		Gld Cst				Gld Cst			
								Nigeria	Nig.
								Rhod	Rhod

Source: Direction of International Trade, OEEC. Percentages are averages for the period 1950-58.

area as a proportion of total trade for the Colonies and for ten independent members of the sterling area⁴. What is immediately obvious from this table is that the sterling area played a varying role in the trade of sterling area members. The peripheral independent members, Iceland and Iraq, conducted the least of their trade with other sterling area members. The Colonies of Malaya and Singapore and Hong Kong also fall into the lowest category of trade with the sterling area. Their trade was more aligned to Far Eastern markets than to the sterling area. India and Pakistan also fall into a category of lower intra-area trade than most sterling area members. For India, German and American imports were important, together accounting for 30% of India's total imports by 1958. Indian exports, however, were more focussed on sterling area markets, averaging 53% p.a. of total exports over the eleven years shown. For Pakistan, the sterling area played a smaller role for both imports and exports and both averages for the period fell below 40% p.a..

For the rest of the members, trade with the sterling area took up at least 45% of their total world trade. South African imports from and exports to other sterling area members hovered around 50% of total. For Australia and Ceylon, imports from the rest of the sterling area pushed above 60% p.a. on average for the period. Sterling area trade figured especially prominently in Burma, Ireland and New

⁴The excluded independent members are Libya and Jordan.

Zealand. The outstanding examples were Irish exports to the sterling area which averaged 86% of total exports p.a. and New Zealand imports from the area which accounted for 76% for her total imports p.a. on average. The three largest African Colonies also fall into the higher categories of trade concentrated in the sterling area. The Colonies in total conducted about half of their trade with other members of the sterling area (including inter-colonial trade). The five Colonies figuring individually in Table III.B., however, attest to the wide variation among Colonies.

The conclusion from Table III.B. is that while the sterling area as a whole conducted the bulk of its trade with fellow members of the system, there was a fairly wide variation in the strength of these trade ties for individual members.

Table III.C shows that behind the high figures for intra-area trade there was a strong bilateral pattern between the UK and the individual members of the sterling area. Rather than generating trade among members, the sterling area system reinforced the dependence of the RSA on trade with Britain. Iceland and Ireland, among the independent members of the system, did not participate in trade with the sterling area outside the UK hardly at all. Ninety-nine percent of Irish exports to the sterling area represented trade with the UK. The same percentage of Icelandic imports from the area during

this period were from the UK. The preponderance of the UK in Icelandic exports and Irish imports is somewhat less, 81.3%

Table III.C.
Trade of RSA with UK as a Percentage of
Total Intra-Area Trade

0%-45%		46%-55%		56%-65%		66%-75%		75%+	
Exp	Imp	Exp	Imp	Exp	Imp	Exp	Imp	Exp	Imp
Burma	Burma								
	Ceylon	Ceylon							
	India	India							
	Pakis	Pakis							
				Colon	Pakis				
				S. Afr	Colon				
						Austr	Austr	S. Afr	
							N.Z.	N.Z.	
						Iraq	Iraq		
								Irel	Irel
								Icel	Icel
H.K.		H.K.							
Malaya	Malaya								
		Rhod	Rhod						
								Niger	Niger
								G.Cst	G.Cst

Source: Direction of International Trade, OEEC. Percentages are averages over 1950-58.

and 86.1% respectively. Non-UK sterling area imports into Ireland were mainly from Australia and India. Icelandic exports to the RSA went mainly to British Africa during the second half of the 1950's. More than 75% of South African imports from the sterling area came from the UK while only 57% of her exports to the area were destined for the UK. This divergence between export and import markets was primarily due to the relatively large amount of South African exports to neighbouring African territories. Rhodesia and Nyasaland was South Africa's primary African market, absorbing 15% of total exports in 1955-58 or 31% of exports to the sterling area,

while the sterling Colonies in the Northwest and Northeast of Africa took almost no imports from South Africa. The non-sterling Colonies of Mozambique and the Belgian Congo were the next two largest African markets for South African exports. Only 12% of South African exports to the sterling area went to members other than the UK and Rhodesia and Nyasaland. To the extent that Rhodesia and Nyasaland can be considered a natural regional trading partner of South Africa, South Africa's intra-area trade outside the UK may be attributed more to a regional African pattern of trade than as evidence of a genuine sterling area system of trade. The half of South Africa's trade that occurred outside the sterling area was fairly evenly divided between the USA and non-sterling OEEC, with the USA as the major source of imports and the non-sterling OEEC as the major export market outside the UK.

The bilateral relationship between the UK and individual members of the sterling area system was strong also for New Zealand and to a lesser extent for Australia and Iraq. About 93% of New Zealand exports to the sterling area went to the UK and an average of 70% of the rest went to other members in Oceania, primarily Australia. 72% of New Zealand sterling area imports came from the UK. The rest came primarily from Australia and to a lesser extent from sterling Asian countries. For New Zealand, then, the large figures for intra-area trade shown in Table III.B. were also based on a bilateral relationship with the UK, combined with a naturally

close relationship with Australia. Australian trade was less concentrated in the UK than was the case for New Zealand but the UK still absorbed two thirds of Australian exports to the sterling area and only slightly less of her sterling area imports. Australia's other sterling markets for exports and imports were in sterling Asia⁵, especially Ceylon, Malaya and India as well as New Zealand. Australia's largest export markets after the UK were Japan and France, neither of whom were members of the sterling area⁶.

Until 1957 Iraq's exports to the UK comprised 80% of its total exports to the sterling area. In 1957 exports to Aden, a sterling area Middle Eastern dependency, expanded to over one third of Iraq's exports to the sterling area. Slightly less of Iraq's imports from the sterling area came from the UK, the other import markets in the area being Ceylon and India. Still, sterling area imports other than from the UK represent less than 12% of Iraq's imports during the period. Her main sources of supply other than the UK were the USA, Germany and Japan which together accounted for one third of Iraq's total imports by 1958. Iraq's trade ties to sterling countries other than the UK, then, seem weak except for exports to Aden, a natural regional trading partner.

⁵Sterling Asia includes India, Pakistan, Ceylon and Burma as well as the Asian colonies, such as Hong Kong and Malaya and Singapore.

⁶Together Japan and France absorbed 15-20% of Australian exports between 1951-58.

The Asian sterling countries, Pakistan, India, Ceylon and Burma all appear in the left half of Table III.C., with larger proportions of their sterling area trade going to countries other than the UK. Hong Kong and Malaya and Singapore, the two Asian Colonies presented individually in the table, also follow this pattern. For the most part this was due to a large proportion of Intra-Asian trade. Close to 80% of Burmese exports were destined to sterling Asia. In the same period close to half of Burmese sterling imports came from the UK and almost all the rest were from sterling Asia. The UK and sterling Asia together accounted for almost 90% of Pakistan exports to the sterling area and 90% of sterling area imports.

Ceylon trade followed a slightly different pattern than was the case for Burma or Pakistan. A larger proportion of sterling area exports went to the UK than for any of the other Asian members (55%), while only 9.5% of her sterling area exports went to other Asian members. For imports, however, Ceylon had a much weaker relationship to the UK with only 25% of sterling area imports coming from the UK. The pattern of bilateralism with the UK combined with regional trade within Asia is therefore evident for 75% of Ceylon's imports but only 65% of her exports. Ceylon's other major sterling exports were tea to Australia and South Africa. Together these two countries absorbed 15%-25% of Ceylon's exports to the sterling area. Since the sterling area produced 75-80% of the world's

tea⁷ it is unlikely that trade in this commodity was generated by the existence of the sterling area system. This trade would probably have occurred even in the absence of the common monetary basis of the trading partners. While Ceylon's export trade appears to be diversified among sterling area members, this was due primarily to product specialisation. It is possible, of course, that if Australia and South Africa had been forced to pay hard currency for Ceylonese tea they would have restricted their imports.

About half of India's sterling area exports and imports represent trade with the UK. Of the rest of its sterling area trade, about half again was with sterling Asian countries. The remaining 25% of India's trade with the sterling area was divided among Australia, the Persian Gulf and Kenya. Australian exports to India were mainly wool and wheat in exchange for Indian cotton goods and tea. The Persian Gulf dependencies figured prominently in India's trade figures because they supplied India's petroleum needs. Kenya exported raw cotton, plant dyes and sodium carbonate in exchange for Indian finished cotton and jute products.

In summary, this analysis of the general pattern of intra-area trade shows the strong domination of the UK both as an export market and as a source of imports for all the non-Asian members. The non-UK trade of the non-Asian members of

⁷The Commonwealth and the Sterling Area Statistical Abstract, London, HMSO.

the RSA was predominantly with their sterling neighbours eg. Australia and New Zealand, Iraq and Aden, South Africa and Rhodesia and Nyasaland. For the Asian members, the UK figures somewhat less prominently due primarily to a large intra-Asian trade but they generally fall into the same pattern as other RSA countries, combining a bilateral relationship with the UK with regional trade.

The sterling area system seems to have reinforced members' trade relationships with the UK and perhaps strengthened regional trade with partners who also happened to be sterling area members rather than generating a genuine intra-sterling area trade network. This is perhaps not surprising given the size of the British economy relative to the individual members of the RSA, the scarcity of manufactured goods in the RSA and the need for sterling area raw materials in the UK. This pattern is consistent with the basis of the triangular balance described at the beginning of this chapter as the goal of British sterling area trade policy in the early 1950's. This triangular pattern involved a complementary exchange of manufactured goods for raw materials between the UK and the RSA on the one side and the trade of the UK and RSA with the non-sterling world on the other.

III.B. Imperial Preference v. Discriminatory Import Restrictions

There were two major strands of policy affecting sterling area trade during the 1950s. The first was Imperial

Preference as arranged under the Ottawa agreements of 1932. The second was quantitative restrictions against dollar and other non-sterling imports coordinated by sterling area members during the early 1950's. It will be argued in this section that Imperial Preference was not a sterling area policy nor an essential part of the sterling area system. Quantitative import restrictions, in contrast, were operated as a uniquely sterling area instrument designed specifically as an integral element of the sterling area.

Certainly the economic policy of the Commonwealth overlapped with sterling area policy, just as the political motives for the sterling area overlapped with the political importance of the Commonwealth. Imperial Preference was designed not only to encourage mutual trade and to discriminate against non-Empire countries but also to strengthen the political ties of the Commonwealth. In turn, the sterling area system was arguably a vital part of Britain's efforts to solidify the Commonwealth through the 1950s. While Imperial Preference overlapped with the sterling area system both as regards economic purpose and geography, however, there are several reasons why it should not be considered a tool of sterling area policy.

Imperial Preference emerged from the Ottawa Commonwealth Conference of 1932 as a system to foster trade among Commonwealth countries and the Empire. Under a series of agreements, Commonwealth countries agreed to impose lower

tariffs against eachothers' goods than those imposed against imports from the rest of the world. The Ottawa agreements excluded what were then members of the sterling monetary system (the Sterling Bloc) such as Portugal and Scandinavia and included all members of the Commonwealth including Canada. At its inception, then, Imperial Preference was deliberately not part of the prevailing sterling monetary system, but rather part of the political union of the Commonwealth.

The system of Imperial Preference persisted through the 1950s and excluded all non-Commonwealth members of the new sterling area except Ireland, which had a special status because of the close integration of the Irish economy with the British economy. The tariff preferences also included Canada which was then part of the dollar area, while the dollar was discriminated against by the sterling area as a whole. The geographical coverage of Imperial Preference thus differed from that of the sterling area in such a way as to bring the aims of this policy into conflict with the aims of the sterling area system.

The rules of the postwar sterling area system were designed to support sterling as both a trading and reserve currency in the presence of the postwar dollar shortage. This was the basis of the willingness of members to impose common exchange restrictions against the non-sterling world (including Canada), to pool their foreign exchange reserves and to maintain sterling balances. The imposition of

quantitative restrictions on non-sterling imports by the sterling area was based on the same general principles as the rest of sterling area policy. Quantitative restrictions were imposed on dollar imports by almost all members of the sterling area in concert in the early 1950s to preserve the foreign exchange reserves of the area as a whole while Imperial tariff preference continued to be offered in theory to imports from Canada. As late as 1956, only India and Pakistan did not offer preference to Canadian exports⁸. In fact, however, quantitative import restrictions, and the necessities of the sterling area system that they reflected, over-ruled Imperial Preference in the case of Canada. These import controls, which amounted in many cases to a virtual prohibition of dollar imports, also played a larger and more direct role in diverting trade from outside the sterling area to trade among its members in the 1950s than did the tariff margins of Imperial Preference. In its 1953 report on the sterling area, the Bank for International Settlements asserted that "trade quotas and foreign exchange restrictions are now of considerably greater importance than differential tariff rates"⁹.

It might be argued that Imperial Preference continued to be important to members of the Commonwealth who were also

⁸Economist Intelligence Unit, The Commonwealth and Europe, EIU, London, 1960. p. 17.

⁹Bank for International Settlements, The Sterling Area, Basle, 1953. p.

members of the sterling area. Indeed, the largest traders of the sterling area were also privy to Imperial Preference and, therefore, it might be assumed that Imperial Preference, while not a sterling area policy, still may have had an important impact on sterling area trade. In fact the effectiveness of Imperial Preference had been deeply eroded by the 1950s. Most of the preference offered by the UK had been based on specific duties of X shillings per volume of a particular import. Between 1932 and the 1950s inflation had therefore eroded much of the benefit that overseas Commonwealth exporters enjoyed in the British market¹⁰. This effect was increased by changes in the pattern of trade away from imports on which preference was given and an increase in trade on non-preferential goods such as raw materials. By 1953 the average preference margin on trade between the UK and the Commonwealth imports and exports was only 5-6%¹¹. The actual rate of preference on individual items was higher of course since only about half of Commonwealth trade was covered by Imperial Preference by this time¹². While preference may still have been important for particular items or industries, therefore, there was probably

¹⁰In 1957-8 Australia and New Zealand, whose exports to the UK had been particularly pinched by inflation eroding UK preference margins, negotiated trade agreements with the UK allowing a reduction of ad valorem preferences offered to imports from the UK.

¹¹D. MacDougall and R. Hutt, "Imperial Preference: A Quantitative Analysis", Economic Journal, No. 254, Vol LXIV, June 1954, pp. 233-257. p. 256.

¹²Ibid.

little aggregate effect on Commonwealth or sterling area trade.

While Imperial Preference was not completely separable from the sterling area, it was essentially not a sterling area instrument. Furthermore, in the 1950s the impact of this tariff system on sterling area trade was eroded by inflation and changes in international tariff policy and swamped by sterling area quantitative import restrictions. An analysis of sterling area trade policy in the 1950s therefore must concentrate on the imposition and effects of the quantitative restrictions and other measures rather than on the preferential tariff policy left over from the 1930's.

III.C. The Sterling Area Quantitative Restrictions: 1949-52

The system of quantitative import restrictions devised by the British and copied in the rest of the sterling area involved discrimination in varying degrees against non-sterling imports for the purpose of conserving the central foreign exchange reserves of the area. As a consequence of this discrimination, the restrictions encouraged the RSA to satisfy their import needs within the sterling area. As was shown earlier, however, the primary relationship of almost all sterling area members was with the UK so encouragement of intra-area trade meant encouraging UK exports to the RSA. In the context of the triangular pattern described at the beginning of this chapter, discriminatory import restrictions

encouraged RSA trade deficits with the UK and inhibited RSA deficits with the NSA. On the other side of the triangle the UK would find it easier to run surpluses in the protected markets of the RSA while decreasing her deficit with the NSA to generate an overall balance. In the event, the sterling area import restrictions proved insufficient to achieve this balance. This section will outline the operation of this policy and the causes of its failure.

Import controls on private trade in the UK were administered through a licensing system established during the war. Importers were granted licences which determined both the amount of a particular good which could be imported as well as the allowable areas of consignment. There were four main categories of license, Open General License (OGL), Open Individual License (OIL), Specific License and Global License. OGLs allowed imports of a specific good by any importer up to any value. The only limitation under this category was the area of consignment. OILs were issued to individual traders usually for six months for specific goods with no quantitative restriction but they were also subject to discrimination by the origin of the good. Specific or Individual licenses were akin to OILs except restrictions were placed on the amount of the good imported as well as area of consignment. Global licences had no restrictions whatsoever.

Most independent members of the sterling area operated a licensing system similar to the UK. New Zealand, in addition

to quantitative restrictions, also controlled all imports through an Exchange Allocation scheme¹³. Pakistan supplemented its quota system by controlling the extension of trade credit for all imports except a few essentials¹⁴. After 1954 Ceylon discriminated, not only in favour of soft currency imports, but also in favour of native Ceylonese importers as against foreign firms operating in Ceylon¹⁵.

Table III.D.
Colonial Dollar Allocations and Actual Expenditure

\$m	1948	1949	1950	1951	1952	1953	1954
Dollar Allocation	346	216	157	192	209	179	166
Total Imports	337	241	128	169	197	168	216

Notes: Figures are cif and exclude oil imports and imports of machinery by oil companies. Source, PRO BT241/332.

The Colonies were given annual foreign exchange allocations decided by the UK after reviewing each colony's needs for the coming year. The dollar allocations and actual expenditure for 1948-54 are presented in Table III.D. where it will be noted that the Colonies underspent their allocations in five out of seven years.

¹³Commonwealth Economic Conference Preparatory Meeting of Officials, Report on the Short Term Balance of Payments Outlook, Appendix II, 11 October, 1952. PRO T236/3295.

¹⁴Ibid.

¹⁵C.E. Thurogood, UK Trade Commissioner in Ceylon, Overseas Economic Surveys: Economic and Commercial Conditions in Ceylon, HMSO, London, 1955. p. 15.

III.C.i. Quantitative Restrictions 1949-50

The coordination of sterling area import controls which set the tone for the early 1950s began at the Commonwealth Economic Conference of July 1949. At the beginning of July 1949, the Chancellor of the Exchequer, Sir Stafford Cripps, had sent messages to all the sterling area finance ministers and Colonial governors which outlined his belief that sterling area dollar imports in 1949-50 would have to be cut by 25% from their 1948 value or from \$2,185m to \$1640m¹⁶. The Chancellor therefore asked, without prejudice to the outcome of the upcoming conference, that the finance ministers should be prepared to submit estimates of dollar earnings and expenditure for the coming year bearing in mind the British estimates of possible sterling area dollar expenditure¹⁷. Two days later, the Chancellor announced that the moratorium on British dollar imports begun in June would be continued for at least three more months¹⁸.

On 9 July 1949, the Economic Policy Committee of the Cabinet approved a Treasury paper on the British objectives for the conference which proposed a new approach to the

¹⁶Telegram from CRO to UK High Commissioners in Commonwealth, 31 June, 1949. Telegrams to the Colonies were sent on 4 July, 1949 to the same effect. PRO T236/1868.

¹⁷Ibid.

¹⁸Telegram from CRO to Commonwealth High Commissioners 5 July, 1949. PRO T236/1868.

sterling area balance of payments problem¹⁹. Under the plan, the sterling Commonwealth would agree on the total sterling area dollar imports possible, allowing for estimated earnings and overseas aid and then negotiate dollar import programmes within this limit. This sterling area dollar programme, the paper suggested, should then be under continuous subsequent review to allow for changes in the state of the international economy. The new multilateral approach, it was suggested, "should certainly minimise the chances of any individual country getting away with dollar expenditure which the sterling area as a whole cannot afford"²⁰. The policy paper went on to suggest that any member unwilling to go along with such a recommendation might be threatened with banishment from the sterling area and a consequent withdrawal of the right of convertibility of their sterling balances. This last threat was especially directed toward India who, it was thought, might resist such an infringement on her sovereignty²¹.

Facing an escalating dollar drain in the middle of July 1949 while the Commonwealth finance ministers were meeting in London, Sir Stafford Cripps led the way by announcing a cut of 25% on the 1948 value of British dollar imports, which amounted to a cut of some \$400m. A few days later, the

¹⁹Economic Policy Committee Paper, 9 July 1949. PRO T236/1868.

²⁰Ibid.

²¹Ibid.

Conference of Commonwealth Finance Ministers then meeting in London issued a joint communiqué stating that

immediate steps necessary to check the continuing heavy drain on the central reserve of the sterling area were discussed, and the Ministers concerned agreed to recommend to their Governments action comparable in its results to that already decided upon by the United Kingdom²².

The sterling area finance ministers dutifully went home with this undertaking and British precedent behind them and suspended almost all licences for dollar imports. In the third quarter of 1949 sterling area imports from the USA fell \$148m and a further \$28m to the end of the year. This coordinated import policy was too little too late for the immediate crisis, however, and in September sterling was devalued to \$2.80/£.

In April 1950 the Chancellor of the Exchequer commended the efforts of other sterling area countries to restrict dollar imports in 1949-50 in a telegram which concluded that "the reductions in dollar expenditure have played a highly significant part in the recent improvements in our dollar position. If we are to pull through we must continue to act together in this way"²³. The way was thus set for the restrictions to be continued, even though the sterling area trade deficit with the USA had fallen to \$22m in the first

²²The Economist, July 23, 1949. p. 204.

²³Telegram Chancellor of the Exchequer to Commonwealth finance ministers, 3 April 1950. PRO T236/3166.

quarter of 1950 from \$159m in the first quarter of 1949²⁴. There followed telegram replies from the sterling area finance ministers pledging their countries' willingness to continue the measures adopted in July 1949 through to June 1951. The Indian Finance Minister's reply was initially reluctant, pointing out that "the continued limitation of dollar purchases after June 1950 will cause further strain on the Indian Economy" but he concluded that

nevertheless in the common interest of the general sterling area position we are prepared to fall into line with other commonwealth countries and to limit our total dollar expenditure on dollar imports during the year July 1950 to June 1951 to the maximum of 75% by value of our expenditure during the calendar year 1948²⁵.

The 25% reduction in sterling area dollar imports agreed in 1949 was, in the end, achieved through 1950. In fact, American trade figures record that sterling area imports from the USA in 1950 were only 63% of their 1948 value²⁶. Table III.E. shows the percentage changes in imports from the USA and Canada for most sterling area countries.

The experience of individual members varied quite widely although dollar imports fell for most members. Particularly

²⁴A.K. Cairncross, Years of Recovery; British Economic Policy 1945-51, Methuen, 1985. p. 204.

²⁵Telegram from Indian finance minister C.D. Deshmukh to Commonwealth Relations Office, 6 April, 1950. PRO T236/3166.

²⁶Direction of International Trade, OEEC. December, 1950.

Table III.E.
Sterling Area Imports from the USA and Canada

\$m Member	1948	1950	% Change
India	340	235	-31
Pakistan	26	35	+35
Ceylon	26	12	-54
Australia	172	150	-13
New Zealand	71	42	-41
South Africa	582	174	-70
Burma	7	3	-52
Iceland	16	8	-50
Eire	57	75	+31
Colonies	379	242	-36
United Kingdom	1616	1095	-32
Total of Above	3292	1996	-39

Source: Direction of International Trade Statistics, OEEC.

striking is South Africa's drop of 70% over the 1948 value. This is in part influenced by the abnormally high level of dollar imports in 1948 although the drop in 1950 over 1949 was still 54%. The figure for Pakistan is in turn affected by a very low level of American imports in 1948. The value of imports in 1950 was 19% lower than the 1949 value. Pakistan did not devalue its currency with the rest of the sterling area in 1949 which also affected dollar imports. Ireland was a direct recipient of ERP aid so its dollar expenditure did not directly affect the central reserves and its imports were not subject to the same restrictions as the rest of the sterling area in 1950.

Overall, the drop in dollar imports from 1948 to 1950 is impressive indeed, but the question for the present purpose is the extent to which this drop was due to the sterling area

import controls of 1949-50. First, 1950 was a bad year in general for American exports. A quantum index with 1948 as the base year shows that the volume of North American exports fell from an index of 100 in 1948 to 90 in 1950²⁷. The corresponding dollar price index shows that North American export prices fell from 100 in 1948 to 92 in 1950. The fall in the value of North American exports was, thus, fairly evenly distributed between price and volume. The fall in American export prices was due to the general fall in the price of manufactured goods, which were the predominant exports from the USA to the sterling area. Table III.F. shows that between 1948 and 1950 the terms of trade moved against the developed world and in favour of underdeveloped areas such as the RSA due both to increases in the price level of raw materials and decreases in the price of manufactures²⁸. To some extent the fall in the price of American exports may have been affected by falling demand due to sterling area restrictions but it is more likely that sterling area policy coincided with a particularly cooperative international price pattern to reduce the value of dollar imports.

The other major influence in 1949, of course, was the

²⁷The quantum and price indexes used in the following analysis are from Yearbook of International Trade Statistics, 1952, United Nations, New York, 1953 unless otherwise stated. They reflect prices in terms of dollars.

²⁸ibid.

Table III.F.
Terms of Trade Index 1953=100

Region	1938	1948	1950	1951	1952	1953	1954	1955	1956	1957	1958
Developed											
	107	101	98	94	97	100	98	98	99	98	102
Undeveloped											
	75	90	106	112	100	100	106	105	102	98	98
Stlg Area	93	95	104	103	96	100	101	100	98	97	98
RSA	80	91	111	117	99	100	102	101	97	95	91
Aus/NZ/SAfr											
	80	91	118	116	90	100	94	89	88	88	74
Stlg Asia	83	93	110	124	107	100	103	107	102	98	100

Notes: RSA is non-European sterling area and so excludes Eire and Iceland. Prices are in terms of US Dollars. Source. Yearbook of International Trade Statistics, 1959, United Nations, New York, 1960.

devaluation in September of sterling and all other RSA currencies except the Pakistan Rupee. This 30% devaluation had the effect of making dollar imports more expensive for sterling area importers which would no doubt have made a significant contribution to a reduction in dollar imports even in the absence of the sterling area controls. It is interesting to note that Pakistan, which did not devalue in 1949 increased its imports of American goods in 1950 over 1948.

The conclusion for the 1949 restrictions, then, is that price movements in terms of dollars accounted for about half of the fall in American exports to the world and that the sterling devaluation no doubt accounted for much of the rest of the decline in the value of imports from the dollar area 1948 and 1950. The quantitative restrictions thus appeared to have been overwhelmingly successful because they coincided

with these other favourable changes in the international economy.

In most cases there was some diversion of RSA trade of which the UK was the primary beneficiary. UK exports to the sterling area increased by 35% or £263m between 1948 and 1950 which accounts for most of the drop in RSA imports from the USA. Only in Pakistan, Australia and to a lesser extent in some Colonies did some of the foregone imports from the dollar area express themselves in an increase in imports from the non-sterling OEEC. For the rest, imports in 1950 fell absolutely from their 1948 level.

III.C.ii. The Korean War Boom 1950-51

Three months after the second sterling area resolution to reduce dollar imports the Korean War erupted, generating a dramatic increase in the world demand for raw materials for re-armament. Sterling area exporters of such war materials as tin, jute, rubber and wool, in particular, benefitted. The price indexes of selected commodities are presented in Figure III.C. In 1950, the sterling area produced about 35% of the world's tin, 99% of the world's raw jute, 50% of the world's rubber and 58% of the world's wool²⁹. These were all raw materials for which the USA was a net importer. In 1950, the RSA together exported 40% of world exports of tin, 100% of world exports of jute, 60% of world exports of rubber and 70%

²⁹The Commonwealth and the Sterling Area Statistical Abstract no. 74, 1950-53, London, HMSO, 1955.

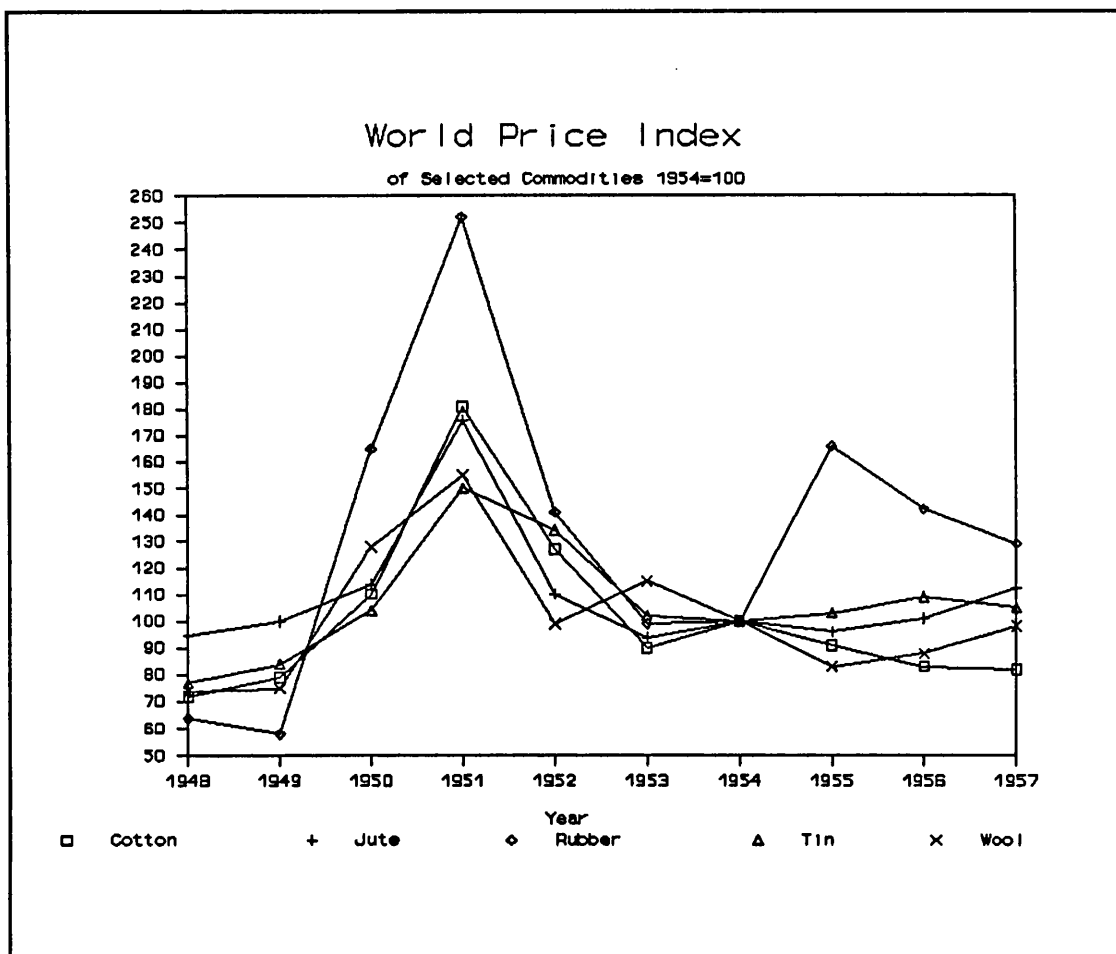


Figure III.C.

of world exports of wool³⁰. As a result of rising prices and volumes, the value of sterling area exports to the NSA as a whole increased by 52% or almost £1 billion during 1950. Of this increase one third was to the dollar area, 38% was to the OEEC and the rest to other non-sterling countries³¹.

Here was the first postwar opportunity to achieve the triangular balance sought by the British if the RSA imports

³⁰Ibid.

³¹Ibid.

from the non-sterling area could be restrained. The RSA earned sizeable surpluses with the NSA and was able to contribute substantial foreign exchange to the central reserves to offset the British deficit with the NSA. This surge in export earnings by the RSA, however, inevitably had a deteriorating influence on the willingness of the RSA to restrict their non-sterling imports. At a meeting near the end of September 1950, the sterling Commonwealth finance ministers reviewed the sterling area import restrictions in the context of the changed balance of payments situation. Before the meeting convened, Mr. Ninmo, a member of the Australian delegation, warned M.T. Flett of the Treasury that the Australian delegation had been instructed that in the interests of introducing greater flexibility into the Australian import programme, the Australians were not to take part in any dollar import agreements that specified cuts using a percentage formula similar to that agreed in July 1949³². It seemed to Flett that the Australians might accept a 'gentlemen's agreement' regarding import restrictions³³ but he had to report the next day to Mr. Ninmo that the Chancellor, Hugh Gaitskell, was not ready to abandon a percentage formula³⁴. Another obstacle was that inflation

³²Note from M.T. Flett to H. Wilson Smith, 18 September, 1950. PRO T236/2757.

³³Ibid.

³⁴Note by M.T. Flett, 19 September, 1950. PRO T236/2757.

had made it more difficult for members to hold their imports to 75% of the 1948 value. As a result, the meeting of Commonwealth Ministers was at first unable to agree to a public statement on dollar import restrictions. They were agreed only on two general points. These were the need to increase the sterling area's reserves and that the measures taken in July 1949 had been important in improving the sterling area's position³⁵.

Three alternative formulas for a commitment on dollar imports were devised by the UK and presented to the RSA. These were first to continue to limit dollar imports to 75% of the 1948 value with additions for exceptional stockpiling needs, secondly to limit dollar imports by a percentage less than 25% to allow for price increases or thirdly to make a more vague statement that dollar imports should be limited to essentials on a basis no less stringent than the 1949 policy³⁶. The first option was unacceptable to most delegates because of inflation as well as the need for restocking and the second option was supported only by India and Pakistan who wanted an explicit ceiling on dollar expenditure to impose discipline on their own Departmental spending. The third option would have satisfied Ceylon and New Zealand but it was rejected by Australia because of its reference to the

³⁵Note of Meeting of Commonwealth Ministers on General Economic and Trade Questions: Dollar Import Policy, 20 September, 1950. PRO T236/2757.

³⁶Ibid.

1949 policy. The final communique of the meeting was, therefore, very much less specific, stating only that the members were

agreed on the need to persevere with measures designed to increase the dollar earnings of the sterling area, whether by exports or by the provision of dollar-earning services. The Ministers of the sterling area countries agreed upon the need to maintain strict economy in dollar expenditure³⁷.

Hugh Gaitskell continued to hope that a more concrete undertaking could be negotiated after the conference was finished³⁸ but by the end of October he was forced to report to the Economic Policy Committee of the Cabinet that

It will be seen, therefore, that we have failed to secure anything approaching the sort of formula which my colleagues authorised me to aim at and that the agreement that eventually emerged is weak enough to permit a really substantial upswing on dollar expenditure by the independent sterling area³⁹.

In the event, the Chancellor's fears were realised as RSA imports from the dollar area increased significantly through 1951, especially for those members who benefitted from the Korean War boom. Table III.G. shows the growth in exports to the USA from Australia, India, Malaya and Singapore and Pakistan from 1948-52. These four sterling area members were major beneficiaries of the raw material boom of 1950-51.

³⁷Communique, 22 September, 1950. PRO T236/2757.

³⁸Letters from H. Gaitskell to C.D. Deshmukh, Mr. Jayawardena, Mr. Doidge (N.Z.), 4 October, 1950. PRO T236/2757.

³⁹Report by Chancellor of the Exchequer for Economic Policy Committee, 25 October, 1950. PRO T236/2757.

Table III.G.
Comparison of Half-Yearly Trade With USA

	\$m	1948	1949	1/2 1950	1/2 1951	% chge	1/2 1952	% chge
Australia								
M		132.9	150.4	62.5	80.0	28%	152.0	90%
X		122.6	96.9	69.4	261.0	276%	91.4	-65%
India								
M		328.7	284.1	101.1	164.1	62%	453.4	176%
X		217.2	197.8	94.6	166.7	76%	136.4	-18%
Malaya								
M		98.3	49.3	12.3	28.8	134%	36.7	27%
X		215.4	181.4	112.2	240.2	114%	123.4	-49%
Pakistan								
M		24.0	38.5	14.0	15.3	9%	26.0	70%
X		48.1	40.1	21.2	26.6	25%	11.9	-55%
St. Area								
M		2003.1	1863.5	667.4	896.7	34%	1142.3	27%
X		1385.0	1155.5	688.5	1250.5	82%	1029.9	-18%
UK								
M		743.2	821.8	291.9	438.0	50%	564.0	29%
X		285.9	224.6	130.0	227.3	75%	265.1	17%

		2/2 1950	2/2 1951	%	2/2 1952	%
Australia						
M		55.9	91.3	63%	98.1	7%
X		75.0	81.8	9%	66.1	-19%
India						
M		110.5	251.5	128%	127.4	-49%
X		119.8	116.1	-3%	116.4	0%
Malaya						
M		16.7	43.7	162%	23.0	-47%
X		230.2	166.1	-28%	91.1	-45%
Pakistan						
M		18.9	6.1	-68%	10.5	72%
X		22.7	3.5	-85%	10.4	197%
UK						
M		300.4	629.2	109%	330.2	-48%
X		227.1	202.6	-11%	235.7	16%
St. Area						
M		602.9	1306.9	117%	715.3	-45%
X		912.8	927.7	2%	831.7	-10%

Source: Direction of International Trade, OEEC.

Australia exported 66% of sterling area exports of wool and India accounted for 76% of the area's cotton exports⁴⁰. Malaya and Singapore provided for 88% of the sterling area tin exports and 83% of the area's natural rubber exports⁴¹. Pakistan exported most of the raw jute in the sterling area⁴². These five commodities alone rose from one quarter of RSA total exports in 1949 to one third in 1950 and 37% in 1951⁴³.

Table III.G. also shows the acceleration of dollar imports for these countries and the sterling area as a whole during 1951 and the first half of 1952. In the first half of 1951, exports were still rising faster than imports for all four countries except Malaya. Malaya's rubber exports were subject to dramatic price increases over 1950 while for most other products, the price boom really only took off in 1951⁴⁴. As a result, Malaya had greater dollar earnings to spend over the first half of 1951 than the other countries. For the sterling area as a whole, imports in the first half of 1951 rose 34% over the same period the previous year but exports were increasing at more than twice this rate, generating a surplus

⁴⁰The Commonwealth and the Sterling Area Statistical Abstract, No. 78, HMSO, London, 1958.

⁴¹Ibid.

⁴²Ibid.

⁴³Ibid.

⁴⁴See Figure III.B.

with the USA of \$354m. The four RSA countries shown in the table together ran a surplus of \$406.3m, offsetting a UK deficit of \$211m. In the second half of 1951 this relatively healthy situation changed. The rate of increase in dollar imports for the sterling area as a whole more than tripled while exports to the USA were almost at the same level as in the second half of 1950. In India, Malaya, Pakistan and the UK, exports to the USA suffered an absolute fall. Only Pakistan succeeded in reducing its imports commensurately but, even so, could not avoid falling into a dollar deficit for the half year. Australian exports increased slightly, but this was not enough to offset the growth in imports. Still, the four countries together only accumulated a deficit of \$25m in the second half of 1951 which was more than adequately covered by their surplus in the first half of 1951 to give them net earnings of \$381m from the USA over the year as a whole. These four major raw material producers, then, were able to continue their spending spree through the first half of 1952, despite sharp drops in their export earnings after the price boom collapsed in the second half of 1951. The sterling area as a whole, however, was in a much less healthy position, accumulating a deficit in the second half of 1951 of \$379m bringing the deficit over the year as a whole to \$25m.

The major culprit in the payments crisis of 1952 was the UK itself. Imports from the USA doubled in the second half of 1951 over the same period in 1950, pushing the UK into a

deficit for the year of \$637m with the USA. Through 1950, the UK ran up a deficit with the NSA amounting to £196m and earned a surplus with the RSA of only £60m. It is not surprising then that the British authorities were eager to preserve and conserve the much more favourable trading situation in the RSA.

Over the course of 1950, the triangular balance seemed almost achievable if the dollar earnings of the RSA could be directed into the proper channels and their deficit with the UK was forced to expand. The surplus of the RSA with the NSA was needed by the UK to cover its deficit and to help bolster the still weak foreign exchange reserves of the area. The RSA was therefore urged to contribute their dollar earnings to the central reserves to be used in the short term to cover the UK's deficit. In the longer term, the RSA would hold sterling balances against future deficits and import more of her manufactured needs from the UK. The key to this solution was the continuation of dollar import restrictions so that the RSA's trade surplus should not be spent on RSA imports from the dollar area.

In January 1951, the British Treasury began to prepare a campaign to re-emphasize the need for dollar economy. The campaign was dubbed "The Darkening Picture" and was to be comprised of telegrams to sterling area finance ministers and

a presentation at the Commonwealth Liaison Committee in London⁴⁵. The telegram from the Chancellor of the Exchequer to the sterling finance ministers pointed out that the improvement in the area's dollar account had been due to the exceptional circumstances of rearmament but that this favourable situation would soon end⁴⁶. British dollar expenditure was expected to increase in 1951 due to supply shortages in the non-dollar area, coupled with the need to replace stocks and expected increases in international prices⁴⁷. These factors together, it was estimated, would cost the UK alone an extra \$490m in 1951⁴⁸. In addition, the UK would have to start payments on the 1946 American Loan. The Chancellor, therefore, correctly anticipated a dollar deficit by the end of 1951 and concluded by urging dollar economy and prudence⁴⁹.

Nine days later, R.W.B. Clarke was sent to appear at the Commonwealth Liaison Committee meeting of 24 January 1951, where he gave a speech specifically designed for the sterling

⁴⁵"Timetable for 'The Darkening Picture'", 5 January, 1951. PRO T236/3287.

⁴⁶Telegram Commonwealth Relations Office to Commonwealth Finance Ministers, 15 January, 1951. PRO T236/3287.

⁴⁷Ibid.

⁴⁸Ibid.

⁴⁹Ibid.

Commonwealth representatives "to make their flesh creep"⁵⁰. Clarke reviewed the Chancellor's pessimistic predictions for 1951 and went on to present estimates that a full 40% of the improvement in the sterling area's gold and dollar position had been due to the reduction in dollar imports by members and only one third was due to increased export earnings⁵¹. The rest was due to capital inflows and reduced payments to non-dollar countries⁵². The lesson from these figures was that dollar restrictions were vital to continue to strengthen reserves.

The estimate Clarke used for the dollar account in 1950 was an increase of dollar reserves of \$2,336m in 1950 over 1949⁵³. Of this figure, then, \$934m was attributed to reductions in dollar imports. A more recent publication puts the increase in gold and dollar reserves at £575m or \$1618m⁵⁴ and this figure will be used to assess Clarke's analysis. In 1950, sterling area imports from the dollar area fell by \$216m which was only 13% of the increase in reserves in 1950⁵⁵. Exports to the dollar area increased by \$994m or 61% of the

⁵⁰"Timetable for 'The Darkening Picture'", 5 January, 1951. PRO T236/3287.

⁵¹Minutes of CLC meeting 24 January, 1951. PRO T236/3287.

⁵²Ibid.

⁵³Ibid.

⁵⁴The Balance of Payments 1946-57, London, HMSO, 1959.

⁵⁵The Commonwealth and Sterling Area Statistical Abstract, no. 78, HMSO, London, 1958.

increase in the area's reserves⁵⁶. Both these calculations and Clarke's estimates allow that about 73% of the increase in reserves was due to improvements in the balance with the dollar area but the weight attributed to import restrictions is considerably different. Clarke's speech would have had very different lessons to tell if he could only attribute 13% of the dollar account improvement to reductions in dollar imports and not 40%. In any case, the urging by the Treasury to restrain dollar expenditure was to fall on deaf ears in the RSA during 1951 and the prospects for a triangular balance became even more remote.

The response to the Chancellor's telegram in January 1951 was less enthusiastic than in April 1950. The Indian Finance Minister, C.D. Deshmukh painted a bleak outlook for Indian dollar imports in 1951. In a telegram to the Commonwealth Relations Office he cited three changes in India's economy which threatened to increase dollar expenditure⁵⁷. Delivery dates from non-dollar countries (including the UK) had proved uncompetitive with dollar sources of supply in recent months. Delays in the delivery of dollar raw materials due to the imposition of export controls in the USA had artificially lowered the figures for dollar payments in 1950 that would have to be borne in 1951. The final development was the poor crop of 1950 which would inflate India's food imports from all

⁵⁶Ibid.

⁵⁷Telegram, 7 February, 1951. PRO T236/3166.

sources. In the event, India's imports from the USA almost doubled to \$416m in 1951⁵⁸.

The response from Finance Minister Jayawardena of Ceylon was scarcely more promising, allowing only that

as a member of the sterling area and of the Commonwealth, Ceylon is anxious to assist sterling area as a whole to maximum extent by contributing to dollar pool its share of dollar earnings with due regard however to Ceylon's own need for consumer and capital goods from dollar area as well as for foreign reserves to strengthen its currency⁵⁹

Ceylon had always been a dollar earner for the sterling area but the resolve to continue to support the area's dollar pool was weakening.

News from the UK High Commissioner in New Zealand was even less promising. On 12 February 1951, he reported that the New Zealand Treasury was up against strong opposition from other official departments in supporting dollar economy⁶⁰. The government had decided to accelerate the removal of quantitative restrictions as a result of pressure from older established manufacturers who felt they could withstand the competition and who wanted their younger competitors who relied on protection to be forced out of business to release

⁵⁸See Table III.G.

⁵⁹Telegram from UK High Commissioner in Ceylon to Commonwealth Relations Office, 12 February, 1951. PRO T236/3287.

⁶⁰Telegram from UK High Commissioner in New Zealand to Commonwealth Relations Office, 12 February, 1951. PRO T236/3287.

scarce labour⁶¹. The responsibilities of New Zealand as a member of the sterling area do not appear to have figured in the decision. The Chancellor of the Exchequer, R.A. Butler pencilled on the bottom of the telegram, "I don't like this at all"⁶². Here was a blatant example of the discipline of the trade system beginning to crumble.

On the same day, the New Zealand finance minister, Mr. Bowden proposed by telegram that a Commonwealth Ministerial meeting be called to discuss "the merit in the general adoption by sterling area countries of the greatest possible relaxation in the discriminatory application of controls against dollar imports under a carefully selected range of commodities"⁶³. At the same time, however, Bowden noted that an end to discrimination would require a joint decision by the sterling area and promised that New Zealand would not take unilateral measures to relax dollar discrimination⁶⁴. The UK High Commissioner in New Zealand had, of course, already informed the British that the New Zealand government intended just such unilateral action through licensing changes⁶⁵.

⁶¹Ibid.

⁶²Ibid.

⁶³Quoted in a minute by A.K. Potter, 15 December, 1951. PRO T236/3287.

⁶⁴Ibid.

⁶⁵Telegram from UK High Commissioner in New Zealand, 12 February, 1951. PRO T236/3287.

This telegram from the New Zealand finance minister put the UK in a very difficult position. Even before the preparation of 'The Darkening Picture' campaign encouraging restraint in dollar expenditure by the RSA, the Programmes Committee in the UK had recommended more liberal treatment of British imports of machinery from the dollar area which would cost an extra \$20m p.a. as well as OGL's on some minor dollar materials⁶⁶. The RSA had not been informed of this decision and to reveal it at the same time as the 'Darkening Picture' campaign would have been embarrassing. The UK was preparing to allow raw material and machinery imports from the dollar area to help domestic industry while urging the RSA in effect to delay their industrialisation by restricting such dollar imports and helping the UK to support its deficit. A.C. Sparks of the Treasury therefore advised that a Commonwealth ministers meeting should be avoided to prevent too deep an analysis of British policy⁶⁷. Instead, the RSA should be urged to lessen discrimination only where the dollar cost would not be high⁶⁸.

The sterling area import controls also under attack from the IMF and the GATT at the end of 1950. In response to the 1949 programme, which comprised an intensification of

⁶⁶Minute by A.K. Potter 15 February, 1951. PRO T236/3287.

⁶⁷Note on "New Zealand Import Control" by A.C. Sparks, 17 February, 1951. PRO T236/3287.

⁶⁸Ibid.

discrimination, the GATT requested consultations with several members⁶⁹ of the sterling area under Article XII of the Agreement and also requested 'advice' from the staff of the IMF under Article XV. These consultations took place at the Fifth Session of the GATT at Torquay in November 1950.

The views of the IMF were influenced by the improvement in the balances of payments of several members since the import restrictions had been imposed. Accordingly, their advice to the GATT was that the restrictions on dollar imports could not be immediately relaxed by India and Pakistan but that Australia, Ceylon, New Zealand, Southern Rhodesia and the UK should begin to relax their restrictions, although this should be done "with due caution"⁷⁰. This analysis undermined the basic principle of the sterling area which was that the policies of the members should be in the interests of the area as a whole and not strictly in response to individual circumstances. The IMF recommendations received support from the 'hard currency' countries such as the USA, Canada, Belgium and Cuba⁷¹ but were disputed by sterling area representatives from Australia, the UK and New Zealand especially. The sterling countries argued that the balances of payments of the

⁶⁹The members were Australia, Ceylon, India, New Zealand, Pakistan, Southern Rhodesia and the UK.

⁷⁰J.K. Horsefield, ed., The International Monetary Fund 1945-1965; Twenty Years of International Monetary Cooperation, Vol. 2, Analysis. p. 230.

⁷¹Ibid., p. 340.

individual members could not be the basis of recommendations on quantitative restrictions because of the importance of the regional association and the sharing of central reserves and that the restrictions could be justified on the grounds that they strengthened the central reserves and "thereby helped to create conditions under which sterling could be made convertible and discrimination eventually eliminated"⁷². It was also argued that the balance of payments of the members would deteriorate through 1951, especially given rearmament commitments⁷³. In the end neither the IMF nor the GATT had the authority to impose changes in sterling area policy but, as noted above, the restrictions on dollar imports were gradually relaxed in response to RSA surpluses. In the second half of 1951, the gold and dollar reserves began to fall, slipping \$600m in the third quarter of 1951 and a further \$900m to December⁷⁴. Sterling area sterling balances were run down by \$865m or 10% in the second half of 1951 as export earnings fell against import expenditure⁷⁵. Finally, in November the UK was forced to retreat on its position on European liberalisation and a wide range of imports were

⁷²Ibid.

⁷³Secretariat of the Interim Commission for the International Trade Organisation, GATT in Action; Third Report on the Operation of the General Agreement of Tariffs and Trade, January 1952. p. 15.

⁷⁴International Financial Statistics, Vol. IV and Vol. VI, I.M.F.

⁷⁵Ibid.

removed from OGL. An emergency meeting of Commonwealth Finance Ministers was called for January 1952. At this point it will be useful to have a brief digression on the sterling area and British European trade policy.

III.D. The Sterling Area and European Liberalization

At the same time as the UK was exerting pressure on dollar imports, the British government was considering relaxing import controls against OEEC countries. On 4 July 1949, two weeks before the announcement of the 25% cut in dollar imports, British pressure on the OEEC was successful and the OEEC passed a resolution requiring its members to progressively and reciprocally free their trade restrictions against each other. On 2 November, a further resolution was passed calling for the freeing of one half of OEEC trade. This process of liberalisation continued until by November 1951, 90% of Britain's 1948 private trade with the OEEC had been freed of restrictions.

This period of European trade liberalisation from 1949-51 gives an interesting insight into the impact of the RSA on British trade relations with Europe as well as the place of the RSA in the delicate balance of trade relations with the USA on the one hand and Europe on the other. The liberalisations of 1950-51 brought the conflict between sterling area policy with respect to dollar goods and British policy with respect to European goods into the open. Most

sterling area countries did not officially discriminate between European and UK imports so their trade policy had always been strictly discriminatory against the dollar. The UK, in contrast, had undertaken to avoid discrimination both as a member of GATT and as a requirement of the American Loan Agreement of 1946.

It was originally hoped by the British that the RSA would deprive themselves of dollar imports but not be privy to European liberalisation. At the end of October 1949, the British Colonies were advised not to make trade concessions to Europe⁷⁶. The explanation from the Board of Trade was that "as... the Area participants have not followed our line of liberalising unilaterally, but are keeping their concessions in reserve as bargaining counters, we are going to advise the Colonies to make no relaxations for the time being"⁷⁷. This advice was directly contrary to agreed OEEC policy which asked participants to urge their dependent overseas territories to follow them in liberalisation with Europe⁷⁸. The British were anxious that no other members of the RSA should extend further trade concessions until the impact of the UK relaxations became more clear⁷⁹. Also, liberalisation by the

⁷⁶Telegram from J.A. Nasmyth, Board of Trade, to UK High Commissioner in Southern Rhodesia. 29 October, 1949. PRO T236/2552.

⁷⁷Ibid.

⁷⁸Ibid. Agreed by OEEC 13 August, 1949.

⁷⁹Telegram from Secretary of State for the Colonies to Colonial Governors, 14 December, 1949. PRO T236/2552.

Colonies or the ISA threatened the precarious balance of British policy with respect to the USA and Canada.

During Tripartite talks in Washington earlier in 1949, the British representatives had asked the Americans if the British commitment to non-discrimination in Section IX of the Anglo-American Financial Agreement would present an obstacle to UK relaxations of trade restrictions against Europe⁸⁰. The reply from the USA and Canada as expressed in the joint communique from the talks was that the discriminatory aspects of liberalizing European trade

should not be considered since the UK's shortage of dollars should not, in itself, force the UK to reduce its purchases from areas with which it does not have a shortage of means of payment⁸¹.

The American Congress raised no subsequent objections to this line "provided that there would be no appearance of discrimination against the United States of America for the sole or primary benefit of the sterling area commonwealth countries"⁸². The question of whether the Colonies or other sterling area countries could be included in the European trade liberalisation scheme without raising objections in the American Congress over Article IX was very uncertain. The Colonies were, therefore, advised at the end of 1949 that, as goods were imported fairly freely from Europe already and the

⁸⁰Telegram from Secretary of State for the Colonies to Governors of the Colonies, 14/12/49. PRO T236/2552.

⁸¹Ibid.

⁸²Ibid.

UK did not know if such liberalisation would necessitate a further approach to the Americans, no action on the part of the Colonies was desired⁸³.

Soon after this advice was sent to the Colonies, the British came under pressure from the independent sterling area to represent their interests in European liberalisation. At this time only Australia and New Zealand discriminated against Europe in favour of the UK but the entire RSA was concerned that bilateral liberalisation by OEEC members would involve discrimination against the RSA⁸⁴. At a meeting of Commonwealth representatives prior to the GATT meeting in Geneva at the beginning of 1950, the Australian and New Zealand representatives raised the issue of extending OEEC liberalisation to the RSA. They saw three ways in which they could pursue this goal. They could raise the issue at GATT, have the UK raise it in the OEEC or pursue bilateral agreements with individual OEEC countries⁸⁵. The British authorities were very reluctant to have the topic discussed in GATT as it would bring the UK into a public confrontation with the USA and Canada over sterling area dollar discrimination. In July 1949, the Board of Trade had noted that

⁸³ibid.

⁸⁴Commonwealth Economic Committee meeting 30 January, 1950. PRO T236/2552.

⁸⁵Board of Trade paper for the Cabinet European Economic Cooperation Committee 20 February, 1950. PRO T236/2552.

While so long as the US and UK Governments only are concerned it may be possible to pass over in silence our breaches of Section IX, the naked truth that we are going to discriminate...against the dollar area is bound to come out very nakedly indeed in any multilateral discussions⁸⁶.

A letter from the UK High Commissioner in Canada in February 1950, reported that the Canadians had "indicated to me in fact that the point at which liberalisation came to be extended by OEEC countries to the sterling area Commonwealth would be when they would start to be actively concerned from the point of view of the impact on their actual trade"⁸⁷.

The Board of Trade prepared a paper on the subject for submission to the Cabinet European Economic Cooperation Committee at the end of February 1950. The paper expressed the belief that European exports to the RSA were likely to be larger in the event of liberalisation than RSA exports to Europe and that therefore, "up to the present we have not been anxious to see the Sterling Area Commonwealth brought into the Western European liberalisation field"⁸⁸. The note went on to argue that increased imports from Europe by the RSA threatened their trade surplus, weakened the defense against cheap sterling since most violations occurred in trade with Europe, and focused attention on sterling area discrimination

⁸⁶Note by the Board of Trade 8 July, 1949. PRO T236/1868.

⁸⁷Letter from UK High Commissioner in Ottawa, 10 February, 1950. PRO T236/2552.

⁸⁸Board of Trade Note for the European Economic Cooperation Committee, 20 February, 1950. PRO T236/2552.

against dollar imports⁸⁹. Finally, the Board of Trade was still not fully confident of the effects of British liberalisation on the sterling area balance of payments and advised that ideally any move to liberalisation by the RSA should wait until the effects of the European Payments Union could be assessed. The paper warned, however, that the UK had no choice but to agree to liberalisation of OEEC imports by Australia and New Zealand given their threat to throw the issue open to GATT⁹⁰. The UK should therefore assist these countries in bilateral negotiations except with the harder currency countries of Belgium, Switzerland and West Germany⁹¹ to ensure that reciprocal concessions were obtained. The Commonwealth governments themselves, however, had to appear to be the primary actors in such negotiations to prevent it seeming that the UK was seeking the agreements in her own interest. Australia and New Zealand already licenced imports quite freely from the soft currency countries of Europe in any case, and were preparing to make this policy official through OGLs. Part of their motive in pressuring the UK to act in their interest was, therefore, to gain concessions for these relaxations. The Cabinet accepted the Board of Trade advice, noting that "as it would be impossible to prevent the Southern

⁸⁹Ibid.

⁹⁰Ibid.

⁹¹The UK herself had not extended liberalisation to these three countries.

Dominions from liberalising their imports from participants it would be best for the UK to cooperate with them from the outset"⁹².

Australia and New Zealand representatives did not at first accept this response from the UK, insisting instead that the UK should mention the wish of some RSA countries to join in liberalisation in an OEEC meeting⁹³. In the end, however, they were convinced to accept the UK offer and refrain from raising the issue of discrimination in either the OEEC or GATT⁹⁴. After this precedent setting case the UK had established two distinct spheres of trade policy, the dollar controls of the sterling area and the liberalisation of trade with Europe. The threat of American pressure, however, continued to cloud their position.

In early 1951 the UK was forced to consider relaxing its import restrictions because of pressure from the USA over the discriminatory effects of European liberalisation. At the end of April 1951, immediately after the Torquay round of tariff negotiations was completed, the US State Department asked the UK to stop action on their lists of goods for European liberalisation to allow discussions on broader liberalisation

⁹²Minutes of European Economic Cooperation Committee of the Cabinet, 21 February, 1950. PRO T236/2552.

⁹³Telegram Foreign Office to UK Delegation to OEEC, 23 February, 1950. PRO T236/2552.

⁹⁴Telegram from UK Delegation to GATT to Foreign Office, 10 March, 1950.

policy in the context of the rising trend of UK reserves⁹⁵. The State Department's case was that as UK reserves were rising the UK should begin to observe their promises in Section IX of the Anglo-American Financial Agreement and in GATT to eliminate trade discrimination⁹⁶. The UK was under an obligation to the OEEC to liberalise trade with Europe and the State Department wanted this liberalisation to be on a non-discriminatory basis with the USA⁹⁷. The response of the UK representatives in Washington was that the UK was

reluctant to make a new departure in policy at this stage, the more so because such a departure by the UK would set an example to other sterling countries who might be less able than the UK to control the results. The UK, which was faced with increasing debt to these countries, would probably be less able than in the past to exercise restraint on them⁹⁸.

Here then was some recognition of the weakening force of British exhortations to the RSA to restrain their dollar imports while their export earnings and sterling balances were rising. The other important aspect of this British response was the fear that UK relaxations would lead to sterling area relaxations. If the UK were to relax restrictions on dollar imports to feed domestic industry or to pacify the Americans,

⁹⁵Telegram from Washington to Foreign Office, 25 April, 1951. PRO BT241/235.

⁹⁶Telegram from Washington to Foreign Office, 26 April, 1951. PRO BT241/235.

⁹⁷Ibid.

⁹⁸Telegram from Foreign Office to Washington, 9 May, 1951. PRO BT241/235.

there was little chance that the RSA could be persuaded to continue to restrain their imports and contribute their dollar earnings to the central reserves to support the British deficit. The sterling area system was thus a justification for continued dollar discrimination by the UK.

The British also threatened the State Department that if the US pressed their point, the UK would have to suspend the European liberalisation program rather than end dollar discrimination. In this event the reasons for the change in UK policy would be made public and the USA would be blamed for restricting the development of multilateral European trade⁹⁹.

While the British waited for the American reaction, the Import Licencing Committee of the Board of Trade compiled a list of raw materials on which relaxations might be made, amounting to an increased expenditure of £13m or \$36m over the 1951 programme¹⁰⁰. As the reserves position deteriorated through 1951, however, Treasury officials rejected the ILC proposals, arguing that Ministers would reject the relaxations as "merely concessions to the USA" and because of the deteriorating trade position¹⁰¹. Instead, the Treasury suggested waiting until the UK's external position deteriorated as expected and the American case dissolved on

⁹⁹Ibid.

¹⁰⁰Note by Import Licencing Committee, 22 May, 1951. PRO BT241/235.

¹⁰¹Letter from Arthur Sparks to A. Burgess (BT), 31 May, 1951. PRO BT241/235.

its own¹⁰². The Treasury's predictions proved correct and when the sterling area balance of payments worsened in the second half of 1951 the American pressure was withdrawn.

The prospect of the UK or another member of the sterling area leading the collapse of sterling area dollar discipline, seen above as an excuse given to the USA for continued discrimination by the UK, was a recurring feature in British policy. In the case of car imports from the USA in 1951, for example, the genuine needs of the Colonies were almost sacrificed to the need for discipline in the system as a whole. In August 1951, Nigeria asked to be allowed to import 500 American cars which were particularly suited to the rough Colonial terrain, on the basis of essentiality. The request was denied by the Treasury on the basis of the weakening dollar position¹⁰³ and because if the imports were allowed, "the independent countries of the sterling area will certainly also take note of these relaxations and be all the more ready to follow the lead now given by New Zealand" ¹⁰⁴ who had announced that they would be importing £1.5m worth of American cars in 1951. Earlier, A.K. Potter had argued that "if we invite the Colonies to submit their requests for the import of American cars, this might have indescribable repercussions in

¹⁰²Ibid.

¹⁰³Letter from W.L. Atkinson to A.M. Jenkins, 16 August, 1951. PRO T236/3563.

¹⁰⁴Minute by W.L. Atkinson, 21 September, 1951. PRO T236/3563.

the independent Sterling Area Countries"¹⁰⁵. In the end the Colonial Office finally convinced the Treasury to overturn its decision, arguing that the restrictions on dollar imports imposed on the Colonies had gone far enough given their development needs and their consistent contribution to the dollar pool¹⁰⁶. The discipline of the sterling area was safer by this time since export earnings had collapsed for most of the RSA but the episode serves as an example of the perceived fragility of the commitment of the RSA to their responsibility to support the UK deficit through trade restrictions and the enforced inflexibility of the British position as a result.

III.E. Return to Restrictions 1952

In December 1951, the Treasury Working Party on the upcoming Commonwealth Finance Ministers Conference compiled a paper on "Objectives and General Policy"¹⁰⁷. There were four main objectives. First, to convince the members that the sterling area was good for them and that the UK was determined to earn a balance of payments surplus for the area after being in deficit over the past few years. The second was to get an

¹⁰⁵Note from A.K. Potter to H. Brittain, 2 August 1951. PRO T236/3563.

¹⁰⁶Letter from Poynton to H. Brittain, 2 October, 1951. PRO T236/3563.

¹⁰⁷Treasury Working Party on the Commonwealth Finance Ministers' Meeting, "Objectives and General Policy" PRO T236/3064.

undertaking from members that they would adopt internal and external measures to correct their economies and cease being drains on the dollar reserves. The third objective was to organise longer term plans for closer economic cooperation to strengthen sterling and the last objective was to agree on a strongly worded communique expressing the area's resolve to strengthen sterling. With regard to import controls, the Treasury Working Group argued that "the present situation is not conducive to the 1949 treatment by a uniform cut of imports from the dollar area" because the sterling area was in deficit with the non-dollar world as well¹⁰⁸. The RSA was to be persuaded to achieve or to increase their surpluses with the whole NSA by cutting imports from their trade creditors.

The survival of the sterling area was described by the Working Party as depending on a sustained surplus of the sterling area as a whole with the NSA to increase the reserves base¹⁰⁹. To achieve this the UK, the Colonies and the independent sterling area each had distinct roles to play. The UK was aiming at an overall surplus achieved through a surplus with the RSA and a balance "at best" with the NSA¹¹⁰. The Colonies were already in surplus with both the dollar area and the sterling area and this was to be continued through ceilings on dollar imports. The independent sterling area was

¹⁰⁸Ibid.

¹⁰⁹Ibid.

¹¹⁰Ibid.

to contribute a surplus with the NSA to offset their deficit with the UK. This pattern, of course, describes the triangular balance discussed at the beginning of this chapter. It was also argued that this pattern had been the goal of British policy-makers since the imposition of controls in July 1949. The Treasury Working Party concluded that

if the pattern of multilateral trade is to be preserved, this is the only means by which the whole sterling area can get its indispensable surplus with the outside world, for UK and Colonies cannot both have a surplus with the ISA and have a surplus with the rest of the world¹¹¹.

Here, then, is implicit acceptance that the UK was chronically unable to earn a surplus with the NSA and that this deficit would have to be borne by the RSA primarily through running larger deficits with the UK and by depriving themselves of NSA imports as the terms of trade moved against their exports.

The task of the RSA in this pattern was considerably more difficult than that assigned to the UK. With the end of the Korean War boom, international demand and prices for the primary goods produced by the RSA had fallen drastically and the prospect of increasing exports to the NSA was unlikely. At the same time, by restricting imports of manufactures and machinery, the RSA was restrained from developing new industrial products to export to the NSA. Indeed the longer term policy of the Treasury Working Party was remarkably shortsighted in recommending an emphasis on the development of

¹¹¹Ibid.

raw materials and food as targets of investment in the RSA rather than industrialisation or "social advance and the provision of amenities"¹¹².

The British task was merely to continue to generate a surplus with the RSA and avoid too deep a deficit with the NSA. The priority for British exports was to be RSA markets, both to allow the UK to achieve an overall surplus and also to supply the RSA with the goods which they would otherwise import from the NSA. In July 1949, this second motive for directing UK exports to the RSA was acknowledged by the Chancellor of the Exchequer who stated that "we cannot possibly bring the sterling area along with us unless we are able to supply them and temper the dollar cuts"¹¹³.

The basis of the triangular balance was the perceived comparative advantage of the RSA for producing raw materials and the UK for manufactures. Unfortunately this comfortable solution for the UK was not sustainable as the terms of trade turned against primary product producers and the RSA was unwilling to continue to suppress the demand of their consumers and industries for goods from the NSA.

There was some dispute among British authorities as to the correct line to take at the conference to achieve both a solution to the present crisis and an overall balance with the

¹¹²Ibid.

¹¹³Chancellor's Paper for the Economic Policy Committee Draft 7 July, 1949. PRO T236/1868.

rest of the world in the longer term. The Bank of England criticised those government officials "who seem to have no other kind of solution to present sterling area difficulties but a further round of intensification of controls and import restrictions"¹¹⁴ adding that "this policy has been tried consistently in the past with no great success and in our opinion is likely to have an unfortunate psychological effect on the independent members of the sterling area if put forward as the sole solution to deal with the present emergency"¹¹⁵. Instead, the Bank suggested putting emphasis on the need to take internal deflationary measures to bring the expenditure of individual members within their means.

The Economic Section, on the other hand, was more concerned with the immediate crisis. Robert Hall, director of the Section, wrote that

it does seem to me that the immediate task will be to convince the members of the Conference that the sterling area will break up from loss of reserves unless the current drain on the reserves is stopped; and that the only way to do this is by sharp reductions in expenditure on dollars and the currencies of OEEC countries¹¹⁶.

In the long term, Robert Hall agreed that internal measures were the root of the solution but he argued that if this approach were stressed the RSA would say that their internal

¹¹⁴Letter George Bolton to Herbert Brittain, 2 January, 1952. PRO T236/3070.

¹¹⁵Ibid.

¹¹⁶Letter R.L. Hall to Herbert Brittain, 2 January, 1952. PRO T236/3070.

economies were their own affair and/or that they were already doing all that they could in this area. In any case, due to time lags internal measures would not get the sterling area out of the immediate crisis¹¹⁷.

In the end, the agreed approach was to emphasise the need for internal measures to get the sterling area 'houses in order' but at the same time to declare the need for an immediate reduction in non-sterling expenditure. At the first preliminary meeting of officials, Herbert Brittain described the British vision of triangular balance and went on to discuss how this must be achieved¹¹⁸. The goal was for the sterling area as a whole to attain a balance with the rest of the world by the second half of 1952. In the context of the triangular balance, this required that the RSA earn surpluses with the NSA, including at least a balance with the dollar area. The Treasury estimated that at the current rate of spending, the sterling area deficit with the NSA would amount to £550m in the second half of 1952. This estimate was comprised of a deficit of the UK of £410m plus a deficit of the independent sterling area of £371m partly offset by a surplus in the Colonies of £25m¹¹⁹. To achieve at least a balance with the NSA various strict measures would have to be

¹¹⁷Ibid.

¹¹⁸Commonwealth Finance Ministers Conference, Preliminary Meeting of Officials, Minutes, 8 January, 1952. PRO T236/3067.

¹¹⁹Ibid.

taken by each sterling area member. Internal deflationary measures were vital because the sterling area as a whole was living beyond its means and inflation was rampant. Internal deflation could not be relied upon alone, however, due to the extreme urgency of the present situation and some immediate cuts in imports were necessary. Herbert Brittain reviewed the steps that Britain had taken in the past few months including, on the internal side, an excess profits tax and the tightening of credit through a rise in Bank Rate and stricter policy in the Capital Issues Committee against investment intended to increase production of goods for the domestic market. The UK had also, however, taken direct measures designed to cut imports by £130m, mostly from Europe.

The response of the RSA delegates to this call to action was mixed. Most countries had already taken steps to reduce domestic inflation, although the officials agreed in their report to their Ministers that further measures were needed¹²⁰. The imposition of import controls, however, was more controversial. Only Southern Rhodesia had followed the UK in imposing controls on the NSA as a whole rather than just on dollar imports. India and Pakistan felt they had already imposed the strictest controls on NSA imports that they could support. Australia and New Zealand had recently taken a mixture of internal and external policies designed to help

¹²⁰Commonwealth Finance Ministers Conference, Report of Officials, 12 January, 1952. PRO T236/3068.

their situation and Australia, in particular, was unwilling to commit itself to further measures until the effects of these policies had time to make themselves felt. Ceylon was already in surplus with the NSA and was more interested in the longer term viability of the sterling area than its immediate problems. The South African government was against direct controls but in any case met her own dollar needs out of gold production.

The report of the officials' meetings agreed to the need to bring the sterling area into balance with the NSA in the second half of 1952 and recommended that

for this purpose, it was agreed that all members should seek to improve their situations vis-a-vis the rest of the non-sterling world as a matter of urgency, by the imposition, where that was decided to be necessary, of emergency import restrictions on goods from these sources¹²¹.

The concluding statement of the Commonwealth Finance Ministers nine days later echoed the report of officials but stated more firmly that, although they were committed to balancing their accounts, "this cannot be attained by negative and restrictive methods alone, or merely by the imposition of cuts on imports from certain parts of the world"¹²². The methods for correcting the situation would be at the discretion of the individual governments and would vary according to individual circumstances but would follow three

¹²¹Ibid.

¹²²Statement of Commonwealth Finance Ministers, 21 January, 1952. PRO T236/3068.

general steps. The first was to ensure that the internal economy was sound and to combat inflation. The second was to increase exports and foreign earning power, for example by long term borrowing outside the sterling area. The third step was that "so far as other methods do not fully achieve the desired results, it will be necessary, as a temporary measure, to reduce imports"¹²³. Import controls were thus relegated to third place in sterling area policy.

What the public statement did not reveal was that in unofficial meetings, the Chancellor had given each member of the RSA a target to achieve in contributing to the sterling area balance. This involved the UK running a deficit with the NSA of £200m balanced by a surplus of the RSA with the NSA amounting to £200m¹²⁴. In March 1952, as the situation worsened, the targets were revised to allow the sterling area as a whole to achieve a surplus of £200m¹²⁵. Each member of the RSA was told that this would be made up of an RSA surplus of £300m and a UK deficit of £100m but the revised targets for the RSA add up to significantly more than this, leaving the British task somewhat easier if a surplus of £200m was the goal. These targets are presented in Table III.H.

¹²³Ibid.

¹²⁴Telegram CRO to UK High Commissioners in the Commonwealth for Commonwealth finance ministers, 4 March, 1952. PRO T236/3360.

¹²⁵Ibid.

Sterling area trade policy had, therefore, changed from

Table III.H.
Targets for Second Half of 1952
Balances at Annual Rate

	Balance with NSA	Balance with \$Area	Change over 1951
Australia	+£70m	-£25m	-65%
New Zealand	+£25m	-£8m	-50%
Pakistan	+£55m	-£10m	-35%
Ceylon	+£31m	+£5m	-60%
South Rhodesia	+£15m	+£16m	-
India	-	-£10m	-35%
South Africa	+£50m] +£53m?	-19%
Colonies	+£94m		-15%
Other RSA	+£40m		
	<hr/> +£380m	<hr/> -	
UK	-£180m		-19%
Sterling Area	<hr/> +£200m		

Source: Telegram, Chancellor of the Exchequer to Commonwealth Finance Ministers, 4 March, 1952. PRO T236/3360.

a uniform import cut for every member of the area to cuts in overall deficits with the NSA according to each member's earning potential. The public statement of the Finance Ministers did not commit them to import restrictions but the RSA was unlikely to achieve their targets by the second half of 1952 without them¹²⁶.

After the Conference, the Indian government accepted the target set for them and stopped import of dollar food grains

¹²⁶There would also, of course, be a delay expected from import restrictions. The Australian delegation believed that restrictions against dollar imports took eight to eleven months to take effect because of the long distance involved. Undated, unsigned note from Australian delegation to Chancellor of the Exchequer, January 1952. PRO T236/3360.

and raw cotton. Other restrictions were put on the import of goods with healthy domestic stocks or where non-sterling countries were the major sources of supply and after March, the collapse of Indian export prices slowed inflation¹²⁷. In March, Australia imposed widespread import restrictions against both sterling and non-sterling imports. In April, New Zealand introduced an exchange allocation scheme which allowed importers only 80% of their 1950 allocation of foreign exchange. This only affected imports from the sterling area and the OEEC which were free from license restriction. Dollar area imports and imports from Japan were already subject to license with their own foreign exchange allocations¹²⁸. Pakistan at first turned to internal measures, tightening credit and increasing the duty on cotton textiles in mid-1952 from 30% to 60%. This did not restrain her foreign exchange expenditure, however, and in August 1952 non-sterling OGLs were retracted for all imports except machinery, capital goods, drugs and other essentials. In November the remaining OGLs were removed and all imports were subject to specific licensing. Existing import controls were tightened in Ceylon, which was already in surplus and in South Rhodesia which had taken measures in late 1951 along with the UK to restrict imports from the entire NSA. Ireland also reduced imports

¹²⁷Commonwealth Finance Ministers Conference, Preliminary Meeting of Officials, 16 November, 1953. PRO T236/4000.

¹²⁸Ibid.

from the NSA from \$17m to \$7m and South Africa rearranged her complicated licensing procedure to be more strict. The Colonies were asked to keep their NSA imports at their 1951 level of \$192m.

As a result of these policies and the fall in international prices, the sterling area was able to achieve balance for the second half of 1952. The UK moved from an overall deficit of £171m on current and long term capital account to a surplus of £31m including a marginal trade surplus of £23m, recovering from a trade deficit of £230m in the first half of 1952¹²⁹. The RSA also moved into a slight current account surplus with the NSA from a deficit in the first half of the year of some £160m. This was due mostly to a drop in NSA imports by 25% (35% drop in imports from the dollar area). The drain on the central reserves of £232m in the first half of 1952 was halted and reserves increased £57m in the second half of the year. The turnaround from the first to the second half of 1952, then, was dramatic indeed.

W.M. Corden calculated the effect of the British restrictions of 1951/2 and noted that there were aspects of the British economy in 1952 which helped the controls seem to be effective, including the large stocks built up in 1951 which reduced the need for some imports in 1952 as well as a

¹²⁹UK Balance of Payments 1946-57, 1959.

recession in consumer demand¹³⁰. These observations are reinforced by the fact that UK imports from the RSA, which were not controlled, fell along with imports from the NSA which indicates a slackened demand for imports in the UK even in the absence of controls. Corden does not extend his analysis to 1953 when the NSA imports into the sterling area were squeezed further. The decline was greatest in 1952 for the UK but the RSA reduced NSA imports more in 1953 than 1952. This perhaps reflects the longer distance between the RSA and large NSA markets like the USA and Europe which would entail longer contracts and more goods in the 'pipeline', both of which delay the effects of import controls. Also, most RSA countries did not take action until the end of the first quarter of 1952 which would further delay the effects of their policy. There were, however, other reasons not directly connected to the controls imposed by the RSA which would reduce imports in 1952/3.

1951 was a year of stockbuilding, not only for the UK, but also for Australia, Ireland, New Zealand and South Africa which facilitated their ability to restrict their imports and might also have made imports less in 1952/53 than in 1950/51 even in the absence of direct controls. There were also important price changes during these years. The price index of sterling area imports fell in 1953 almost as much as the

¹³⁰W.M. Corden "The Control of Imports: A Case Study", Manchester School of Economic and Social Studies, Vol XXVI, No. 3, September 1958. pp. 181-225.

quantum index for sterling area imports, just as in 1950. In particular, the prices of manufactured goods finally fell in 1953 after rising in 1952. For 1953, therefore, price changes again account for a significant part of the decline in the value of NSA imports into the sterling area. Again, to some extent the reduction in the sterling area market may have depressed the prices of some NSA exports but it is more likely that the quantitative restrictions of 1952/53, like those of 1949, were favoured by exogenous changes in international prices.

III.F. End of Quantitative Restrictions

A Commonwealth Economic Conference was called for November 1952 to review the progress on the sterling area balance of payments situation and to introduce the Collective Approach programme as a path to sterling convertibility. At this conference, coordinated import controls were pushed further into the background of sterling area trade policy. The Preparatory Meeting of Officials completed a Report on the Short Term Balance of Payments Outlook in October 1952, which observed that the improvement in sterling area balance of payments had been due to reductions in imports rather than increases in exports¹³¹. Imports had been reduced due to the fall in international prices and export earnings as well as by

¹³¹Commonwealth Economic Conference, Preparatory Meeting of Officials, Report on the Short Term Balance of Payments Outlook, 11 October, 1952. PRO T236/3295.

drawing on existing stocks¹³². The report emphasized that this trend had been encouraged by the internal measures adopted by the RSA and that

the role of such policies in maintaining and improving the Sterling Area's Balance of Payments with the rest of the world is likely to be of crucial importance both in its effect on imports and in increasing competitive power and production for exports¹³³.

It was frequently noted that import controls were a short term measure whose effectiveness could not be relied upon for too much longer. In a brief for the Chancellor on the Balance of Payments outlook, Paul Vinter of the Treasury suggested that the Chancellor

should not as on some past occasions, suggest precise targets for imports or for the non-sterling balance, but rather that he should...lay the predominant stress on the need for substantial increases in exports from the Sterling Area at competitive prices¹³⁴.

The Treasury added in a later brief that specific balance of payments targets for members of the Area were not necessary since most members were individually in enough trouble to induce them to maintain strict control on their domestic economies¹³⁵. On the external side, import controls were not to be abandoned but rather kept as they were, except for

¹³²Ibid.

¹³³Ibid.

¹³⁴Brief for the Chancellor by P. Vinter, 14 November, 1952. PRO T236/3295.

¹³⁵Treasury Brief on the Short Term Balance of Payments Outlook, 19 November, 1952. PRO T236/3295.

relaxations by Australia in favour of British exports¹³⁶. In the longer run, in conjunction with the approach of convertibility, it was felt that discrimination should be gradually relaxed. The British approach was to concentrate the attention of the conference on anti-inflationary policy to reduce demand for imports and to release goods from domestic consumption for export.

There was, then, a distinct change of spirit in the British attitude toward sterling area trade policy. The priority given to restricting dollar imports had been relaxed at the January conference and the emphasis had begun to shift to general balance of payments considerations with special regard to the importance of trade policy, rather than trade policy in isolation. By December, the immediate crisis had passed and no emergency measures had to be urged on the RSA. The Conference was preoccupied with the longer term issues of convertibility and development and this made itself felt in discussion of trade policy. The emphasis was on longer term solutions such as the coordination of internal policy to effect a general decrease in demand pressure and an increase in exports to make the sterling area viable on an ongoing basis in preparation for the eventual freeing of trade and payments restrictions.

¹³⁶Ibid. Australia's import restrictions will be discussed below.

The final communique of the Conference accurately reflected these changes in the character of sterling area policy. Internal stability of members was described as the key to the external balance of the area as a whole, while it noted that "the level of the reserves is as yet too low to warrant any substantial relaxation of the restrictions on imports from outside the sterling area"¹³⁷. The triangular balance was to be achieved through more positive means, then, such as efforts to "expand the earning power of all sterling countries" while imports were held to a minimum¹³⁸. This was to take place partly by strict internal policies and partly by the more careful direction of development funds to "projects which directly or indirectly contribute to the improvement of the area's balance of payments with the rest of the world" by increasing their competitive power in world markets¹³⁹.

III.G. Relaxation of Discrimination: 1953-1955

A major obstacle to the triangular balance after 1952 was the failure of the UK to earn a trade surplus with the RSA. In October 1952, the British presentation to the Commonwealth Economic Conference Committee on the Short Term Balance of Payments Outlook had reminded the sterling area delegates that

¹³⁷Commonwealth Economic Conference, Final Communique, Cmd 8717, HMSO, December 1952.

¹³⁸Ibid.

¹³⁹Ibid.

"it is recognised as an essential part of the agreement [of January 1952] that the UK should remain in surplus with the overseas sterling area"¹⁴⁰. By the second half of 1952, however, the UK was already running a trade deficit with the RSA which was to continue until the second half of 1953. This reverse in the basic component of the triangular scheme was mostly accredited to import restrictions in the RSA and justifies a short discussion of Australian import policy in 1952.

III.G.i. Australian Trade Policy

On 8 March 1952, facing an accelerating drain on reserves and poor export prospects, the Australian government imposed severe quantitative restrictions on imports from all sources. Specific goods were divided into either Category 'A' imports or Category 'B' imports. Category 'A' included various raw materials and semi-manufactures which were limited to 60% of the value of similar imports in 1950-51. Category 'B' goods were mainly consumer goods, including most textiles and all clothing, and were to be cut to 20% of their 1950-51 value. It was estimated by the Board of Trade that the UK supplied 75% of the non-dollar category 'B' goods¹⁴¹. Some other items such as capital goods and other essentials would be

¹⁴⁰Committee on the Short Term Balance of Payments Outlook, Minutes, 2 October, 1952. PRO T236/3295.

¹⁴¹Note by Mr. Leckie, April 1952. PRO BT11/4958.

subject to administrative control and licensed individually. These arrangements covered all non-dollar, non-Japanese imports, including UK goods. Dollar imports were licensed separately.

Mr. Wilson, an Australian delegate at the Finance Ministers meeting in January 1952, had warned that Australia would have to cut sterling area imports to bring its balance of payments into order. R.W.B. Clarke of the Treasury had responded at the time that the UK did not advocate import cuts among sterling area members. Any reduction in imports from sterling sources should be the result of internal monetary policies, not direct controls¹⁴². This was a rather naive attitude since a full 62% of Australian imports came from the sterling area in 1951 and 45% from the UK alone¹⁴³. Australian imports from dollar sources were already restricted to essentials so a reduction in imports which excluded the sterling area would require an almost complete embargo on European goods to be at all effective and this might invite retaliation.

The Board of Trade tried to resist the practical necessity for Australian restrictions against UK exports but eventually had to concede¹⁴⁴. What the British found

¹⁴²Minutes of Preparatory Meeting of Officials, 9 January, 1952. PRO T236/3067.

¹⁴³OEEC, Direction of International Trade.

¹⁴⁴Brief for meeting with Australian Prime Minister, May 1952. PRO BT11/4958.

particularly offensive in the Australian policy was the lack of consideration for the balance of payments needs of the sterling area as a whole. A.L. Burgess objected that the Australian position was "in complete contradiction to the whole concept of the sterling area" because it acted on the principle that a member should restrict imports based only on their individual balance of payments rather than on the situation of the area as a whole¹⁴⁵. The January conference, however, had committed each member to balancing its own economy vis-a-vis the rest of the world as a contribution to the viability of the area as a whole and the Australians believed their new policy was part of this commitment¹⁴⁶. Australia found it could not continue to run such a large trade deficit with the UK even though the British surplus was integral to the triangular balance which the British sought for the sterling area. In 1951, the UK had a trade surplus of £300m with Australia and a surplus with the whole sterling area of only £30m. Britain's surplus with the RSA was, therefore, very dependent on access to the Australian market.

Despite all the attention focussed on Australian restrictions in 1953-54, other sterling area countries were also restricting their imports of British goods as part of their balance of payments programme. New Zealand's exchange

¹⁴⁵Report by A.L. Burgess, 4 June, 1952. PRO BR11/4958.

¹⁴⁶Press Statement by R.G.Menzies, 15 March, 1952, in J.G. Crawford, Australian Trade Policy 1942-1966: A Documentary History. Australian National University Press, Canberra, 1968. p. 511-513.

allocation scheme covered imports from the UK and the RSA from March 1952, until it was abolished in September 1954. New Zealand was an important market for automobile exports and for textiles, both of which were especially strictly controlled in 1952-53¹⁴⁷. New Zealand imports from the UK were almost halved in the first quarter of 1953 over the same period a year earlier¹⁴⁸. The Pakistan import controls of 1953 were also directed against UK imports. As in the Australian and New Zealand cases, imports from the dollar area were treated more strictly but the controls on all but industrial capital goods along with trade pacts with Japan pushed UK imports from 21% of total in 1951 to 16% in 1953¹⁴⁹.

These other examples of the 1952-3 trade controls affecting sterling area trade obviously did not generate the excitement of the Australian controls of March 1952 because the British interest in these markets was not as great. From the end of 1951 to the end of 1953, before temporary relaxations of the restrictions began to have effect, Australian imports from the UK fell by £334m or 35% while her exports to the UK rose by £158m¹⁵⁰. By the end of 1953 Australia had a trade surplus with the UK of £153m compared

¹⁴⁷Economic Review of New Zealand, Economist Intelligence Unit, May 1953. p. 11.

¹⁴⁸Ibid.

¹⁴⁹Direction of International Trade, OEEC.

¹⁵⁰Ibid.

with a deficit in 1951 of £339m. This change in the fortunes of UK trade with Australia, her largest trading partner, necessarily had a great impact on Britain's ability to earn an adequate surplus with the RSA on which the triangular balance depended, and in 1953 the UK actually ran a trade deficit with the RSA.

III.G.ii. Reduction in Trade Barriers

The conclusion of the December 1952 Conference had signalled a change in policy from restricting imports to emphasis on expanding exports. Quantitative discriminatory restrictions on imports were less palatable among the sterling area's trading partners in Europe and North America as the sterling area recovered from the 1951-52 crisis and reserves began to increase. It was also in keeping with the general movement in European relations that the British trade barriers which had been restored in the wake of the crisis should be removed once the crisis had passed and Britain's balance in the EPU improved.

The years after 1952 were also influenced by increasing reliance in Britain on the indirect effects of monetary policy on the balance of payments in general. The nature of export policy, dealing as it does with indirect incentives and controls on domestic investment and consumption rather than the direct controls associated with import policy, made it more difficult for the UK to strictly coordinate sterling area

policies. As a result, British policy grew more focussed on stimulating her own exports to the NSA to help her balance of trade and the vision of the trade pattern of the sterling area as a whole as a possible solution to Britain's chronic trade deficit with the NSA faded. One final influence in British sterling area trade policy after 1953 was the fact that the urging from the UK to impose direct import controls in 1952 had resulted in the RSA imposing controls on imports from the UK as well as the rest of the world. This route no doubt seemed a self-defeating one for the UK after 1953. In sterling area discussions the issues of development and convertibility gained precedence.

British trade policy was to relax imports of raw materials and foodstuffs and then machinery to allow British industry to become more competitive before relaxing controls on consumer goods¹⁵¹. Import relaxations moved gradually at the end of 1952 and accelerated through 1953 and 1954. In 1953, over 35% of imports from the dollar area were coming unrestricted into the UK compared to only 3.3% in 1952¹⁵². By November 1953, the UK had freed 75% of its trade with the

¹⁵¹Working Party on the Effects of Ending Dollar Discrimination, Paper by J. Leckie, 30 June, 1955. PRO BT230/380.

¹⁵²M.F.W. Hemming, G. Miles and Ray, "A Statistical Summary of the Extent of Import Control in the United Kingdom since the War", Review of Economic Studies, Vol XXVI No. 70, Feb. 1959. p. 103. Based on trade controls existing on 30 June in each year.

OEEC, compared with only 46% in April 1952¹⁵³. This European liberalisation helped the sterling area to weather the American recession of 1954.

London markets for various commodities were also reopened to trade in commodities from all sources¹⁵⁴. The London market for lead was reopened in November 1952, zinc in January 1953, grain and animal feed in June 1953, copper in August 1953 and raw cotton later in 1954. Only the markets for wool futures and grain were forced to deal on a dollar for dollar basis, to restrain traders from using the market to convert sterling to dollars. This affected the usefulness of these markets, especially the grain market where most supplies were mostly from the dollar area.

These relaxations in British import restrictions were in large part designed to stimulate production for export by giving industry access to cheaper raw materials. The commodity markets also contributed to the current account through invisible merchanting earnings and were seen as a step toward the rehabilitation of London as a major trading centre. The sterling area was not ignored in the decisions to relax imports of specific items. The projected foreign exchange cost to Britain was carefully calculated to include any

¹⁵³P.B. Kenen, British Monetary Policy and the Balance of Payments 1951-1957, Harvard University Press, Cambridge Mass., 1960. p. 94.

¹⁵⁴An attempt had been made to to this in August, 1952 but applications for dollar imports far exceeded the expected demand and the attempt was abandoned.

diversion of imports from RSA sources and the interests of RSA producers were sometimes also considered before action was taken. In the case of hardwood, for example, the UK made special allowance for dollars to be made available to Colonial producers to purchase capital goods which would allow them to become competitive with dollar suppliers once discrimination was ended¹⁵⁵. In 1955 and 1956 the UK concluded agreements with Australia and New Zealand guaranteeing purchases of their wheat and meat to protect them from NSA competition in the British market. In general, however, the trade relaxations of the UK in this period were made in the more immediate interests of the British economy.

It was in the field of development that Britain tried to exert influence over the pattern of sterling area trade. The Commonwealth Economic Conference of December 1952 had stipulated that sterling area development was to be directed at projects which would help the sterling area balance of payments and the finance ministers' meeting in January 1954 had reasserted the sterling area's determination to "take appropriate steps both individually and in concert with each other to sustain production and trade and the sound development of resources"¹⁵⁶. This allowed the Capital Issues Committee to ration scarce London capital to projects

¹⁵⁵Telegram from Secretary of State for the Colonies to Gold Coast, Nigeria, Malaya, North Borneo, Sarawak and Singapore High Commissioners, 25 November, 1954. PRO BT241/332.

¹⁵⁶Quoted in The Banker, Vol CII, No. 337, Feb. 1954. p. 67.

that were export generating or at least dollar saving in the interests of the sterling area balance of payments. In March 1953, for example, an application from the New Zealand government to float a £4.5m issue on the London market to finance construction of an Auckland Harbour bridge was turned down. A few months later, however, an issue of £10m was allowed for the Murupara pulp and paper scheme which promised to save some \$16m p.a. for the sterling area¹⁵⁷. The Economist Intelligence Unit described this turnaround as "clearly in keeping with the decision of the Commonwealth Prime Ministers last November to put the emphasis of development on projects designed to aid the balance of payments"¹⁵⁸.

III.G.iii. Reduction in Discrimination

A second new aspect of RSA trade policy after 1954 was the movement away from discrimination. The UK efforts in this regard through the liberalisation of dollar imports have been discussed above. The change in the policy of other sterling area countries away from discrimination between sterling and non-dollar sources has also been detailed above. The biggest change, however, came from South Africa and Pakistan as they abandoned dollar discrimination in 1954 and 1955 respectively.

¹⁵⁷Economic Review of New Zealand, Economist Intelligence Unit, London, January 1953. p. 9.

¹⁵⁸Ibid. May 1953. p. 7.

In May 1953, the South Africans informed Lord Swinton, Secretary of State for Commonwealth Relations, that they proposed to begin to dismantle import restrictions and end dollar discrimination as of the beginning of 1954 in the interest of ending distortions in the South African economy¹⁵⁹. South Africa was not a member of the dollar pool but since they met their dollar requirements out of gold sales, the ending of dollar discrimination meant that less gold would be offered to the UK on an annual basis. From 1948 to 1951 South Africa had sold an agreed minimum of gold to the UK to contribute to the central reserves, plus the excess after settling her own foreign exchange needs. In 1952, South Africa agreed to reimburse the UK for the South African deficit in the EPU. In 1953, South Africa had guaranteed £50m worth of gold for sale to the UK. This slice of South Africa's gold production was in part guaranteed by the South African policy of restricting 1953 dollar imports to their 1952 level while reducing the value of total imports to give the impression of reducing dollar discrimination without increasing dollar expenditure¹⁶⁰. South Africa was under considerable international political pressure over the apartheid system and was anxious at this time to avoid

¹⁵⁹Letter from Mr. Geyer, South African High Commissioner to Lord Swinton, Secretary of State for Commonwealth Reslations, 4 May 1953. PRO BT11/4950.

¹⁶⁰Treasury Paper on South Africa, 21 May, 1953. PRO BT11/4950.

attracting American displeasure in the IMF or GATT over trade discrimination.

The British authorities were understandably concerned for the fate of British exports to South Africa and were also determined to maintain some entitlement to part of South Africa's annual gold production. The Treasury therefore outlined three objectives for negotiations with the South Africans. The first was to secure as much gold as possible for 1954, and secondly to make sure that South Africa's plans were consistent with her relationship with the sterling area and would not have serious repercussions on other sterling area governments' policies regarding dollar discrimination. The third object was to get the South Africans to remove existing restrictions on traditional UK exports to South Africa¹⁶¹. The methods to achieve these objectives were either to "get tough" and threaten to expel South Africa from the sterling area, depriving her of free access to the UK financial markets and excluding her exports from the UK market, or to "rely on persuasion"¹⁶². The Treasury believed that the first option was too fierce since relations had so far been cordial and such an attitude would invite retaliation which would put at risk the UK's interest in South African gold mining and threaten her position in the South African market. Relying on persuasion, then, the UK was able to

¹⁶¹Ibid.

¹⁶²Ibid.

secure the annual £50m sale of gold for the central reserves. On the repercussions for other RSA governments, the Treasury wrote that

the present South African proposals can be regarded as generally in line with ultimate sterling area policy of removing restrictions and freeing world trade, but the sterling area is not yet in a position to dispense with discrimination against dollar imports¹⁶³.

The British stressed the need for sterling area discipline in negotiations with the South Africans in June 1953 but they were not impressed¹⁶⁴. Nevertheless, the threat to sterling area discipline was not considered to be too overwhelming since South Africa had traditionally had a special status in the system as a gold producer and was not part of the dollar pool which was the rationale for coordinated discrimination. Nor indeed was it in the interest of most other RSA countries to relax dollar discrimination given their own external imbalances¹⁶⁵. On the relaxation of restrictions on UK exports, South Africa gave an undertaking to give consideration to priority relaxation on items in which the UK had a special interest¹⁶⁶. Finally, on 19 October 1953, P.R. Botha announced in GATT that South Africa would be ending

¹⁶³Ibid.

¹⁶⁴Draft report for Herbert Brittain by M.T. Flett, 9 June 1953. PRO BT230/244

¹⁶⁵Ibid.

¹⁶⁶Letter from C. Kemp UK Trade Commissioner in Cape Town to R.C. Bryant, Board of Trade, 26 January, 1955. PRO BT241/161.

discrimination as of January 1954, and was congratulated by the Canadian and American representatives¹⁶⁷. The effect on South African dollar imports, however, was not very damaging to the sterling area. As a percentage of total imports, those from the USA and Canada grew only from 23% to 25% from 1953 to 1956 and declined thereafter¹⁶⁸.

At the beginning of 1955 Pakistan also ended discrimination against dollar imports. At the end of August 1954, facing political and economic crisis, the Government of Pakistan approached the USA for substantial aid. In October, \$75m was granted to allow imports of capital goods, agricultural commodities and a wide range of scarce essentials from the USA. In June 1954, Pakistan had embraced the general sterling area export drive, introducing an Export Incentive Scheme which increased import licenses to industrial importers for raw materials and machinery for use in producing goods for export. As of January 1955, with American dollars in the offing, these import licences were declared valid for imports from all countries. The licences covered basic raw materials, spare parts and capital goods for the industrial sector and more limited imports for established and registered commercial importers. At the end of January a list of twenty-two items was published to be imported specifically against aid from the

¹⁶⁷Minutes of GATT 8th Session 21 October, 1953, Summary record of the 17th meeting, 19 October, 1953. PRO BT11/4950.

¹⁶⁸OEEC, Direction of International Trade.

USA. These were mainly raw materials and semi-manufactures for industry. Between the end of 1953 and the end of 1955, Pakistan imports from the USA and Canada grew from 5% of total imports to 12% but much of this increase was funded by American aid and not the central reserves.

Other sterling area countries also relaxed their restrictions on dollar imports in less spectacular fashion. India relaxed dollar import licencing and increased quotas gradually through 1954-5 to allow greater imports of cheaper machinery and raw materials from the dollar area to help Indian industrialisation. By 1956, however, the adverse trade balance could no longer be ignored and consumer goods imports were cut in April and more wide ranging import controls were introduced in July 1957.

The movement to non-discrimination was motivated by politics as much as economics. Australia and South Africa were concerned to disentangle restrictions on their domestic industry but were also preoccupied with the strength of their political stance in GATT and IMF and their popularity with the USA. Pakistan was influenced by her position as a recipient of American aid which made it politically difficult to continue to discriminate against American exports as well as less necessary. The Indian relaxations, however, had resulted from the desperate need for imports from the cheapest market for their development effort.

The liberalisation by the UK was motivated by the need to increase the competitiveness of British industry as well as the recognition that freer trade was a desirable and necessary companion to the steps toward convertibility which were taking place through 1954 and 1955. By this time, the publicity surrounding the international talks on the Collective Approach to convertibility and tangible steps toward convertibility taken in March 1954 had virtually committed Britain to gradual trade liberalisation and continued progress to convertibility. Opinion in both the Treasury and the Bank of England was convinced that this route was the only feasible approach to long term stability of sterling¹⁶⁹.

The principle of discrimination was, thus, gradually disappearing from sterling area trade policy. Imports from the NSA to the independent RSA increased from 48% of total imports in 1953 to 53% by 1955 but despite liberalisation, imports from the dollar area alone fell from 19% in 1953 to 17% by 1955¹⁷⁰. Because the erosion of discrimination coincided with an American recession and a subsequent drop in exports from the USA, the liberalisation of dollar imports for South Africa and Pakistan and the more liberal licensing of dollar imports in other sterling area countries had little

¹⁶⁹See Chapter VI.

¹⁷⁰Balance of Payments Yearbook, IMF.

immediate impact on the geographical composition of RSA trade.

III.H. Abandonment of a Sterling Area Trade Policy: 1955-58

After the boom years of 1953 and 1954, the sterling area was rocked by a series of crises of varying intensity and cause through 1955, 1956 and 1957. At the Commonwealth Finance Ministers' Meeting at Istanbul in September 1955 the Chancellor of the Exchequer explicitly informed the RSA that although the sterling area's balance of payments had run into deficit, the UK did not intend to revert to import controls rather than credit restriction and other internal measures and recommended similar internal solutions to his RSA colleagues¹⁷¹. This was the first real test of the sterling area's commitment to indirect measures of trade policy. The response of the RSA was less enthusiastic than the Chancellor may have wished. The Australian finance minister reported that the wool crop was expected to be poor in the coming season which would restrain the inflationary boom that Australia was experiencing, but he added that internal measures were not going to be sufficient to correct the balance of payments¹⁷². Import restrictions had already been tightened in October 1954 and April 1955 but after the Istanbul conference there was a further tightening in category

¹⁷¹Minutes of first meeting of Commonwealth Finance Ministers, 16 September, 1955. PRO DO35/5633.

¹⁷²Minutes of Commonwealth Finance Ministers' Meeting, 16 September, 1955. PRO DO/5633.

'B' goods designed to reduce imports by a further £80m p.a.. The South African representatives reported that their balance of payments was in a satisfactory situation due to strict import controls but that they would not hesitate to cut imports further if the need arose¹⁷³. New Zealand representatives reported that they were coping so far with balance of payments problems through credit controls but that direct import controls would have to be considered soon¹⁷⁴. New Zealand had adopted a policy of moving away from quantitative restrictions and replacing them with tariffs for protective purposes. This was continued after Istanbul, except in the case of woollen textile imports which were cut to 50% of their 1954 value in 1956, affecting both UK and NSA trade. India's imports were already very strictly controlled as part of her Five Year Plan but good crops had lessened her balance of payments problems. The Second Five Year Plan, however, was due to start which emphasised heavy industry and would require greater capital goods imports¹⁷⁵. The RSA, then, appear to have kept their faith in direct import controls as a short term palliative to their balance of payments problems and in some cases (e.g. Australia) as an alternative to strict internal measures.

¹⁷³Ibid.

¹⁷⁴Ibid.

¹⁷⁵Ibid.

Ceylon and New Zealand had embraced the British zeal for internal restraint most strongly. Ceylon had introduced an 'austerity budget' at the end of July 1953 which provoked riots over its fiscal strictness. The government held firm, however, and taxes and import duties were increased and food subsidies were cut until the balance of payments began to recover in May 1954¹⁷⁶. In New Zealand credit control was exercised with "dedicated ferocity" by even British standards¹⁷⁷. Restraint was exercised by the establishment of a central capital issues control administration and by repeated increases in the reserve ratio of trading banks and restriction of import credits. Bank rate was also raised from 1 1/2% in July 1954 to 7% in October 1955¹⁷⁸.

Other countries did not follow internal restraint to such lengths. Pakistan was continually on the brink of revolution and famine through the middle 1950s so internal economic management took second place to emergency measures. Australia relied heavily on import restraint to correct her balance of payments. The Indian economy was strictly controlled but expansionary due to the government's commitment to industrialisation through successive 5-year plans. In

¹⁷⁶Economic Review of Ceylon, Economist Intelligence Unit, London, May 1954.

¹⁷⁷Economic Review of New Zealand, Economist Intelligence Unit, October, 1955. p. 2.

¹⁷⁸Bank Rate changes had little effect on other interest rates due to the structure of the New Zealand financial market. Ibid.

February 1956, the South African government imposed direct controls on capital flows from South Africa to the UK instead of squeezing domestic credit by raising South African interest rates in response to increases in the UK Bank Rate¹⁷⁹.

In the event, the payments problems of 1954/55 were not solved through direct trade policy. Both the UK and the RSA continued to run deficits with the NSA from 1955-58, due primarily to increases in imports. RSA imports from the NSA rose by £780m or more than 50% between 1954 and 1958, which was the same value as the cumulative trade deficit over these four years. To some extent the sterling crisis of 1955 was due to speculative movements which, though not of course unrelated to the sterling area's trade position, were partly solveable in the short term through psychological rather than economic means. The relevant measures in 1955 were the Chancellor's steady denials that the exchange rate of sterling would be reduced from its \$2.80 parity, first in the House of Commons in July and then at Istanbul in September. The years 1955 and 1956 were testing years also for British monetary policy with Bank Rate raised twice to 4 1/2% in 1955 and then to 5 1/2% in 1956 while at the same time a wide range of domestic credit restrictions were activated. These measures, however, were not completely successful and although the British balance of trade improved significantly after January

¹⁷⁹Economic Review of South Africa, Economist Intelligence Unit, March 1956, p. 3.

1956, the central reserves did not recover their 1953/54 level before the Suez crisis disrupted sterling area payments once again.

What seems evident from the point of view of sterling area trade is that the adverse balance of 1955 was due much more to British deficits than to drains in the RSA. The RSA supplied almost half of the sterling area's exports to the NSA and was responsible for only 16% of the sterling area's deficit with the NSA (see Table III.A.). On overall balance of payments both the Colonies and the ISA had slight surpluses with the NSA over 1955 while the UK was in deficit by £300m on current and long term capital account, excluding aid¹⁸⁰. The run down in reserves of £230m, £200m in the second half of 1955 alone, can largely be attributed to the poor British trade performance from mid 1954 to the end of 1955, as well as to speculative pressures related to doubts about the sterling exchange rate.

By the time of the 1956 crisis, the heart seems to have gone out of sterling area trade policy coordination, both in Britain and in the RSA. India, Ceylon and Pakistan were increasingly being courted by West Germany, Eastern European countries and Japan as trading partners to replace the UK. India made trade agreements with Roumania and China in the Spring of 1954 and with East Germany in December and received

¹⁸⁰IMF Balance of Payments Yearbook, IMF. The RSA surplus includes gold sales, which represent revenue not evenly distributed in the RSA.

substantial technical and financial aid from the USSR in 1955/56. Ceylon had concluded trade agreements with China in 1953 and 1954 and concluded trade pacts with Poland and Czechoslovakia in early 1956. In March 1953, Pakistan concluded its first trade agreement with Japan for cotton and through 1954 sought bilateral agreements with Western and Eastern Europe to secure a market for her exports and agreements to allow deferred payment for her imports which the UK was unwilling to do. West Germany, in particular, increased its share of Pakistan's trade, creating a market for German capital exports by developing industry in Pakistan and buying an increasing share of Pakistan goods to supply her with foreign exchange. Australia was increasingly orienting her economic relations to the USA and the IMF as potential sources of capital which was not available in the UK and then to earn the foreign exchange to repay dollar loans. Up to 1957, Australia received \$317m from IBRD to purchase dollar imports. Australian relations with the UK in 1956 were almost completely monopolised by negotiations to revise the Imperial Preferences between the two countries in Australia's favour. This was accomplished at the end of the year.

British policy after 1955 also moved further away from the preoccupation with the sterling area that had characterised the early 1950s. As noted above, trade between the sterling area and the rest of the world was gradually freed, making the area less of a discriminatory bloc. The move to de facto

external convertibility in February 1955 reinforced this trend. The resilience of European trade to the effects of the American recession may also have had an influence in the declining importance of the sterling area to British trade policy. The healthy trade of Western Europe in 1954 had perhaps banished the spectre of American economic instability and with it the need to maintain a protective trade cushion in the sterling area.

The payments crisis of 1956 was essentially restricted to a speculative run on sterling and a temporary interruption in British and RSA trade due to the closure of the Suez Canal so similarly temporary solutions were sought by the British authorities. The UK drew £200m from her IMF quota and standby funds of \$440m were arranged with the IMF and the American Export-Import Bank. This supported the reserves through to mid-1957 when a second speculative crisis rocked sterling due to rumours of imminent convertibility at a flexible rate and to the imbalance among European economies. The Chancellor, Peter Thorneycroft, used internal deflationary measures to re-establish confidence in British policy and sterling in September 1957. The trade figures in Table III.A. show that, unlike 1955, these two crises had little directly to do with the trade position of the UK or the RSA.

III.I. The Sterling Area and UK Export Competitiveness

It was widely believed in the 1950s that the RSA provided British traders with an easy market based on traditional trading relationships and RSA holdings of expendable sterling assets. In 1956, for example P. Harris of the Board of trade reported that this was the view of the Board of Trade, the Treasury and the Economic Section¹⁸¹. D.H. Robertson wrote in 1954 that British traders were able to "lie back on the featherbed of mutual trade" with the sterling area rather than moving into more competitive world markets such as America and Europe¹⁸². The triangular vision of sterling area trade implied that the UK could earn foreign exchange indirectly through exports to the RSA so direct competition in the NSA was not necessary. This scenario on its own would not have been damaging to British export interests except for the fact that the RSA's imports grew much more slowly than the world average. Between 1948 and 1958, the RSA's total imports increased by 38% from \$9803m to \$13,563m¹⁸³. Over the same period world imports grew by 71% which suggests that the RSA was, indeed, a relatively slow growing market for exports. North American imports grew by 84% over the same period but

¹⁸¹P. Harris, "UK Export Trends", 1 October, 1956. PRO BT241/266.

¹⁸²D.H. Robertson, Britain in the World Economy, George Allen and Unwin, London, 1954. p. 75. This sentiment was also expressed in the Board of Trade Journal, Vol 175, No. 3209, 8 August, 1958. p. 268-9.

¹⁸³The figures for this analysis are from the OEEC's Direction of International Trade series.

this was mostly due to large increases between 1948 and 1951. From 1951 to 1958 American imports grew only 23%. The Continental European market in contrast absorbed almost twice the value of imports in 1958 as in 1948 due to their industrial recovery after the war and the removal of trade restrictions. Figure III.D. shows the growth of imports for these three areas. RSA imports grew roughly in line with North American imports after 1951 although at a lower level.

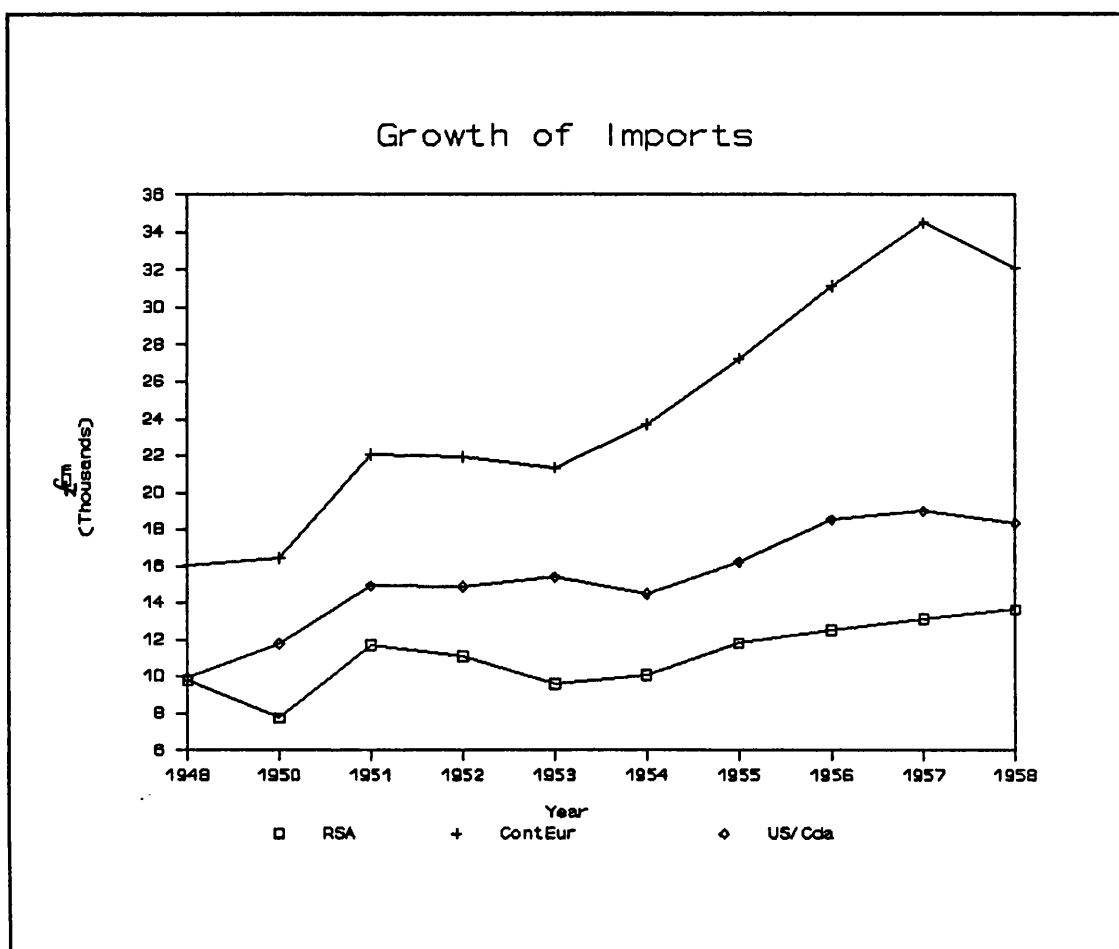


Figure III.D.

The trade figures for the 1950s show that, contrary to contemporary belief, British traders were quite successful in

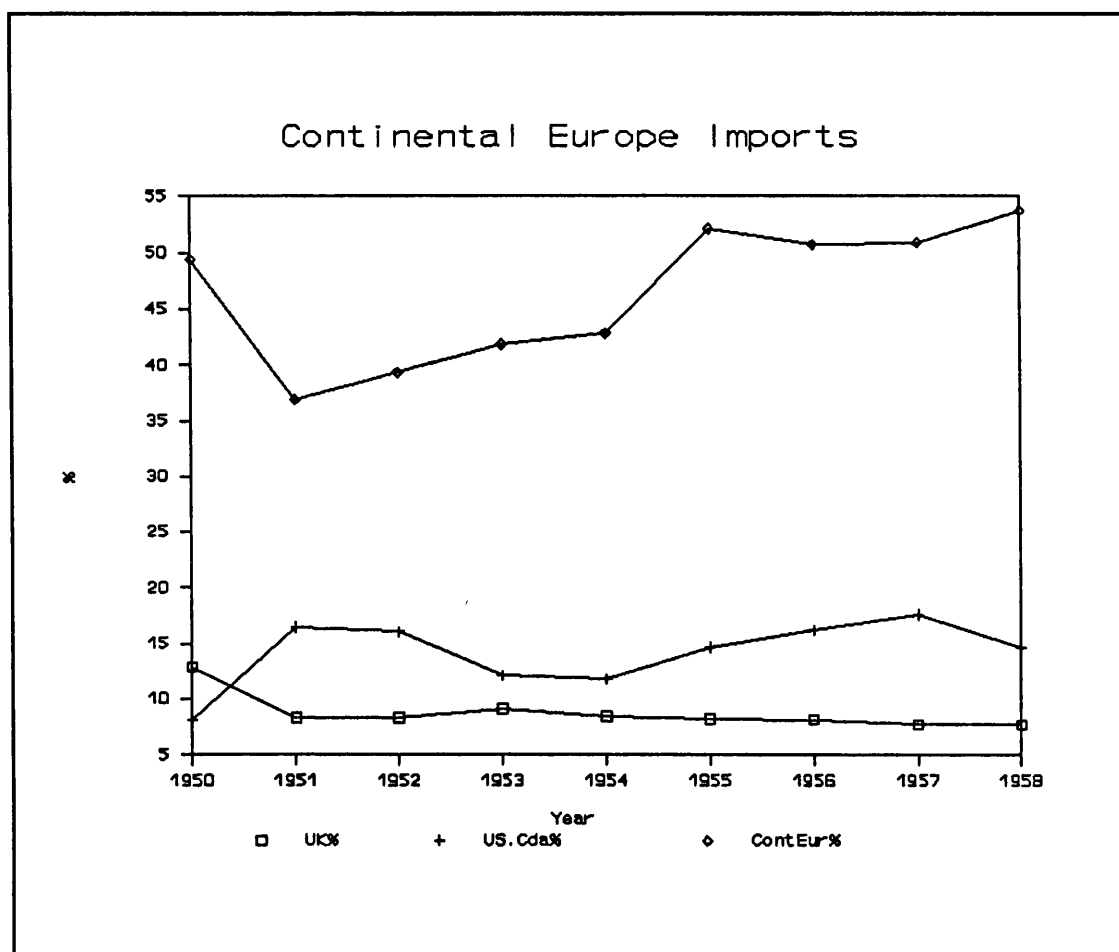


Figure III.E.

penetrating the competitive American market. British exports to the USA and Canada almost doubled between 1950 and 1958 and grew to 15% of total British exports¹⁸⁴. Britain's performance in the faster growing Continental European market, however, was less successful. British exports to Western Europe increased only by 46% and remained a fairly constant proportion of Britain's total exports (23-25%). Figure III.E. shows that Britain's share in the European market remained

¹⁸⁴Direction of International Trade, OEEC.

below 10% after 1951, declining after 1953 to 7.7% while intra-continental European trade expanded by 16% from 1951. The real issue of the 1950s in this context is why the British share of the European market fell during the 1950s. In the longer term this was the forerunner of a more damaging trend in Britain's export power.

The belief that this decline in market share for British exports was due primarily to undue concentration in the slowly growing RSA market has been abandoned by subsequent studies¹⁸⁵. In the Brookings Institution investigation of the British economy in the 1960s Lawrence B. Krause concluded that "while the large concentration in the slowly growing sterling area markets has been somewhat unfavourable, it has been offset by a desirable product concentration"¹⁸⁶. Thus, the benefits to British industry of having a large market for high growth manufacturing exports offset the effects of the slower overall growth in the RSA market. Krause's study concluded that Britain's slow economic growth and lack of price competitiveness were the primary causes of her falling world market share in the early 1960s¹⁸⁷. An earlier study

¹⁸⁵R.L Major, for example attributed only 9% of the decline in Britain's world market share during 1953-66 to the combined effects of commodity and area pattern changes. "Note of Britain's Share in World Trade in Manufactures, 1954-1966", National Institute Economic Review, No. 44, May 1968. pp 50-56.

¹⁸⁶Lawrence B. Krause, "British Trade Performance" in R.E. Caves ed. Britain's Economic Prospects, Brookings Institution, Washington, 1968. p. 215.

¹⁸⁷Ibid., p. 222.

of price competitiveness in industrial markets showed a marked decline in British export price competitiveness in the European market between 1953-63¹⁸⁸. Price and cost movements were, thus, probably responsible for much of the loss of Britain's market share in Europe in the 1950s and 1960s. The price elasticity of demand for exports would be less during the periods of quantitative trade controls in the early 1950s but the European market did not really recover until after the controls were relaxed¹⁸⁹.

While the relatively slow growth of the RSA market was not directly responsible for the loss of British competitive power it is still possible that the RSA provided a 'soft' market for British exports which allowed her traders to sell inferior goods with respect to price and quality and still maintain their market while their competitors were forced into the harsher climate of American and European markets which demanded cheaper goods of better quality. In this case the existence of the sterling area system allowed the British manufacturing sector to fall behind European competitors in productivity and competitiveness. The 'softness' of the RSA market, however, should not be exaggerated. Figure III.F. shows that Britain's share in the RSA market increased in the first half of the 1950s but that after 1954 British exporters

¹⁸⁸R.L.Major, "Note on Britain's Share".

¹⁸⁹Between 1951 and 1953 total European imports fell by \$700m and then increased by \$11b between 1953 and 1958. Direction of International Trade, OEEC.

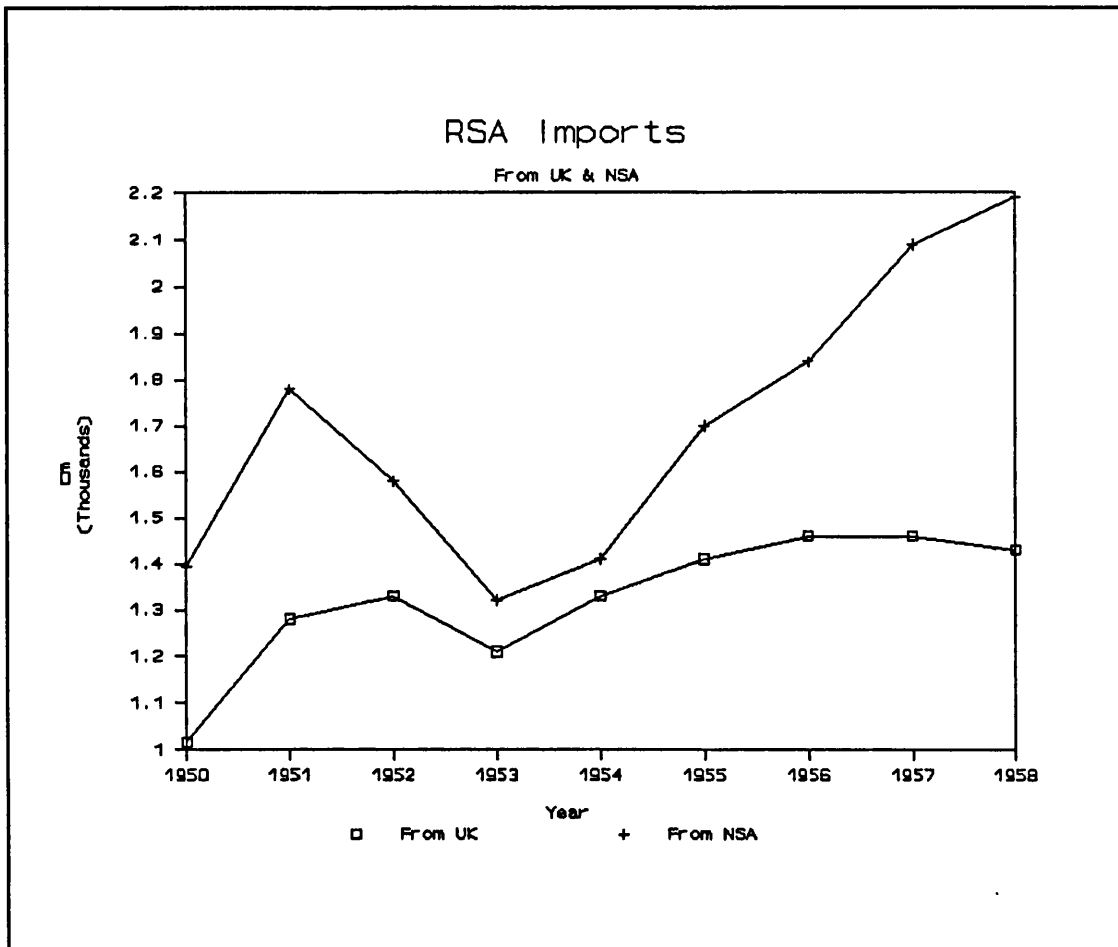


Figure III.F.

competed less successfully with foreign traders. This coincides with the relaxation in discrimination in RSA import controls and the acceleration of British exports to the USA and Canada.

British goods were also uncompetitive with respect to delivery dates, especially to the far off markets of Australia and New Zealand. Thus, in 1952, the Economist Intelligence Unit warned that "delivery dates are of vital significance and America, Germany and Japan can often deliver more quickly and

at competitive prices"¹⁹⁰. Quality and service were other aspects of weak competitive power of British exports as is evident in the following quotations from Economist Intelligence Unit research. With respect to British car exports, the EIU reported in 1957 that

Recently there has been considerable discussion on the prospects for British cars in Australia. Considerable criticism has been levelled at many types as "dust-boxes" and unable to stand up to poor roads, and there are recurrent complaints of poor after-sales attention and inadequate supply of spares¹⁹¹.

With respect to British textile exports, the UK Trade Commissioner in Sydney warned in a speech to the Manchester Chamber of Commerce that

competition from other textile producers was strengthening and designs from Switzerland, Italy and Germany are often considered more attractive than those from the UK¹⁹².

In the later 1950s and early 1960's the UK was further forced out of the RSA market because of the increasing amount of American exports tied to American aid¹⁹³.

After 1954 and the easing of discriminatory trade controls by the RSA, the share of British exports in the RSA market fell to 40%. Figure III.G. shows imports from the UK

¹⁹⁰Economist Intelligence Unit, Economic Review of Australia, October, 1952. p. 2.

¹⁹¹Ibid., April 1957. p. 6.

¹⁹²Ibid., p. 10.

¹⁹³Krause, "British Trade Performance", in R.E. Caves ed. Britain's Economic Prospects, Brookings Institution, Washington, 1968. p. 216-17.

RSA Imports from UK

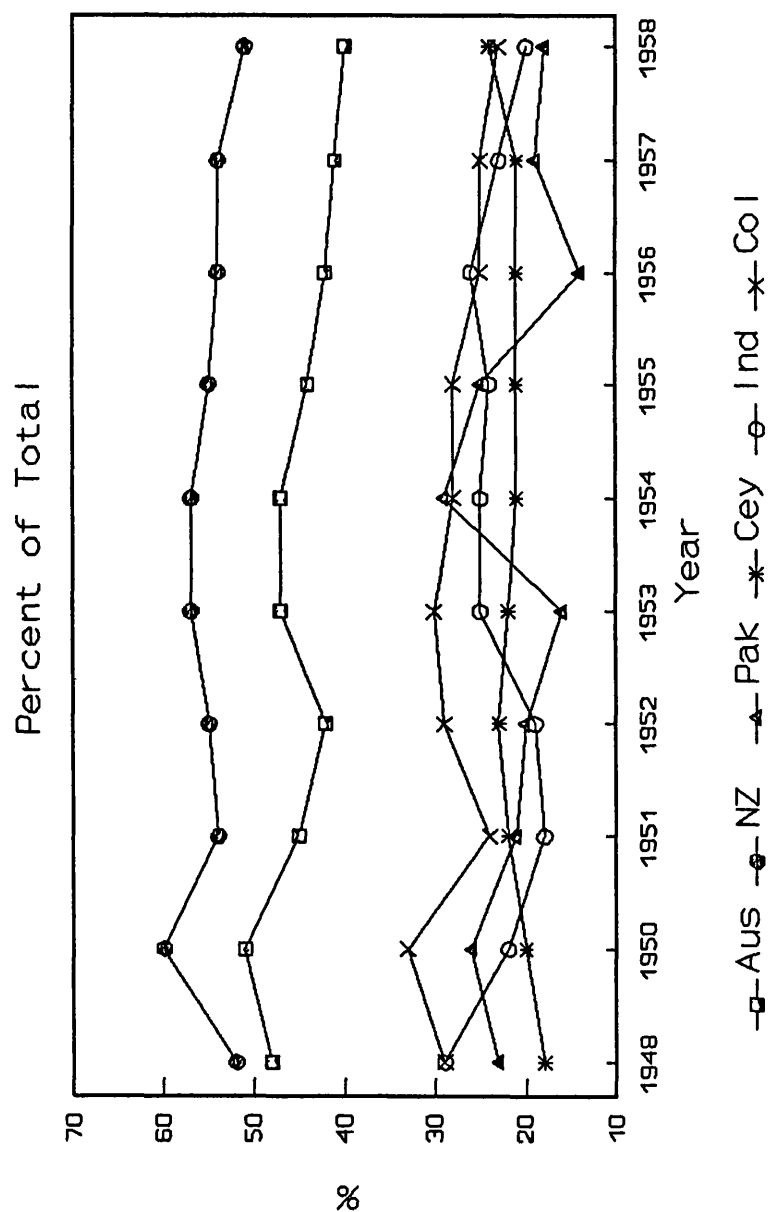


Figure III.G.

as a percent of total imports for selected RSA countries and

the Colonies. The downward trend after 1954 was most marked in Australia, Britain's largest trading partner, which contributed to most of the overall decline in Britain's market share in the RSA. Similar declines were also, however, apparent for New Zealand and the Colonies. Britain's share of India's market also slipped after 1954 but had a short reprieve in 1956 before tumbling to 1958. Ceylon's imports from Britain declined as early as 1953 and stagnated through to 1958. Britain's share of Pakistan's imports was very erratic but it too declined after 1954.

Britain's share in RSA imports of manufactured goods alone fell considerably faster than for overall imports. From 1954 to 1960, the British share of manufactured imports into the non-European sterling area fell from 47.5% to 43.1%¹⁹⁴. R.L. Major's calculations show that almost all of this was due to the general loss of British competitiveness in the goods exported to the RSA¹⁹⁵. The loss in the RSA market was about the same as Britain's overall loss of market share in manufactures trade which dropped from 20.9% to 16.8% in the same period¹⁹⁶.

Contemporary observers were aware of increasing competition in RSA markets. The import restrictions imposed by Australia and some other RSA countries against UK exports

¹⁹⁴R.L. Major "Notes on Britain's Share in World Trade", p. 51.

¹⁹⁵Ibid.

¹⁹⁶Ibid.

in 1952/3 focused British policy on the development of non-sterling markets and highlighted the danger of relying on the RSA to be a secure market indefinitely. Thus, through 1953 Peter Thorneycroft, as President of the Board of Trade, gave a series of speeches to British industrialists and the House of Commons warning that the imposition of restrictions in the sterling area

requires a willingness on the part of our exporters to make the determined efforts necessary to establish themselves in newer markets that are open to our goods¹⁹⁷

Lord Lloyd exhorted the Plymouth Mercantile Association that

if we encounter import restrictions in our established markets we cannot afford simply to sit down and wait until they are removed. We must go out and seek new business in the new markets that are open to our goods¹⁹⁸

Apart from the tightening and relaxation of discrimination by the RSA, there are other reasons for the changing fortunes of British exports in the RSA market. G.D.N. Worswick argues that the constraint on Britain's overall exports in the early 1950s was primarily a shortage of supply¹⁹⁹. This was due to the recovery and rearmament programme and to the high international demand for raw materials. The British steel shortage, especially, raised the

¹⁹⁷Draft of speech for Thorneycroft for Queens Speech Debate, 30 October, 1953. PRO241/266.

¹⁹⁸Draft speech for Lord Lloyd by the Board of Trade, 23 September, 1953. PRO BT241/266.

¹⁹⁹G.D.N. Worswick, "Trade and Payments" in Sir A. Cairncross ed. Britain's Economic Prospects Reconsidered, 1969. p. 71.

problem of the UK continuing to supply the RSA market. In the estimates for 1952 steel exports a conflict arose between the need to sell scarce supplies to the RSA and the need to export to Europe in accordance with British bilateral agreements. In 1951, priority was given to the European agreements but this provoked protests from the RSA, especially Australia. It was believed in the Board of Trade that the future of the sterling area's multilateral trading system was at stake if European importers were treated more favourably than the RSA in 1952. A Board of Trade note from R.H. King to K. Anderson in the Treasury expressed the fear that

for the sterling area mechanism to continue to work in its present form, the other members need to feel sure that, in return for the raw materials and foodstuffs they send us, they will be able to obtain the greater part of their import needs of semi-manufactured and manufactured goods essential to their economy²⁰⁰

There is, then, evidence that the lower share of British exports to the RSA in the early 1950s was in part due to supply shortages in Britain.

It has been argued, then, that the RSA was not a very soft market after 1953/4 and was competing for scarce British supplies in the earlier 1950s. Earlier studies have shown that the relatively slow growth of the RSA market was not responsible for much of Britain's loss of market share. The problems of British export competitiveness must, therefore, be

²⁰⁰Note drafted by J.A. Bergin for R.H. King to K. Anderson 10 September, 1951. PRO BT11/4722.

found in her own productivity and cost levels rather than blamed on the sterling area system.

III.J. Conclusions

Quantitative restrictions were essentially short term emergency restrictions to tide the economy over until longer term and more fundamental measures could take effect. This aspect was recognised in repeated sterling area statements that import restrictions were a short term solution and that internal measures were necessary in the longer term to make the sterling area viable. From 1953, the discriminatory element of the restrictions weakened and they became entrenched instead in the economic policy of the RSA as instruments of protection and as successive short term solutions to the longer term problem of developing trading power. Internal deflation never really took hold in the RSA as an alternative to direct import control because of the desire for expansion and development in most of these countries and because the financial and credit systems in the RSA were less developed so the effects of monetary policy and credit control were even less predictable than in the UK.

The goal of British trade policy in 1949-52 was the same as that of the RSA i.e. emergency rationing of scarce hard currency. From 1953, the process of trade liberalisation took hold in Britain and with it there was increased emphasis on the need for internal deflation and demand management to

replace direct import controls. This was based on the recognition that import controls alone would merely divert domestic consumption to domestic production and so compete with exports as well as contributing to inflationary pressure as demand for domestic goods increased. This approach to the balance of payments in the 1950s became known as the absorption approach. It was believed that deflationary internal measures could be used to allow an increase in saving or decrease in investment necessary to correct the balance of payments problem in the medium term. From 1953, as direct controls became politically unsustainable, internal deflation on its own was increasingly relied on to correct the balance of payments generally and, of particular interest here, to help the balance of trade by reducing domestic demand for imports and for goods which could be exported. This policy was urged on the RSA governments as well.

All RSA members undertook some form of demand management through a mixture of credit control and fiscal policy. These measures were not, however, sufficient to obviate the need for direct import controls to avoid recurring balance of payments crises. The attempt by the UK to switch the RSA from direct controls to internal deflation policy was not altogether successful. This was due not only to the lack of consistency and enthusiasm with which the RSA governments imposed internal restraint but also to the inappropriateness of strict internal controls to these RSA economies. The RSA countries were, in

general, undeveloped economies and this had three consequences for the effectiveness of monetary and fiscal restraint. The first was that the governments of these countries were in most cases committed to general economic development of their nations, both industrially and with respect to general amenities and the standard of living. This was inconsistent with the strictly balanced budgets and restraint on investment which was urged from Whitehall. Most countries, therefore, applied instruments of domestic restraint less firmly than was possible in the UK and some, such as India and Australia, chose to continue to rely on direct import controls rather than forego the development of secondary industry. The second characteristic of RSA economies in which they differed from the UK was in the sophistication and efficiency of their financial markets which, as noted previously, made the impact of monetary policy even less reliable or predictable than in the UK. Thus, we have seen that enormous Bank Rate increases in New Zealand had little effect on the credit conditions of the New Zealand economy.

Thirdly, due to the relatively undeveloped state of most RSA economies their exports were concentrated in a few primary commodities while they imported a wide range of consumer goods, capital goods and food. The 'absorption approach' to balance of payments problems embraced in the UK and urged on the RSA was, thus, much less appropriate to these less developed economies. Rather than discouraging the consumption

of goods which might be exported, this was actively encouraged in some RSA countries. The diversion of resources from raw material exports to secondary production for the domestic market was the active policy of the governments of the poorer RSA countries such as India, Pakistan and Ceylon who were actually driven to tax some of their natural raw material exports to divert them to the domestic market for development purposes. In Australia and New Zealand, import controls and tariffs were increasingly used for protectionist purposes to help develop domestic manufacturing industry such as textiles in order to use their own raw materials such as wool. Although all RSA members agreed to the need for strict internal deflation, they were either unable to fulfil their commitments, given the need for development or, as in Ceylon and New Zealand, even very strict internal measures proved insufficient to correct their balance of trade problems as the terms of trade turned against primary producers.

Figure III.H. shows the terms of trade of the UK and the RSA separately. These indexes move generally countercyclically throughout the 1950s. They move together only in 1955 when there is little change in either and in 1953 when a slight increase in the terms of trade of the RSA coincides with a massive increase for the UK. These offsetting movements had the benefit of softening the effects of the often violent fluctuations in prices which characterised the 1950s. The terms of trade for the sterling

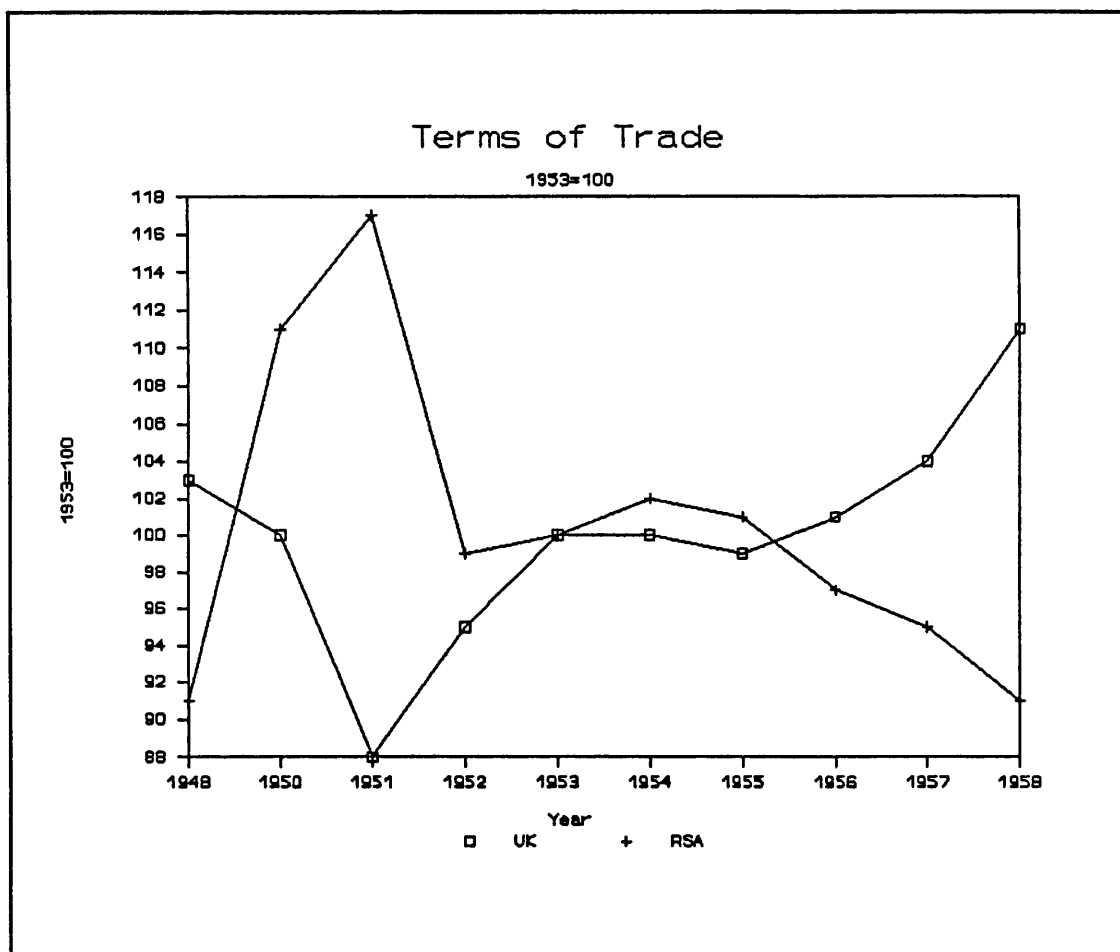


Figure III.H.

area trading system as a whole were thus less extreme than for either part of the area alone.

The sterling area system was important to the UK as a soft currency source of raw materials. In judging the contribution which the RSA trade balance made to instability and drains on reserves in the early 1950s it must be remembered that the RSA provided the UK with essential raw materials from a source which did not cause a direct drain on the British reserves. If the UK had been forced to pay hard currency for these materials either the reserves position

would have been in much more straightened circumstances or the recovery of British industry and manufacturing would have been delayed or made even more dependent on American aid with its attendant conditions. In 1953-55 when the UK trade balance with the RSA deteriorated, the RSA's sterling balances were growing steadily. In this sense, the RSA was giving Britain credit to cover her raw material imports.

The net effect of the RSA trade balance on the central reserves is thus difficult to determine. It certainly could not be said, however, that the existence of the sterling area trade system was the source of the apparent weaknesses in the British balance of payments, nor was it the source of the recurring need for restrictive measures. This reinforces the conclusions of Chapter II. The extent to which the sterling area system contributed to the weakness of the British balance of payments through long term capital flows will be addressed in the next chapter.

Chapter IV. Long Term Capital Flows within the Sterling Area

After the sterling crisis of 1947 and the indefinite suspension of convertibility, free capital flows emerged as an important component of the sterling area system. This chapter will discuss how the principle of free long term capital flows to the sterling area manifested itself in British policy and how management of the sterling area was affected by this policy through the 1950's.

IV.A. Capital Flows and British Policy

The principle of free of capital flows from the UK meant that there were no direct controls on private investment in the sterling area. In practice the British authorities were able to exert some control over the nature and timing of some of this investment if not over the volume of capital flowing abroad. The Capital Issues Committee vetted all private applications to the London market for investment in the sterling area, deferring to the Treasury, Board of Trade and Colonial Office as to the likely benefit of the project for the UK or sterling area balance of payments. Sterling area central governments had the exclusive privilege of floating official loans in London. The timing of the government issues accepted by the CIC was under the further control of the Bank of England who maintained a list of pending applications ranged in order of priority. In some

cases, depending on the conditions prevailing in the market, the Bank would rearrange this list, so delaying the issues of particular governments.

Until 1952 the requirement for capital raised on the London market for sterling area investment was that it had to be for specific projects which promised to benefit the British balance of payments. This was not especially limiting provided that such projects promoted British exports, restricted imports, exploited foreign expertise or gained control of scarce raw materials which were useful to British industry.

In 1952, sterling area access to the London market was widened. At the Commonwealth Economic Conference in December of that year, the British government committed itself to a 'Special Effort' to encourage capital flows to the rest of the sterling area. Applications from sterling area governments and from private investors to the London market for capital destined for sterling area countries were to be accepted on the basis of their effect on the general sterling area balance of payments rather than on their effect on the UK directly. Thus, any application which promised to encourage sterling area exports or to promote production which replaced non-sterling imports would be allowed. The communique also explicitly recognized the need for basic development in some regions. As part of the 'Special Effort' the Commonwealth Development and Finance

Company was established with £15m subscribed by the Bank of England and ninety-one British business concerns to channel private capital into development projects in the sterling area and Canada. The CDFC was empowered to borrow up to twice the original capital stake but by March 1957 they had committed only £14m¹.

The 'Special Effort' was reconfirmed and extended at the Commonwealth Economic Conference of January 1954. From this time sterling area governments could float loans on the London market for general development programmes as well as specific projects.

To this point, at least, it appears that official policy consisted of a broad commitment by the British authorities to encourage investment and British financed development in the sterling area. Behind the scenes, however, there was serious doubt among officials at the Treasury and the Bank of England about the wisdom of encouraging capital flows to the sterling area. In January 1953, immediately after the much heralded announcement of the 'Special Effort', a debate rose between R.W.B. Clarke, an under-secretary at the Treasury, and Robert Hall, Director of the Economic Section of the Cabinet. In response to requests from the Economic Secretary for a policy paper on sterling area investment, both submitted reports in early 1953.

¹'UK Investment in the Sterling Commonwealth', May 6 1957. PRO BT213/96.

Clarke's paper contended that the UK would never attain the level of exports necessary for an adequate current surplus if investment continued to be directed overseas². He calculated that Britain needed an annual current surplus of £300-£350m to meet existing obligations on the capital account. This was proving a difficult target to meet and Clarke argued that in this climate no further capital claims should be introduced. He suggested a tight monetary policy to direct resources into domestic export industries and concluded "what has to be done is to put as many obstacles as possible in the way of sterling area borrowing"³.

Robert Hall's response three days later argued that increasing overseas investment and export credit facilities to stimulate demand for British exports was the only way the UK would ever achieve the necessary current surplus⁴. Based on earlier Treasury working party reports that predicted a £300-£600m slack in the British economy in 1953, Hall argued that exports were demand constrained rather than limited by under-investment in the domestic economy⁵. Furthermore, he argued that the British economy should be able to expand enough to allow for both sufficient domestic and foreign investment. While recognizing that in the short

²Paper by R.W.B. Clarke 26 January, 1953. PRO T229/543.

³Ibid.

⁴Paper by Robert Hall, 2 February 1953. PRO T230/226

⁵Ibid.

run the external capital position of the UK was 'precarious', Hall asserted that this did not affect the economy's capacity for long term overseas investment. Sound investment in the sterling area was a long term solution to the balance of payments problem by increasing invisible earnings and developing non-dollar sources of British imports, thus reducing the dollar deficit. In the short term, commercial credit should be increased to combat international illiquidity and to stimulate demand for British exports. A freer overseas investment policy would only prompt a drain on reserves if British investment stimulated dollar expenditure by the rest of the sterling area. In this case, Hall suggested that the British authorities should try to come to an arrangement with the sterling area to further limit dollar expenditure. The bottom line, however, was that investment in the sterling area would ultimately strengthen the British balance of payments and a tighter monetary policy would be ill-advised⁶.

The debate continued through February 1953 with the Economic Section of the Cabinet promoting a wide interpretation of the 'Special Effort' and the Treasury pressuring to conserve resources for the domestic economy. Near the end of February a paper expressing both views was prepared for the Economic Secretary with some favouritism

⁶Ibid.

allotted to Robert Hall's view⁷ and this bias was reflected in the widening of sterling area access to British capital announced in January 1954. The debate over the advantages and disadvantages of British investment in the sterling area, however, continued.

Much of the contemporary literature seems to have sided with Otto Clarke's analysis. As noted in Chapter I, A.C.L. Day, writing in 1954 warned against the dangers of devoting too many resources to overseas investment and "failing to realize that Britain's wealth depends primarily on the competitive strength of her manufacuturing industry, and only secondarily on the profits of international banking and merchanting"⁸. Shonfield, in his tract on British economic policy published in 1958, stated more categorically that British economic growth was "stunted as a result of this too vigourous pursuit of overseas investment"⁹. On the eve of the 1954 Commonwealth Economic Conference, The Economist also warned its readers that the financing of sterling area development could only be at the expense of the British economy¹⁰.

⁷Treasury Paper, 24 February, 1953. PRO T229/543.

⁸A.C.L. Day, The Future of Sterling, Clarendon Press, Oxford, 2nd ed., 1956 (first edition 1954). p. 154.

⁹A. Shonfield, British Economic Policy Since the War, Penguin Books, London, 1958. p. 125.

¹⁰The Economist, 16 January, 1954. p. 183.

That the Treasury, especially, continued to have reservations about the wisdom of free capital flows to the sterling area is apparent in the negotiations for the renewal of the Colonial Development and Welfare Act during 1954 and 1955. Throughout the prolonged discussions of how much official money should be allotted for the programme over the next four years, the Treasury stood firm against Colonial Office warnings about the potential for unrest and hardship which would result from the combination of a further restriction on the amount of official funds available to the Colonies coupled with a tightening of the London market against Colonial issues¹¹. Instead, the Treasury emphasized the need for Colonies to fund their own development or to look for non-British sources of finance. The figure for the four year development allocation was thus whittled down from £120-£130m suggested in June 1954 to only £80m by March 1955. The unwillingness or inability to afford extra capital for the CDC is evidence of the weakening of Britain's most basic financial commitment in the sterling area, namely the development and welfare of her colonial territories.

In 1956, the Treasury-Bank of England Sterling Area Working Party concluded that ideally sterling area

¹¹Note of a Colonial Office/HMT meeting 9 June, 1954. PRO CO1025/75.

investment should be cut¹². The reasons given were first to force the RSA to use their existing sterling balances to finance their investment thus reducing UK liabilities, and secondly that overseas investment drained resources away from British industry¹³. Otto Clarke's interpretation of the effects of overseas investment was thus still held in the Treasury and shared by the Bank of England. While on this basis investment flows ought to be cut, the report recognized that there were other circumstances which made such a policy less attractive. The report noted that the current surplus was in part dependent on the invisible earnings and exports generated by overseas investment. More emphasis was given to the assertion that these capital flows linked the sterling area together, that the British government had a political commitment to continue investment after the Commonwealth Economic Conferences of 1952 and 1954 and finally that the Colonies at least had a right to development as dependencies of the UK¹⁴. Since direct controls were impossible for these essentially political reasons, the report concluded that high interest rates should be allowed to curb overseas investment since they would not appear to be directed uniquely at sterling area

¹²"Report of the Sterling Area Working Party" 25 June, 1956. BoE OV 44/32.

¹³Ibid.

¹⁴Ibid.

borrowing. The implication of the Report was that the relatively free capital flows to the RSA were an economic burden that had to be borne for political reasons. The accuracy of this assessment will be examined later in this chapter.

The premise that capital flows were a cohesive force in the sterling area was based on two assertions. First, it was believed that freedom of capital flows was a major attraction of membership for the rest of the sterling area. Secondly, if investment flows from the UK were severely restricted, the rest of the sterling area would be forced to look elsewhere for capital. This would encourage them to accumulate non-sterling reserves to pay back loans and, on the principle that trade follows investment, their trading patterns would be gradually aligned away from British exports. These two considerations were connected through the sterling balances problem since if capital flows were further restricted this might precipitate a wholesale running down of sterling balances both to replace the lost development capital and to diversify of reserves as the RSA realigned itself to the USA. These fears were apparently limited to the consequences of severe rationing of capital flows since official British policy was to encourage the RSA to seek out new sources of development capital as far as they were able. It should be noted that the RSA was not particularly successful in attracting foreign investment

from outside the UK. Whether this would have been the case if British capital had been officially curtailed, however, is not certain.

The conclusions of the 1956 Sterling Area Working Party report were repeated through to the end of the 1950s. Three days after the report was completed, a more general Economic Policy Review was commissioned by the Chancellor of the Exchequer which reiterated the Working Party conclusions¹⁵. In May 1957, the Treasury and Bank of England completed a series of papers on "The Prospects for Sterling: The Capital Account" for the Economic Policy Committee of the Cabinet which looked more specifically at where investment in the sterling area could be pruned without resort to direct controls¹⁶. It showed that withdrawing the 'Special Effort' commitment would not have had any real effect since the impact of the policy had been offset by high interest rates and the CDFC was not working to capacity¹⁷. The dangers to British influence which might result from large scale sterling area borrowing outside the sterling area were repeated but the prospects for the sterling area raising substantial funds outside London were acknowledged to be

¹⁵"Overseas Investment" HMT Paper 25 July, 1956. PRO T230/306.

¹⁶Treasury Papers May, June 1957. PRO BT213/96

¹⁷'UK Investment in the Sterling Commonwealth', May 6 1957. PRO BT213/96.

poor¹⁸. Finally, cutting back on the £60m commitment to sterling area development made by the UK through the IBRD was considered politically undesirable¹⁹. In any case, the prospects for UK exports were taken into account in allowing releases of the UK subscription to the IBRD so in this sense the capital outflow was 'tied'.²⁰

In the end no action was suggested or taken beyond letting high interest rates discourage borrowing on the London market²¹. When the Radcliffe Committee questioned Governor Cobbold of the Bank of England about the effect of investment flows to the sterling area in determining interest rate policy he replied "I think that [sterling area investment] would certainly be a consideration, that it [interest rate] affects investment all over the area" however he added that he "would not regard it as ever having been a main influence in anything we have done; not decisive, but certainly a factor in our minds"²². To some extent, then, sterling area investment may have affected interest rate policy because there was no other politically

¹⁸'Commonwealth Borrowing Outside the Sterling Area', May 7 1957. PRO BT213/96.

¹⁹HMT Paper "Sterling Releases to the IBRD" 6 May, 1957. PRO BT213/96.

²⁰Note for the Minister of State by the Board of Trade, 26 June 1956. PRO BT213/67.

²¹'Direct Investment Summary', 6 May, 1957. PRO BT213/96.

²²Radcliffe Committee Minutes Q 875-76, 26 July, 1957.

sound way of restricting capital flows to the area. This point should not, however, be overemphasized given Governor Cobbold's hesitation and the many other influences on interest rate policy in the 1950s²³. Furthermore, in 1957 the Colonial Office reported that there was little evidence that high interest rates had restricted Colonial borrowing since the amount of capital raised on the London market had increased from £9.5m in 1955 to £11.5m in 1956 and to £15.5m by May 1957 during which time Bank Rate had been raised from 3.5% to 5.5%²⁴. The Colonial Office asserted that Colonial borrowing was governed by needs and access to the market and that they could afford the higher interest payments²⁵. A Board of Trade report noted that while the high interest rates had not affected Colonial borrowing there was some evidence that Australia and South Africa had been encouraged by high interest rates to look elsewhere for capital²⁶.

The pattern that emerges from this survey of the official policy toward sterling area capital flows is that the Treasury and Bank of England were powerless to limit overseas investment for political reasons, although in most

²³For an account of the intentions of monetary policy in the 1950s see J.C.R. Dow, The Management of the British Economy 1945-60, Cambridge University Press, Cambridge, 1964. p. 252-57.

²⁴Colonial Office note Date PRO BT213/96.

²⁵Ibid.

²⁶"UK Investment in the Sterling Commonwealth", 6 May, 1957. PRO BT 213/96.

cases they believed that this would be a good thing (the exception was investment in Middle Eastern oil interests). The over-riding political consideration was the cohesion and continued stability of the sterling area. Since direct controls were impossible, it was hoped that the high interest rates would restrict borrowing. Since the policy was not obviously targetted specifically at sterling area investment it was hoped that the political difficulties could be avoided at the cost of a more generous outflow of investment than was desired.

Two questions arise from this interpretation of policy.

First, was sterling area investment such a burden on the British economy as was commonly supposed both among officials and in the contemporary literature? Secondly, was the continuation of these capital flows to the sterling area an important cohesive factor in the system, worth the perceived burden on the balance of payments and on British industry. The next two sections of this chapter will address these questions suggesting that, while the capital flows were not a very strong cohesive factor, nor were these flows an onerous burden on the British economy.

IV.B. The Burden of Long Term Capital Flows

IV.B.i The Volume of Long Term Capital Flows

Tracing the volume and direction of British investment in the sterling area employs the arts of speculation and

estimation to a degree that, while by no means unique in economic history, still leaves the working figures at the level of rough estimates. The problem with the data is due to the nature of the sterling area itself. Because members enjoyed unrestricted capital movement among themselves, no precise record could be made of the flow of investment capital from the UK. Thus David Bensusan-Butt complained in 1958 that

our own White Papers give figures which are quite certainly wrong by large amounts. They are pieced together, for the most part from RSA countries' own estimates which range from big figures for Australia and New Zealand (who have wide definitions and elaborate surveys) through to wobbly guesses or mere balancing items for South Africa and Hong Kong²⁷.

Grants, official loans and other official investment could all be accounted for. Capital raised on the London market by private companies based in the overseas sterling area could also be traced since the Capital Issues Committee vetted sterling area as well as domestic applications to the market. The gap in the overseas investment figures was in the volume of private direct investment by UK firms in sterling area branches or subsidiaries. Where this investment capital was raised within the parent company without recourse to the London market or was raised through an issue in the domestic company's name and then sent overseas, British exchange control authorities had no record

²⁷D.M.B. Butt, 'Capital Movements within the Commonwealth', 6 May 1958. PRO T236/4079.

of the capital flow. The other large omission was in the measurement of reinvested profits of sterling area branches of UK companies. It was the contemporary belief that reinvested profits were substantially underestimated, suggesting that the outflow of capital from the UK to the sterling area was larger than the official figures allowed²⁸. Conan suggested this omission amounted to perhaps £200m per year²⁹. Later analysis by Arthur Hazlewood refuted the importance of reinvested profits based on data available for the period after 1958³⁰. From 1958 onwards, the Board of Trade commissioned a census of private overseas investment by UK companies which showed that net reinvested profits during this later period were fairly insubstantial. This evidence does not, of course, prove that such investment was insignificant for the rest of the 1950's. It is conceivable that, with some branches in an earlier state of development, the proportion of profits ploughed back into the enterprise might be higher than when the branches had matured. The evidence that is available

²⁸A.R. Conan, Capital Imports into Sterling Countries, Macmillan, London, 1960. p. 84., Committee on the Working of the Monetary System: Minutes of Evidence, Appendix, HMSO, 1960., M. Scott, 'What Should Be Done About the Sterling Area?' Bulletin of the Oxford University Institute of Statistics, Vol. 21, No. 4, Nov. 1959. p. 217.

²⁹Conan, Capital Imports, p.84.

³⁰A. Hazlewood, "The Export and Import of Capital" in Worswick and Ady ed., The British Economy in the Nineteen-fifties, Clarendon Press, Oxford, 1962. p. 176.

for Australia and New Zealand at least, suggests that the proportion of reinvested profits in the 1950s was fairly substantial but volatile³¹. The components of UK investment in the rest of the sterling area will be discussed in greater detail later in this chapter. It suffices for the present to recognize the potential for error in the estimates of capital flows from the UK due to the nature of the sterling area 'rules' and the fact that private investment accounted for up to 90% of gross investment by the UK in the sterling area³².

Estimates of the outflow of long term capital from the UK to the sterling area vary widely in the literature concerning this period. Shonfield estimated that the net total of private and official capital plus government grants amounted to perhaps £150m per year between 1952 and 1956³³. Conan calculated that capital imports into the major non-oil members of the sterling area (ie. Australia, South Africa, the Colonies, Rhodesia and

³¹Annual Bulletin of Overseas Investment : Australia 1960-61, Commonwealth Bureau of Census and Statistics, Canberra, 1962., New Zealand: Report on Official Estimates of Balance of Payments 1960-61, Department of Statistics, Wellington, 1961. These figures were included in the UK Balance of Payments estimates since the data were available to the British authorities.

³²Radcliffe Committee Minutes, Appendix

³³A. Shonfield, British Economic Policy Since the War, Penguin Books, London, 1958. p. 125.

India) from the UK amounted to £2075m between 1946 and 1958³⁴. In an earlier version of this paper he estimated that the capital inflow from the UK to these countries and territories amounted to £1650m between 1946 and 1955, an annual average of £165m for these years and £142m for the years 1956-68 if his estimates are consistent³⁵.

With respect to gross capital outflow to the sterling area, there are two sets of data which can be compared. The Bank of England, in evidence to the Radcliffe Committee, estimated UK gross investment in the sterling area at between £172m and £272m per year between 1952 and 1957 or an average of £220m per year³⁶. The estimate of the gross total capital outflow to the RSA for 1946-54 was £1621m³⁷. More recently, W.P. Michael undertook an exhaustive study of capital flows to and from the sterling area for 1950-54³⁸. Michael's figures for gross private investment plus government loans amount to £1053m for the years 1950-54. If the two sources are consistent, the total gross outflow for 1946-49 would be £568m. The net figure for the sum of

³⁴Conan, Capital Imports, p. 70.

³⁵A.R. Conan, The Changing Pattern of International Investment in Selected Sterling Countries, Essays in International Finance, No. 27, Dec. 1956, Princeton University, New Jersey, 1956. p.17.

³⁶Radcliffe Committee Minutes, Appendix.

³⁷Ibid.

³⁸W.P. Michael, Measuring International Capital Movements, National Bureau of Economic Research, New York, 1971.

inter-governmental loans, private long and short-term capital and the balancing item for 1946-49 amounts to a net outflow of £574m as recorded in the Treasury balance of payments estimates³⁹.

The likelihood is that the Michael figures and the Bank estimates are fairly consistent. The Michael data for the UK are based mainly on balance of payments figures published in the IMF Balance of Payments Yearbooks which in turn are compiled mostly from official balance of payments estimates⁴⁰. Furthermore, very little adjustment to these figures was required after breaking them down into gross values based on partner data. Michael's breakdown of UK capital outflow to the sterling area accorded to within £25m with sterling area receipts for the five years together⁴¹. Within the sterling area the estimates are less precise but the total volume is comparable to the Bank's Radcliffe Committee estimates.

One final indication of the volume of capital flowing to the sterling area is to look at the figures compiled by the rest of the sterling area for capital imports from the UK and used by the British authorities when compiling their estimates for the UK balance of payments. The sources of data vary widely for each country or territory. Australia,

³⁹UK Balance of Payments, 1946-57, HMSO, London, 1959.

⁴⁰Michael, Measuring Capital Flows, p. 22.

⁴¹Ibid.

New Zealand and India all published censuses of inflows of private overseas investment in industrial or manufacturing concerns although these are also incomplete to varying degrees. The Australian figures are the most complete, covering private direct and portfolio investment⁴². The drawback of the data, as with the New Zealand data, is that they were calculated according to fiscal years ending 30 June rather than the calendar years used by the rest of the sterling area. The New Zealand census data has the further limitation that it covers only direct investment flows⁴³.

The Indian census results were published in a series of articles by the Reserve Bank of India and recorded stock values of foreign business investments at the end of 1948, 1953 and 1955-58⁴⁴. Capital flow were recorded only for 1956-58. Comparison of yearly stock figures does not give a true picture of capital flows since they include revaluations of old investments as well as new capital. From 1956-58, when it is possible to compare them, the changes in stock values underestimate recorded net capital

⁴²Annual Bulletin of Overseas Investment: Australia 1960-61. No. 6, Commonwealth Bureau of Census and Statistics, Canberra, 1962.

⁴³New Zealand: Report on Official Estimates of Balance of Payments 1960-61, Department of Statistics, Wellington, 1961.

⁴⁴Reserve Bank of India Bulletin, Dec. 1957, Sept. 1958, June 1959, April 1960.

inflows.

The Ministry of Finance of the Federation of Rhodesia and Nyasaland also compiled estimates of foreign capital receipts by both official and private sectors⁴⁵. The results, however, are not broken down geographically until 1953 and then only into sterling area, dollar area and international agencies. The sterling area classification includes capital from South Africa although the reports state that "most" of the new sterling area capital is from the UK while only "small amounts" are from South Africa. The South African census recorded a stock value of investment in Rhodesia and Nyasaland of £90.5m in 1956⁴⁶. Before 1953, details of the larger components of the capital inflow into Rhodesia and Nyasaland were described so it is possible to attribute most of the capital to its country of origin.

South Africa published a census of overseas investment in 1956 but this recorded only stock values of overseas investment as at the end of 1956⁴⁷. Approximate net

⁴⁵Economic Report, Ministry of Finance, Federation of Rhodesia and Nyasaland, Salisbury, 1954, 1956, 1958, 1958.

⁴⁶Economic Report, Ministry of Finance, Federation of Rhodesia and Nyasaland, Salisbury, 1958. p. 38.

⁴⁷South African Reserve Bank Quarterly Bulletin of Statistics, Supplement, Dec. 1958.

figures for British investment in South Africa and the Colonies is available from the relevant IMF Balance of Payments Yearbooks for 1950-58.

The Balance of Payments and Census returns tend to disguise oil investment. Detailed figures, however, are available from Board of Trade and Treasury papers for investment in oil in the sterling area based on confidential company returns for the years 1952-57⁴⁸. These figures are

Table IV.A.
Partner Data on net Flow of UK Investment
to Selected Sterling Area Countries

£m	1950	1951	1952	1953	1954	1955	1956	1957	1958
Colonies	51	63	119	91	122	93	134	152	118
Australia	36	38	89	34	43	55	49	50	54
South Africa	51	55	24	9	26	2	-10	-20	-10
Rhod & Nyasaland	18	19	18	25	14	25	22	33	40
New Zealand	6	-33	11	0	15	7	2	0	30
India	28	-5	-6	0	-2	-9	-2	-11	12
Total	190	137	255	159	218	173	195	204	244
Oil				58	48	32	44	52	

Source: Colonies, India and South Africa: IMF Balance of Payments Yearbook (IMFBPYB),
Australia: Annual Bulletin of Overseas Investment: Australia 1960-61. No. 6, Commonwealth Bureau of Census and Statistics, Canberra, 1962.,
Rhodesia and Nyasaland: Economic Report, Ministry of Finance, Federation of Rhodesia and Nyasaland, Salisbury, 1954, 1956, 1958, 1958.
New Zealand: New Zealand: Report on Official Estimates of Balance of Payments 1960-61, Department of Statistics, Wellington, 1961.

⁴⁸Treasury Paper "UK Investment in the Sterling Commonwealth" 6 May, 1957 PRO BT213/96 and "UK Long Term Capital Transactions", 12 May 1958 PRO T236/4079.

presented in the last line of Table IV.A. If these figures are accurate, 25-27% of private investment in the sterling area during these years was in oil, most of which was destined for the sterling Commonwealth.

The results for net capital investment in individual sterling area countries in 1950-58 is presented in Table IV.A. and covers approximately 80% of official estimates of total UK investment in the sterling area as a whole. The geographical distribution of UK capital flows must be considered approximate but it serves to establish the relative orders of magnitude of the receiving countries. Thus, the greatest part of UK investment in the sterling area was destined for the Colonies, Australia and South Africa although the political situation in the latter country led to a net capital outflow after 1955.

The UK Balance of Payments for 1946-57, published by the Treasury in 1959 offers the most consistent annual survey of British investment in the entire sterling area. After 1952, short term capital flows and errors and omissions are separated from private long term capital along with outstanding intercompany balances and intercompany loans. The data also include intergovernmental loans by and to the UK. These figures are presented in Table IV.B. along with the relative magnitude of UK investment in the non-sterling area. It is clear that by far the greater part of British overseas investment in the 1950s was destined for the

sterling area.

Table IV.B.
Official Estimates of
Net Long Term Capital Flows
From the UK to the Rest of the Sterling Area

fm	1950	1951	1952	1953	1954	1955	1956	1957	1958
Official Donations	18	20	30	24	41	47	41	46	48
Net Government Loans	13	14	11	11	21	19	10	15	34
Private Investment	195	151	150	190	180	110	180	280	220
Total	234	192	199	235	243	175	231	340	302
Investment in rest of world	-113	169	19	40	31	54	51	-87	
Grand Total	121	361	218	275	274	239	282	253	

Notes: Data for 1950-57 from UK Balance of Payments for 1946-57, HMSO, 1959. 1958 from IMF Balance of Payments Yearbook.

These annual estimates can be compared to UK Gross Domestic Product to show the relative magnitude of British capital exports. The results are presented in Table IV.C. As a proportion of GDP, UK capital flows to the sterling area seem fairly insubstantial, varying between 1% and 1.7% only. In the period 1870-1914, when capital exports were also popularly considered to be a burden on the economy, they comprised 5% of GDP⁴⁹. Relative to the American economy in the 1950's, however, the UK figures appear much more substantial. It should also be noted that the UK figures cover investment in the sterling area only although

⁴⁹S. Pollard, "Capital Exports, 1870-1914: Harmful or Beneficial" Economic History Review Vol XXXVIII, No. 4, Nov. 1985. p.489-514. p. 491.

this accounts for by far the greatest part of total overseas investment.

Table IV.C.
Long Term Capital Flows to the Sterling Area
As a Percentage of GDP

	1950	1951	1952	1953	1954	1955	1956	1957
1958								
UK £b								
GDP	11.5	12.8	13.9	15.1	15.9	17.1	18.5	19.6
20.4								
Capital Flow	.234	.192	.199	.235	.243	.175	.231	.340
.302								
%	2.0	1.5	1.4	1.6	1.5	1.0	1.2	1.7
1.5								
USA \$b								
GDP	261.4	302.5	317.9	333.2	331.1	362.5	385.0	404.3
Capital Flow	.278	1.6	1.0	.630	.639	.455	2.7	3.6
%	0.1	0.5	0.3	0.2	0.2	0.1	0.7	0.9

Source: GDP is at factor cost at current prices from Economic Trends, Annual Supplement to 1988 edition. USA figures from Historical Statistics of the United States, Bureau of the Census, Washington, 1960.

A further indication of the relatively large part that overseas investment played in the UK economy is evident in a comparison of US and UK domestic savings in relation to overseas investment. These figures are presented in Table IV.D. If

Table IV.D.
Overseas Investment as a Percentage of Domestic Saving
Comparison with USA

	1950	1951	1952	1953	1954	1955	1956	1957
USA %	0.7	3.2	2.0	1.2	1.2	0.8	4.2	5.4
UK %	12.8	8.1	9.5	10.4	9.2	6.1	6.7	9.2

Notes: USA statistics from Historical Statistics of the United States, 1960. UK statistics from relevant editions of Estimates of National Income and Expenditure, HMSO.

domestic and overseas investment were substitutes competing

for the same funds (as in the Shonfield scenario), overseas investment in the UK took up a larger part of available resources than did American overseas investment. This suggests that the squeeze on domestic investment imposed by overseas investment opportunities may have been considerably stronger in the UK than in the USA. This would support Shonfield's contention "that the British economy is robbed of necessary nourishment...as a result of this too vigorous pursuit of overseas investment"⁵⁰. The OEEC in a 1953 report also blamed low domestic industrial investment partly on the need to share available capital with the rest of the sterling area⁵¹.

IV.B.ii. The Impact of Foreign Investment on the Domestic Economy

The impact of overseas investment on the donor economy is an issue that has occupied the attention of economists for decades and a simple judgement is not possible with respect to investment in the sterling area. It is, however, possible to come to some approximation of whether the effect of British investment in the sterling area on the British economy in the 1950s was positive or negative. The first step is to construct a tentative counterfactual case to arrive at the possible effects of a system of exchange

⁵⁰Shonfield, British Economic Policy. p. 107.

⁵¹OEEC, Economic Conditions in the UK, Paris, 1953. p. 16.

controls which diverted all of British investment in the sterling area to gross fixed capital formation at home. This gives the most optimistic case since it is by no means certain that in the event of controls on overseas investment all of the capital invested abroad would have been invested as productively at home as actual domestic investment. Even in this optimistic case, however, the results show that the extra domestic capital formation would have contributed little to the rate of growth of UK gross domestic product.

The model begins by assuming that Britain's incremental capital-output ratio (ICOR) for the 1950s reflects structural aspects of the British economy which determine the productivity of capital and is therefore constant. The ICOR describes the proportion of GDP devoted to capital formation that is associated with a percentage increase in GDP⁵². The inverse of the ICOR is thus a measure of capital productivity. Expressed algebraically,

$$\text{ICOR} = \frac{\text{I/GDP}}{\text{Growth Rate of GDP}}$$

Where I = gross Capital Formation
GDP = Gross Domestic Product.

ICORs for the UK and twenty-one other countries for the 1950s were calculated by the United Nations Economic

⁵²S. Kuznets, "Quantitative Aspects of the Economic Growth of Nations Part V, Capital Formation Proportions: International Comparisons for Recent Years:", Economic Development and Cultural Change, Vol VIII, No 4, Part 2, July 1969. p. 46.

Commission for Europe in 1964⁵³. A selection of the results is presented in Table IV.E.

Table IV.E.
Incremental Capital/Output Ratios
1949-59

	Rate of Growth GDP	Gross Investment Ratio	ICOR
West Germany	7.4	24.2	3.3
Netherlands	4.8	25.0	5.2
France	4.5	20.6	4.6
Sweden	3.4	21.4	6.3
USA	3.3	18.1	5.5
Denmark	3.2	17.5	5.5
Belgium	3.0	16.9	5.6
UK	2.4	16.1	6.7
Ireland	1.3	17.9	13.7

Source: UN Economic Commission for Europe, Some Factors in Economic Growth in Europe During the 1950s, 1964, Chap II, P.17.

Gross investment ratio = Gross Fixed Capital Formation at constant (1954) prices / GDP.

In general, a low value of ICOR was associated with a higher rate of growth of GDP and vice versa⁵⁴. The UK had the lowest gross investment ratio of the twenty-two countries surveyed by the Economic Commission for Europe and its ICOR was exceeded only by those of Ireland and Norway. The UK also suffered from the lowest rate of growth of GDP of all countries except Ireland.

As can be seen in Table IV.F., adding the annual investment in the Sterling Area in the 1950s to actual gross

⁵³United Nations Economic Commission for Europe, Some Factors in Economic Growth in Europe During the 1950s, Economic Survey of Europe, 1961, U.N., 1964.

⁵⁴Ibid., Chapter 7, P. 5.

domestic fixed capital formation increases the average investment ratio for the 1950s to 17.7% from 16.1%. This is about the level of the actual

Table IV.F.
Analysis of Growth Rate of GDP
In Case of All Sterling Area Investment
Devoted to Domestic Investment

fm	1950	1951	1952	1953	1954	1955	1956	1957	1958
GDFCF	2138	2140	2149	2382	2588	2716	2848	2976	3005
Sterling Area Investment									
	234	192	199	235	243	175	231	340	302
Total	2372	2332	2348	2617	2831	2861	3079	3316	3307
GDP (£b)									
	14.3	14.6	14.5	15.1	15.7	16.4	16.5	16.8	16.8
Investment Ratio									
%	16.6	16.0	16.2	17.3	18.0	17.4	18.7	19.7	19.7

Notes: Gross domestic fixed capital formation at constant (1954) market prices. GDP constant (1954) prices factor cost (source: ECE, Some Factors... 1964).

investment ratios of Greece and Denmark but does not approach the level of West Germany. Using the given UK ICOR of 6.7, this generates a rate of growth of GDP of 2.6% p.a. or only 0.2% p.a. greater than the actual rate for the 1950s. This still leaves the UK rate of growth below all twenty-two countries surveyed by the Economic Commission for Europe.

The analysis errs on the side of exaggerating the investment ratio to the extent it is likely that some selectivity in any controls on investment would be used. Official donations and government loans to the Colonies would probably not have been included in a policy restricting investment in the sterling area. This amounted

to about £46m p.a. Another likely exception would be British oil companies which would surely be allowed to continue to exploit their resources to ensure the continuation of British supplies for sterling. This accounted for a further £47m p.a. Together these two items account for close to £100m p.a. of investment in the sterling area, which would reduce the investment ratio in Table IV.F. to 17.1% with the associated growth rate of GDP of 2.5% or only 0.1% higher than the actual.

The accuracy of this analysis should not, of course, be overstated⁵⁵ but the indication is that if the resources devoted to investment in the sterling area had been instead devoted to investment in the UK, the problem of relatively slow growth of the British economy in the 1950s would not have been solved. This seems to arise both because the volume of investment going abroad was only a small proportion of actual domestic investment and because the productivity of investment in the UK as measured by the inverse of the ICOR was low relative to other Western economies⁵⁶.

W.B. Reddaway, in his exhaustive study of UK direct investment overseas, presented a brief account of the

⁵⁵It ignores, for example, possible multiplier effects of increased domestic investment.

⁵⁶The Economic Commission for Europe survey also points to relatively low rates of labour productivity and low rates of 'technical progress' in the UK as factors correlated to slower growth rates. *Ibid.*, Chapter 7, p. 5.

effects of a short term restriction on overseas investment⁵⁷. His survey of investing companies suggested that an increase of £100 in net operating assets overseas generated £11 in UK exports in the first instance plus £4 p.a. worth of exports etc. in subsequent years as a 'continuing effect'⁵⁸. His analysis of the effects of a reduction in direct investment by these companies of £100 as against what they would otherwise have invested produces the cumulative effect on the balance of payments shown in Table IV.G.

Table IV.G.
Effect of Cut of £100 in Direct Foreign Investment

	Year 1	Year 2	Year 3	Year 4	Year 5
Loss to Current A/C	11	11	11	11	11
		4	4	4	4
			4	4	4
				4	4
					4
	11	15	19	23	27
Gain to Capital A/C	100	100	100	100	100
Net Gain to BP	89	85	81	77	73

Source: W.B. Reddaway, UK Direct Investment Overseas: Final Report, pp. 240-242.

Reddaway's analysis suggests that a restriction on direct investment overseas would not be a particularly costly way to ease a balance of payments deficit for the short term. After several years, however, the policy would

⁵⁷W.B. Reddaway with S.J. Potter, C.T. Taylor, Effects of UK Direct Investment Overseas: Final Report, Cambridge University Press, 1968.

⁵⁸Ibid., p. 242.

run into seriously diminishing returns as the continuing effects of the 'lost' investment accumulated⁵⁹.

Accordingly, Reddaway's conclusion was that "a policy of restriction will bring an easing of the 'cash' problem for a substantial number of years, but at the expense of making the long-run problem worse"⁶⁰.

Based on Reddaway's findings, Richard N. Cooper and Benjamin J. Cohen analysed the effectiveness of restrictions on capital flows as a means of solving short term balance of payments deficits in the late 1960s⁶¹. Cooper calculated the magnitude of alternative policies to improve the UK balance of payments by £100m in any given year. Cohen extended the analysis by calculating the cost of each policy to the national income in the given year. Cohen concluded that "so far as Britain is concerned, capital restriction is a cheaper means of adjusting the balance of payments than either trade restriction or domestic demand management"⁶².

Some adjustment to the figures is necessary to make the

⁵⁹The costs to the current account due to lost interest, profits and dividends will be estimated later in this chapter.

⁶⁰Ibid., p. 338.

⁶¹R.N. Cooper, "The Balance of Payments", in Caves & associates eds., Britain's Economic Prospects, Brookings Institution, Washington, 1968. pp. 147-197. Benjamin Cohen, "The United Kingdom as Exporter of Capital", in Machlup, Salant and Tarshis eds., International Mobility and Movement of Capital, National Bureau of Economic Research, New York, 1972. pp. 25-49.

⁶²Cohen "The UK as Exporter of Capital", p. 26.

analysis appropriate for the 1950s which weaken Cohen's conclusion for this period. Cooper's and Cohen's figures are presented in Table IV.H. along with alternative figures for the 1950s.

With respect to demand management, Cooper estimated that a 0.34% addition in the rate of unemployment would generate a £100m saving in the balance of payments. Based on empirical studies, Cohen estimated that changes in gross output in Britain were roughly double the change in the rate of unemployment⁶³. Thus 0.68% of GDP represented a decrease of £245m in 1968 but only £107m in 1954.

Table IV.H.
Size and Alternative Methods
of Improving The Balance of Payments by £100m

Method	Action	Size	Cost p.a.	
			1968	1954
Capital Control	Non-Discriminatory Reduction of Private outflows	£112m	£3m	£3-4m
Trade Control	Manufactured Import Surcharge	4%	£45m	£20m
Domestic Demand Management	Increase Unemployment Rate	0.34%	£245m	£107m

Source: B.J. Cohen, "The United Kingdom as Exporter of Capital", Machlup, Salant and Tarshis eds. International Mobility and Movement of Capital, National Bureau of Economic Research, NY, 1972. For last column see text.

Empirical evidence of the effectiveness of short term import surcharges in 1964-65 described by Cohen suggests that a 15% surcharge reduced imports only by approximately

⁶³Ibid., p. 46.

£156m⁶⁴. On this evidence, the surcharge necessary for a reduction on £100m would be about 10%. Cooper, however, argued that the short term nature of the controls in 1965 undermined their effectiveness, and he estimated that only a 4% surcharge would be required⁶⁵. Explicit in Cohen's analysis is the short term nature of any of these policy alternatives⁶⁶ in which case the experience of 1964-5 would generate a more accurate estimate. In Cohen's terms an import surcharge of 10% would cost the GDP in 1968 £118m rather than the £45m he suggests⁶⁷. The cost of a 10% import surcharge in 1954 would be £51m. This indeed strengthens his argument that the cost of alternative policies is greater than the cost of restricting investment. On the reckoning that only a 4% surcharge would be necessary, the cost to GDP in 1954 would be £20m.

Based on Reddaway's estimate of the export generating capacity of direct foreign investment, Cooper estimated the amount by which capital outflows would have to be restricted to generate a net saving to the balance of payments of £100m in the year of restrictions⁶⁸. Both his and Cohen's

⁶⁴Ibid., p. 46.

⁶⁵Cooper, "The Balance of Payments", p. 167.

⁶⁶Cohen, "The UK as Exporter of Capital", p.43.

⁶⁷Cohen calculates that a 4% surcharge costs 0.13% of GDP, therefore a 10% surcharge would cost 0.325% of GDP ($4:0.13=10:0.325$).

⁶⁸Cooper "The Balance of Payments", p. 196.

analysis, however, ignore the 'continuing effects' on the current account⁶⁹. The impact of continuing effects is to increase annually the amount by which capital must be restricted to still generate a net saving of £100m p.a. The increases are shown in Table IV.I.

Table IV.I.
Investment Restrictions Necessary to Generate
a £100m Saving to the Balance of Payments

Income	Period	Amount of Restriction	Loss to Nat.
	Year 1	£112m	£3.36m
	Year 2	£118m	£3.54m
	Year 3	£124m	£3.72m
	Year 4	£131m	£3.93m
	Year 5	£139m	£4.17m

Notes: Loss to National Income is based on Reddaway's estimate of a 3% return on overseas investment net of domestic 'opportunity cost' of this investment.

The cost of this alternative policy relative to the others is still not fundamentally changed by this addition to the analysis. Capital restrictions still appear to be the cheapest means of improving the balance of payments although the gap between the alternatives has been narrowed for the 1950s. What Table IV.I. emphasizes is that the amount of investment that would have to be foregone would escalate if the policy were maintained for several years.

Another omission from Cohen's and Cooper's analysis of alternative ways to improve the balance of payments is the

⁶⁹Cohen mentions this in a footnote but does not bring it into his analysis.

relative magnitudes of the variables which would be affected⁷⁰. Investment outside the sterling area was already strictly controlled with little room for further restrictions. Almost all of the reduction in investment would therefore have to fall on capital destined for the sterling area. Thus a 4% import surcharge or a .34% increase in unemployment are compared with a 62%-77% cut in private overseas investment in the sterling area in 1954. This would require an almost total embargo on overseas investment at the outset to allow for inevitable leaks in the system. This level of restriction would prohibit replacement and maintenance investment required to keep existing capital productive which would further undermine the prospects for the longer term balance of payments. In addition, if the policy were to be extended beyond a few years, this might lead to disinvestment by British firms and the loss of overseas assets. The loss to the national income would not just be the profits that would have accrued in that year but the present value of future profits that would be foregone. When judging among possible short term remedies to balance of payments problems it is not possible to divorce the longer term consequences from the cost of each policy. Once the longer term consequences of restricting overseas investment are considered, capital

⁷⁰Cohen mentions this aspect but does not integrate it into his analysis. Cohen, p. 40-42

controls seem a relatively inefficient way to improve the balance of payments. Import surcharges may impair channels of trade in the medium term but they are administratively less costly than capital controls and a relatively more flexible instrument of policy that had a precedent in the 1950s. Unemployment levels in the UK were historically low, hovering between 1%-2% but a 0.35% increase would account for only an 20% increase on the existing levels.

IV.B.iii. The Source of Capital for Overseas Investment

When discussing the effect of British capital flows abroad on the domestic economy, it is important to look at the source of finance for the investment.

Table IV.J.
The Financing of Sterling Area Investment

£m	1950	1951	1952	1953	1954	1955	1956	1957	1958
Savings									
	1715	1985	2264	2557	2752	2933	3423	3685	3649
GDC	1719	1919	2153	2423	2624	2911	3193	3481	3604
Residual									
	-4	66	11	134	128	22	230	204	45
Sterling Area Investment									
	-234	-192	-199	-235	-243	-175	-231	-340	-302
Amount Financed from Foreign Borrowing									
	238	126	188	101	115	153	1	136	257
Sterling Area Sterling Balances									
	398	84	-97	284	128	-79	-298	-161	-76
Reserves (drawings +, increases -)									
	575	-344	-175	240	87	-229	42	13	284

Notes: GDCF = Gross Domestic Capital Formation

Table IV.J. compares long term capital flows to the sterling area with domestic investment and saving. In this case overseas investment is treated as a residual to show

how much was possibly financed from domestic savings. From this analysis it seems that investment in the sterling area could have been financed from domestic saving only in 1956. The implications of this are that the excess of overseas investment over saving in the rest of the period had to be financed through current surpluses or extraordinary capital inflows such as the accumulation of sterling balances by the rest of the sterling area.

From 1950-54, the RSA accumulated £797m worth of sterling assets and British investment in the sterling area not covered by domestic savings amounted to £768m. In these five years, then, the sterling area as a whole was providing for its own capital within the system. Thus it appears that in this period, those sterling area countries accumulating sterling assets, thereby indirectly lending their surpluses back to the UK, were financing UK overseas investment. As noted in Chapter I, an alternative view is that UK overseas investment generated the accumulation of short term British liabilities. The data thus warrant a comparison of investment and sterling balances. Table IV.J. shows that this relationship did not continue for the years 1955-58. In these years there was a net disinvestment in sterling assets by the Colonies and the independent sterling area of £614m while British investment in the sterling area in excess of domestic saving accelerated to £547m for the four years together. The external financing for this investment

had to be found from other sources for these years.

The contemporary interpretation of the source of capital for UK overseas investment was that the Colonies accumulated sterling balances which financed capital flows to the independent sterling area⁷¹. In this way the UK was in some sense borrowing from the Colonies to lend to the independent sterling area who were not forced to reduce their claims on the UK in order to finance their own development.

Table IV.K. shows changes in sterling balances and flows of UK investment for those members of the sterling area for which partner data on capital flows are available.

Table IV.K.
Changes in Sterling Balance Holdings and
Net Flow in UK Investment
1950-58

£m Member	Sterling Balances Increase	Investment
Colonies	607	943
Rhodesia Nyasaland	48	214
New Zealand	29	38
South Africa	-52	127
Australia	-86	448
India	-666	5

Notes: Sterling balance figures from Monthly Report on External Finance, BoE EID3/98-106. Investment estimates from partner data, see Table IV.A.

From Table IV.K. it is clear that allegations that the Colonies were financing investment in the independent sterling area are false since there was a net capital

⁷¹J. Polk, Sterling: Its Meaning in World Finance, Harper Bros., New York, 1956. p.229., BIS, The Sterling Area, Basle, Jan. 1953. p. 45., OEEC, Economic Conditions in the UK, p. 25.

outflow from the UK to the Colonies amounting to some £340m during the 1950s. The figures for India reflect her poor credit rating in London and the large volume of sterling balances in 1950 that were subsequently run down as part of India's development programme.

On the basis of the experience of this group of sterling area countries it does not seem that there was a positive relation between investment flows and movements in sterling balances. This undermines the allegation that UK investment in the RSA was directly related to increases in sterling balances. This does not, however, refute the suggestion that sterling balances were larger than otherwise due to capital inflows and that therefore a restriction on UK capital exports would have improved the UK external 'position'. In May 1957, the Treasury undertook a study of the volume of government borrowing by the RSA in relation to their sterling holdings and concluded that the major sterling area borrowers did not have sufficient liquid assets available to finance their investment programmes⁷². In this case, an embargo on UK capital exports would have simply meant a slower rate of development for these countries rather than an improvement in the ratio of UK reserves to liabilities. Indeed, in this scenario, the abandonment of the development plans of these RSA countries

⁷²"Commonwealth Government Borrowing in the UK in Relation to Sterling Balances", May 1957. PRO BT213/96.

would no doubt have hurt the UK current account in the medium term.

A more detailed breakdown of Colonial borrowing on the London market shows the redistribution of surpluses among the Colonies. This is shown in Table IV.L. which shows increases in sterling balances for selected Colonies from 1950-55 (the years for which detailed data are available) and official borrowing from the London market for these

Table IV.L.
Sterling Balance Holdings and Official London Borrowing
1950-1955

fm Colony	Increase in Sterling Balances	London Borrowing
Nigeria	177	6.8
Gold Coast	116	0.0
Hong Kong	64	0.0
Uganda	34	13.1
Malaya	13	4.8
Jamaica	13	6.8
Cyprus	12	7.8
Mauritius	11	4.7
E African Harbour Commn	11	24.6
Sierre Leone	10	3.7
British Guiana	1	2.2
Aden (1950-4)	0	1.3
Tanganyika	-4	6.8
Kenya	-31	18.7

Notes: Colonial sterling balance figures from J.G. Littler, "Sterling Balances of the Colonial Territories", 2 March 1956, PRO T236/3562. Official borrowing on the London Market from Times Issuing House Yearbook.

years. It is apparent that the surpluses of Nigeria, the Gold Coast and Hong Kong in part 'subsidized' borrowing by others such as Kenya and the East African Harbour and Railroad Commission. Allegations that the Colonies were 'exploited' to finance development in the Independent

Sterling Area must therefore be further ammended to allow for this redistribution of surpluses among the Colonies.

The next step in the assessment of the effect of investment in the sterling area on the British economy is to consider the return from the investment.

IV.C. Returns from Investment in the Sterling Area

IV.C.i. Exports

W.B. Reddaway's survey of direct overseas investment in the period 1956-64 gives the most complete source of empirical evidence on the returns to British investment. As part of the country analysis, W.B. Reddaway calculated the initial and continuing effects of direct investment in seven sterling area countries and eight non-sterling countries. His results are presented in Table IV.M.

Investment in the sterling area countries surveyed generated markedly more exports from the UK than non-sterling area investment both in the initial and continuing effects. On average, British direct investment in the sterling area countries generated exports equal to almost 25% of the increase in net operating assets compared with a total for all countries of only 9%⁷³. This is no doubt due to the fact that most of the sterling area countries were less developed than the non-sterling area countries

⁷³The total figure is not an average of the values for all countries, but rather an average for the questionnaire returns of participating companies.

surveyed. As Reddaway pointed out, this meant that the less

Table IV.M.
Effects of Increase in Net Operating assets of £100
1956-64

Country	Initial Exports	Additional Exports p.a.	Actual Increase in net Operating Assets 1956-64
Jamaica	27	9.5	£7.0m
Ghana	n.a.	8.5	£3.5m
South Africa	18	7.0	£53.0m
Nigeria	39	5.0	£14.6m
Malaysia	35	4.0	£27.5m
Denmark	15	4.0	£6.3m
India	20	3.5	£84.2m
Germany	2	3.5	£44.8m
Argentina	14	1.5	£14.9m
Australia	8	1.0	£201.2m
Canada	4	0.5	£267.7m
USA	1	-1.0	£133.3m
Brazil	11	-1.0	£8.9m
France	1	-5.0	£17.3m
Italy	10	-9.0	£8.0m
Total	9	1.5	£892.3m

Source: W.B. Reddaway, Effects of UK Direct Investment Overseas, Final Report, Cambridge University Press, 1968. p. 216.

developed countries were more likely to import capital goods and inputs related to the investment rather than using goods produced locally⁷⁴.

Reddaway further disaggregated the effect of direct investment on exports by type of export and by country. The interesting aspects of the results for the sterling area are presented in Table IV.N.(a) and Table IV.N.(b). In Table IV.N.(a) it is apparent that the less developed ex-colonies

⁷⁴Ibid., p.217.

show greater dependence on UK exports than the older independent sterling countries as reflected in the percentage of fixed asset expenditure spent on British equipment. This reinforces the conclusion that the effect of direct investment on exports of capital equipment was closely related to the level of development of the receiving country. The exception is investment in South Africa. The implication is that investment in sterling area countries had more favourable effects on machinery exports than investment outside the area because of their lower level of development than the non-sterling countries surveyed⁷⁵.

Table IV.N.(a)
Purchases of Capital Equipment from the UK
By Subsidiaries

Annual Averages for 1955-64

fm p.a.

Country	(1) Purchases of Capital Equipment	(2) Expenditure on Fixed Assets	(3) (1) as % (2)
Jamaica	0.3	1.1	26.0
Malaysia	1.4	5.5	25.6
Nigeria	1.1	4.3	25.2
Ghana	0.5	2.1	25.1
South Africa	1.4	6.4	21.3
India	2.3	13.7	16.9
Australia	2.7	25.5	10.5
Total 15 Countries	12.3	129.3	9.5

Source: W.B. Reddaway, Effects of UK Direct Investment Overseas: Final Report, p. 364.

⁷⁵The non-sterling area countries are; Denmark, Argentina, Brazil, Italy, Germany, Canada, U.S.A and France.

Table IV.N.(b)
Purchases of Input Items from the UK
By Subsidiaries
Annual Averages for 1955-64

fm p.a.

Country	(1) Purchases of Inputs	(2) Net Operating Assets	(3) (1) as % (2)
South Africa	12.7	97	13.0
Jamaica	1.0	8	12.1
Australia	16.1	202	8.0
Malaysia	3.3	55	6.0
Ghana	1.5	25	6.0
India	7.0	156	4.5
Nigeria	2.0	51	4.0
Total 15 Countries	52.7	1281	4.1

Source: W.B. Reddaway, Effects of UK Direct Investment Overseas: Final Report, p.365.

Table IV.N.(b) tells a similar story for input items although there does not appear to be the same division between Colonies and independent sterling countries for Column (3). South Africa and Australia stand out as accounting for more than half of the purchases of UK inputs by the sterling countries. This probably reflects the fact that many of the subsidiaries operating in Malaysia, Nigeria, Ghana and India were plantations or mining interests which would not import as many inputs due to the nature of the enterprise. Still, of those companies surveyed, sterling area subsidiaries accounted for 46% of the net operating assets and 83% of the purchases of inputs from the UK.

It is interesting to note that imports of inputs to UK subsidiaries amounted to more than twice the amount of imports of capital goods. The absolute values are, however,

small relative to total British exports. Subsidiaries' imports of capital goods amount to only 7%-8% of UK machinery exports to the ex-colonial group and about 3% of UK machinery exports to the older independent members⁷⁶.

It is possible that Reddaway's results are distorted by the type of industry he was able to survey in the sterling area countries as compared with the non-sterling area. Table IV.O. shows the subsidiaries' purchases of capital equipment broken down by industry. The geographical results would be distorted, for example, if the 'Vehicles and Components' companies surveyed all operated in the sterling area while the paper companies operated in the non-sterling area.

Unfortunately, it is not possible to determine to what extent the geographical distribution of industrial concerns distorts the figures. All of the manufacturing companies surveyed by Reddaway and listed in an Annex to the reports had subsidiaries in several countries, usually both in the sterling area and outside, and there is no way of knowing to which subsidiary in which country the details of the companies' investments pertain. In the case of Vehicles and Components, for example, most of Dunlop's and Joseph Lucas' subsidiaries were in France and Germany but most of British Leyland's subsidiaries were in sterling area countries.

⁷⁶Ibid.

Table IV.O.
Purchases of Capital Equipment and Input Items from the UK
By Subsidiaries
Annual Averages for 1955-64

%	Purchases of Capital as % Expenditure on Fixed Assets	Purchases of Inputs as % Net Operating Assets
<u>Industry</u>		
Vehicles & Components	20.7%	18.5
Textiles	18.0	4.5
Building Materials	14.5	8.4
Chemicals	12.6	2.8
Non-electrical Engineering	10.6	17.2
Food, Drink, Tobacco	10.5	1.9
Metals & Metal Products	9.7	3.9
Electrical Engineering	4.4	7.6
Paper	2.4	0.1
Total Manufacturing	10.5	4.7
Mining	5.2	0.9
Plantations	8.2	1.2
Total	9.5	4.1

Source: W.B. Reddaway, Effects of UK Direct Investment Overseas: Final Report, Table VI.1(b), p. 364.

It is somewhat easier to interpret the data for mining and plantations. The mining companies' subsidiaries were mostly located in South Africa, Malaysia and Nigeria and all of the plantations surveyed were located in either Malaysia or India. The purchases of capital equipment from the UK by these countries all exceeded the 15 country average. This was especially true for South Africa, Malaysia and Nigeria. The ratios for mining and plantations, however, were much lower than for all industries, only 5.2% for mining and 8.2%

for plantations. Since the ratios for these countries far exceeds the 5% and 8% associated with mining and plantations, it is likely that the manufacturing subsidiaries operating in these sterling area countries must have been especially oriented toward importing capital goods.

In the case of Malaysia, for example, rubber plantations account for 56% of the recorded net operating assets. Malaysian subsidiaries' total purchases of capital equipment amounted to 25.6% of expenditure on fixed assets, while the rubber plantations tended to spend only 18.8% of their fixed asset expenditure on British capital equipment⁷⁷. The contrast for imports of inputs is 0.5% for rubber plantations and 3.3% of Malaysian subsidiaries as a whole⁷⁸. This suggests that on average Malaysian manufacturing subsidiaries were much more geared to importing capital goods from the UK than subsidiaries in other countries.

The same story can be told for India where tea plantations accounted for 46% of subsidiaries' net operating assets. Imports of British capital goods of Indian tea plantations were only 5.2% while the proportion for British

⁷⁷Reddaway, Effects of UK Direct Investment, Table I.1, p. 380. It is not possible from the data to calculate the percentage of expenditure on fixed assets by Malaysian subsidiaries was for rubber plantations.

⁷⁸Ibid.

subsidiaries in India as a whole was 16.9%⁷⁹. Imports of inputs by tea plantations was 'negligible'⁸⁰ but the proportion for all Indian subsidiaries was 4.5%.

The implications of this analysis are not water-tight but they point consistently toward the conclusion that direct investment in the sterling area was more successful in generating exports of capital goods and British made inputs than investment elsewhere. The importance of this to the British balance of payments, however, should not be overstated since the exports of these goods to UK subsidiaries comprised such a small part of machinery exports to these countries.

Table IV.P. shows the relationship of UK overseas investment to exports in the 1950's as compared with the American experience. Line A shows that long term investment as a proportion of exports to the sterling area fluctuated through the period but the proportion was substantially larger than UK investment in the rest of the world or American overseas investment. This is especially true when shown as a proportion of GDP. The low figure in Line B is to be expected since capital flows to the non-sterling area were more strictly controlled

⁷⁹Ibid.

⁸⁰Ibid.

Table IV.P.
UK and USA Net Long Term Investment as a Proportion of
Merchandise Exports and GDP

	1950	1951	1952	1953	1954	1955	1956	1957
UK								
To Sterling Area								
a) KX/X	.230	.150	.150	.193	.181	.124	.158	.230
a)/GDP	.020	.012	.011	.013	.012	.007	.009	.012
To Rest of the World								
b) KX/X	-.091	.115	.013	.027	.021	.032	.026	-.043
b)/GDP	-.008	.009	.001	.002	.001	.002	.001	-.002
USA								
c) KX/X	.027	.107	.069	.040	.043	.030	.142	.173
c)/GDP	.0001	.0003	.0002	.0001	.0001	.0001	.0003	.0004

Notes: KX = Overseas long term investment

X = Merchandise Exports

UK GDP current prices at factor cost, £b. USA GDP current market prices, \$b. Source; Historical Statistics of the United States, Colonial Times to 1957, Bureau of the Census, Washington, 1961, Long Term Economic Growth 1860-1970, US Department of Commerce, 1973, Balance of Payments of the UK, 1946-57, HMSO, 1959, Annual Supplement, Monthly Bulletin of Statistics, Central Statistical Office, 1975.

while exports to the dollar area, especially, were actively encouraged. Still, assuming a relationship between investment and merchandise exports, it appears that investment in the sterling area was relatively less efficient in generating exports than investment elsewhere by the UK or overall foreign investment by the USA. For UK investment in the sterling area, £5.69 worth of merchandise exports is associated with each £1 of investment while £11.3 of merchandise exports is associated with each pound of investment outside the sterling area. For the United States, £12.7 of exports is associated with each £1 of overseas investment.

Export earnings were, of course, not the only returns to expected from overseas investment. Unfortunately the measurement of interest, profits and dividends falls prey to the same difficulties as the measurement of the capital flows themselves since a large proportion of these earnings was not officially recorded.

IV.C.ii. Interest, Profits and Dividends

Most of the official capital destined for the sterling area was in the form of grants on which no immediate return was expected. Official loans such as those offered under the CDC carried an interest rate 1% above bank rate, amounting to between 3% and 6% through the period. Still, as is apparent in Table IV.B., private investment accounted for most of the investment in the sterling area and therefore most of the returns on investment but the rate of return is fairly difficult to establish.

W.B. Reddaway's enquiry revealed that the average annual post-tax profitability of UK manufacturing subsidiaries operating in the sterling area was 10.4% in 1955-64, but the post-tax profitability to the UK stake as a whole in the sterling area 9.5%. Still, this is 1% higher than the comparable figure for profitability of UK stake in all fifteen countries combined⁸¹. Reddaway's results are presented in Table IV.Q.

A second source of information is the census returns

⁸¹W.B. Reddaway, Final Report, Table IV.5 p. 358.

of investment in Australia, South Africa and India.

According to the official census for 1950-58, the investment income payable to the UK from Australia averaged 10.8% of the book value of net

Table IV.Q.
Profitability of UK Stake in
Direct Investment in Sterling Area Countries

Country	UK Stake (£m)	Post-Tax Profitability (%)
Malaysia	50.8	19.8
Ghana	24.1	13.4
South Africa	97.0	10.5
Jamaica	5.2	8.4
Australia	156.4	8.0
India	132.4	7.7
Nigeria	49.5	4.7
Total	515.4	9.5

Source: W.B. Reddaway, Final Report, Table IV.5, p. 358.

assets in Australia of branches of UK companies plus paid up value of shares, debentures, unsecured notes and other obligations of Australian companies held by UK companies or individuals⁸². These figures include portfolio investment in Australian companies as well as direct investment by the UK. The figures are presented in Table IV.R. which also shows the importance of investment income from Australia to the total investment income earned from sterling area investments⁸³.

⁸²Annual Bulletin of Oversea Investment: Australia, 1960-61, Canberra.

⁸³Not all of the recorded Australian investment income payable would appear in the UK balance of payments since some part was retained in Australia.

Information on investment income from South Africa is limited to figures for 1956 which show investment income paid to the UK amounted to 8% of the recorded UK-owned capital stock in that year according to the 1956 census of foreign investment⁸⁴.

Table IV.R.

Total Income Payable on UK Investment in Australia,
Net Assets of Branches of UK Companies and
UK Investment in Australian Companies

£m	1950	1951	1952	1953	1954	1955	1956	1957	1958
UK Investment (Book Value)	203.8	227.0	244.8	268.9	294.8	333.8	368.0	399.3	428.5
Income Payable	24.8	22.6	23.8	28.2	31.7	38.4	39.6	39.0	45.3
%	12.2	10.0	9.7	11.5	10.8	11.5	10.8	9.8	10.6
Investment Income from Australia as % of Sterling Area Total	13.6	10.7	12.4	15.3	16.2	17.5	17.2	17.6	

Source: Annual Bulletin of Oversea Investment: Australia, 1960-61 Tables 20 and 24., Sterling Area total income paid from UK Balance of Payments 1946-57, HMSO, 1959.

For India, complete data on investment returns are available only for 1953 and 1955-58. For these years investment income payable to the UK averaged 8.8% of UK-owned capital stock. Investment income payable is presented in Table IV.S.

From this admittedly sketchy data, returns on UK investment in the sterling dominions was probably between 8% and 11% of capital which is roughly consistent with Reddaway's finding for these three countries as a group.

⁸⁴'Final Results of the 1956 Census of The Foreign Liabilities and Assets of the Union of South Africa', Quarterly Bulletin of Statistics, South African Reserve Bank, 1958.

This can be compared with an opportunity cost of a return on

Table IV.S.
Investment Income Payable on
UK Private Investment in India
(net of Indian tax)

£m	1952	1953	1954	1955	1956	1957	1958
UK Business Investment	n/a	244.9	n/a	282.7	294.5	299.2	298.6
Income Payable	14.4	21.1	32.3	26.8	31.7	22.9	22.6
%	-	8.6	-	9.5	10.8	7.6	7.6

Source: Reserve Bank of India Bulletin, April 1960 for stock of business investment, January 1956, June 1958 and August 1960 for income payable.

non-industrial investment in the UK of 3%⁸⁵ yielding a net gain of 6% on investment in the sterling area compared with 3% for overseas investment as a whole.

Table IV.T(a)
Summary of Return to UK Investment
Percentages
Profits % Capital Goods Imports Input Goods
UK Stake % Increase in Fixed % Operating

Imports Country Assets	UK Stake	% Increase in Fixed Assets	% Operating
Malaysia	19.8	25.6	6.0
Ghana	13.4	25.1	1.5
Jamaica	8.4	26.0	12.1
Nigeria	4.7	25.2	2.0
India	8.8	16.9	7.0
Australia	10.8	10.5	8.0
South Africa	8.0	21.3	13.0

⁸⁵W.B. Reddaway, Final Report, p. 336.

Table IV.T.(b)
Summary of Returns to UK Investment
Effect on Current Account

£m p.a. Country Imports	Profits	Capital Goods Imports	Inputs Goods
Malaysia	10.1m	1.4m	3.3m
Ghana	3.2m	0.5m	1.5m
Jamaica	0.4m	0.3m	1.0m
Nigeria	2.3m	1.1m	2.0m
India	25.0m	2.3m	7.0m
Australia	33.3m	2.7m	16.1m
South Africa	55.5m	1.4m	12.7m
Total	129.8m	9.7m	43.6m

Notes: India, Australia and South Africa Profits figures from Census data (see text). All other figures from Reddaway, Final Report.

In summary, Tables IV.T. (a) and IV.T.(b) present the rate of return on UK investment in the sterling area against estimates of the stock of UK investment to arrive at estimates of the benefits of this investment to the current account. Reddaway's survey of the absolute value of per annum imports from the UK by subsidiaries is added to the value of average annual profits. What is revealed in Table IV.T.(b) is that, on this sample, profits comprised the most important contribution of overseas investment in the sterling area, amounting to perhaps 70% of the direct credit due to the current account.

From 1950 to 1957 interest, profits and dividends from the sterling area amounted to a cumulative surplus of £896m or a yearly average surplus of over £112m. This surplus was maintained despite escalating interest payments on the sterling balances held by sterling area members.

If continued investment in the sterling area was

Table IV.U.
UK Invisible Account
Interest, Profits and Dividends

fm Area	1950	1951	1952	1953	1954	1955	1956	1957
Sterling Area								
Credit	182	212	192	184	196	220	230	221
Debit	-49	-56	-79	-88	-94	-112	-134	-130
Net	133	156	113	96	102	108	96	91
Dollar Area								
Credit	53	58	57	58	57	67	81	83
Debit	-35	-76	-78	-81	-97	-110	-70	-71
Net	18	-18	-21	-23	-40	-43	11	12
Non-Sterling OEEC								
Credit	14	14	13	16	25	24	27	29
Debit	-20	-18	-28	-29	-28	-31	-38	-32
Net	-6	-4	-15	-13	-3	-7	-11	-3
All Areas								
Credit	271	305	289	286	310	346	373	361
Debit	-112	-158	-198	-211	-231	-269	-259	-251
Net	159	147	91	75	79	77	114	110
Current Balance								
	297	-419	227	179	211	-73	258	272

Source: UK Balance of Payments 1946-57, HMSO, 1959.

considered to be a quid pro quo for the overseas members to maintain their sterling balances, the direct cost of this policy to the current account was interest payments on the sterling balances and the direct benefits were interest, profit and dividend credits from the UK investment. The net interest, profits and dividends from the sterling area might thus be considered to approximate the net benefit of this arrangement to the current account of the UK balance of

payments⁸⁶.

The net direct benefit of some £112m p.a. to the current account in the form of interest, profits and dividends (see Table IV.U.) must be set against the debit on the capital account of the balance of long term investment less accumulations in sterling balances. The volume of long term capital outflow to the sterling area in excess of short term capital inflows in the form of sterling balances is presented in Table IV.V..

Table IV.V.
UK Capital Account with the Sterling Area

£m	1950	1951	1952	1953	1954	1955	1956	1957
Sterling Area Sterling Balances	398	84	-97	284	128	-79	-298	-161
Long Term Capital Flows to the RSA	-234	-192	-199	-235	-243	-254	-231	-340
(A) Balance of Long Term and Short Term Capital	164	-108	-296	49	-115	-104	-529	-501
(B) Net Invisible Balance with Sterling Area	133	156	113	96	102	108	96	91
(A) + (B)	297	48	-183	145	-13	4	-433	-410

Source: UK Balance of Payments 1946-57, HMSO, 1959 for long term capital, Monthly Report on External Finance, BoE EID/98-106 for sterling balances.

Bearing the assumptions of the relationship between sterling balances and long term capital flows in mind, if the rationale of continuing investment in the sterling area was to encourage the RSA to continue to hold short term sterling assets which in turn were available to finance the

⁸⁶The approximate nature of this calculation must be emphasized since it excludes £30-£60m worth of exports p.a. associated with investment in the sterling area.

long term investment, the policy may be said to have been a success from 1950 to 1955. During these years the long term capital outflow of £1.357b was met by an inflow of short term capital and invisible earnings of £1.426b. By 1956 and 1957, however, the sterling area sterling balances were being run down at a much faster rate due to a decline in the RSA balance with the NSA, suggesting that the quid pro quo was no longer recognized and/or that the guarantee of free capital flows from the UK was no longer an incentive to restrain dollar expenditure.

IV.D. Capital Flows as a Cohesive Factor

The basis of the theory that capital exports were key to the cohesion of the sterling area is three-fold. First, there was an evident decline in the other components of the system. Trade discrimination was being undermined by GATT and by the general movement toward freer trade in the international economy. The practice of maintaining reserves in sterling and pooling foreign exchange earnings was also weakening as the United States and the rest of the world became more important markets both for trade and capital. Finally, the traditional alignment with the UK that most members had enjoyed in the early post-imperial days was dissolving as the dominions grew further away from the UK, and Colonial territories approached independence. Free access to British capital thus became a relatively more

important part of the system as the other incentives dissolved.

A second piece of evidence that free access to British capital was a cohesive factor, at least at the beginning of the period, is an episode in 1948-49. At this time, South Africa was refusing to supply other sterling area members with gold in payment for their exports. In retaliation, during the first half of 1949, Britain refused the South African government access to the London market through which South Africa had hoped to relieve their growing sterling shortage. Private capital was also inhibited from flowing to South Africa⁸⁷. Finally, in November 1949 the South African government was allowed to float a £10m loan in London and two months later it was announced that South Africa was to pay gold for all essential imports from the rest of the sterling area. This meant South Africa could no longer restrict gold payments when she had sterling to spend due to capital flows from Britain or export earnings from the rest of the sterling area. By starving South Africa of sterling through restrictions on capital movements, Britain had been able to bring South Africa back into her traditional role of gold supplier for the sterling area. Access to the London market was, thus, an effective sanction against South Africa although this was due to the special situation of a sterling shortage that would not prevail in

⁸⁷The Economist, Vol. CLVIII, No. 5554, 4 Feb., 1950. p. 278.

the case of a member with large sterling balances.

Thirdly, official opinion in the 1950s seemed convinced that capital flows were key to the cohesion of the sterling area. At the beginning of the period, for example, a Colonial Office Programmes Committee Report concluded that the dependence of the rest of the sterling area on long term British capital was perhaps the most important factor on which the UK could rely to keep the system together⁸⁸.

This belief was echoed in the Treasury-Bank of England Sterling Area Working Party Report of 1956 which concluded that "any trend which connotes an absolute or relative decline of London as a source of capital cannot help but weaken in some degree the ties of the sterling area"⁸⁹.

Whether the free capital movement enjoyed by the members of the sterling area really was an important factor in maintaining the cohesion of the system through the 1950's depends on the importance of British capital to the sterling area recipients. Here again, because of the sketchy nature of the records of long term capital movements, any assessment must remain incomplete. However, the census data available for Australia, New Zealand, India and South Africa show the proportion of total foreign capital that originated in the UK.

⁸⁸D.J. Morgan, The Official History of Colonial Development Vol III, p. 38.

⁸⁹Bank of England copy of the Sterling Area Working Party Report, 26 June, 1956. p. 19. BoE OV 44/32.

In Australia, British investors accounted for 61% of private foreign capital flows through the period with a slight downward trend. The USA was the second largest source of capital, claiming 30% on average with a slight upward trend. In New Zealand, an even larger proportion of foreign direct investment came from the UK, averaging 72% while dollar area investment claimed only 15% of the total with a slight downward trend to the end of the period.

The Indian census data is slightly more complicated and is available in detail only for 1956-58. Through these three years, the UK share of net foreign investment fell from 64% to a net disinvestment. Through the same period the American share grew from 28.7% to 159% as it offset the disinvestment by the UK. The net figures, however, distort the true picture since they are heavily affected by massive capital repatriations in the form of compensation for nationalization of British interests. In 1958, for example, some £16m was repatriated, mostly to the UK, as a result of the nationalization of the petroleum industry⁹⁰. Since most compensation payments were to the UK, the gross figure for capital flows tells a significantly different story, with the UK share of foreign investment rising from 66% to 74% from 1956-58 and the American share declining from 23% to 18%⁹¹. It should also be noted that

⁹⁰Indian Reserve Bank Bulletin, April 1960, p. 469.

⁹¹Ibid.

these capital flow figures do not account for all of the flow of capital from the UK to India since much of the Indian development plans were financed by a rundown of her substantial sterling balances. More general information on UK capital flows for the period 1948-53 is available from comments in the Indian Reserve Bank Bulletin which estimate that the UK accounted for 90% of the total inflow of foreign business investment in these years⁹². By 1954-55 this estimate had fallen to 70% and by 1956 was 64%⁹³. The figures for the UK share in stocks of foreign-owned capital reflect this decline. In 1953, the UK claimed 83% of the stock of foreign capital in India but by 1958 this had fallen to 70% although the absolute value of UK capital had risen from £245m to £299m⁹⁴.

For South Africa, stock values of foreign capital for 1956 only are available. In this year, the UK was responsible for 65% of foreign capital (69% in manufacturing). The USA was a distant second, accounting for only 14% of foreign capital⁹⁵. For all these major independent members of the sterling area, then, the UK was still the single most important supplier of foreign capital with the United States and the rest of the world following a

⁹²Indian Reserve Bank Bulletin, Sept. 1958, p. 1012.

⁹³Ibid.

⁹⁴Ibid.

⁹⁵South African Reserve Bank Bulletin

distant second through to the end of the period.

Data for the Colonies are less specific but, as expected, the evidence available indicates that Britain was the largest foreign investor. Between 1949-57 Colonial authorities were able to borrow only £11m outside the sterling area and private interests only £9m, none of which came from private sources⁹⁶. The British authorities actively encouraged private foreign investment in the Colonies, including a campaign after 1952 to give the Colonies "sex appeal" for the American market on the basis that "the American is an emotional creature, and that if one can find a 'good cause' the possibilities of tapping his pocket are almost endless"⁹⁷. Discussions with American trade officials in London, however, served only to indentify the problems of attracting investment to the Colonies rather than achieving any real improvement. Wayne Taylor, the American adviser, suggested setting up Investment Trust schemes which would better suit American tax law. Other changes to sterling area tax rules were also suggested along with revisions of sterling area exchange control to allow repatriation of capital profits⁹⁸. The Treasury was

⁹⁶"Non-Sterling Borrowing by the Sterling Commonwealth Since 1945 (Effectively 1949)", 7 May, 1957. PRO BT213/96.

⁹⁷Letter from Mr. Flett of HMT to Mr. Christelow of UKSTD, Washington, 19 May, 1952. PRO T231/605.

⁹⁸Notes of meetings at HMT with Mr. Wayne Taylor 10-13 June, 1952. PRO T231/605.

unwilling to tailor sterling area tax law to American wishes and such changes in the sterling exchange control were unlikely. Foreign investors were allowed to repatriate only the sterling value of their original capital stake to avoid enterprises designed simply to breach currency boundaries to allow otherwise illegal exports from hard currency to soft currency countries⁹⁹. These discussions suggest that the UK was the major private investor in the Colonies.

In both the dependent and independent sterling area then, the UK was still the primary market for foreign capital which would seem to support the thesis that these capital flows were an integral part of the sterling area system. The cohesive force of these flows, however, hinges on how dependent the sterling area members were on foreign capital. A rough calculation based on Morgan's estimate of Colonial capital formation¹⁰⁰ and the IMF Balance of Payments Yearbook estimates of capital flows suggests that British capital accounted for as much as 23% of Colonial capital formation. The dependence of the Colonies on British capital thus seems evident but the independent sterling area was the primary threat to the cohesion of the system. Here, the figures available look much less

⁹⁹HMT note on the 'Need for Controls on Inward Dollar Investment', 29 July 1952. PRO T231/605.

¹⁰⁰D.J. Morgan, The Official History of Colonial Development Vol IV: Changes in British Aid Policy, 1951-70, Macmillan, London, 1980., p. 10-11.

promising.

In Australia and New Zealand British capital amounted to an average of only 4% of gross domestic fixed capital formation in each year¹⁰¹. According to UK estimates, total net foreign long term capital and official donations from abroad to India and South Africa comprised only 1.8% of GDP for each country by 1958¹⁰². The UK share of this net figure for India was negative for that year. If the UK share in foreign capital in South Africa was the same or less in 1958 than in 1956, British capital would amount to at most 1.2% of GDP¹⁰³. This evidence suggests, then, that although the UK was the largest supplier of foreign capital to the independent sterling area, these countries were not overwhelmingly dependent on free capital flows from the UK.

The cohesive role of these continuing free capital movements among members of the sterling area must therefore be thrown into some doubt. Certainly the 3%-5% of fixed capital formation might have been an important addition to the economies of the independent sterling members but this contribution was certainly not of the order of the dependence of the Colonies on continued British investment.

¹⁰¹Yearbook of National Accounts Statistics 1959 & 1960, Statistics Office of the United Nations, New York, 1960 & 1961.

¹⁰²Ibid.

¹⁰³International Flow of Long Term Capital and Official Donations 1951-59, UN Department of Economic and Social Affairs, New York, 1961. p. 28-29.

This analysis also serves to put into perspective the degree to which sterling area development was accomplished from domestic rather than overseas resources.

The weakness of the capital market incentive is further illustrated by an episode in 1955 which contrasts with the successful sanction against South Africa in 1949-50 described above. In 1955, India appeared unwilling to peg to a fluctuating pound and was accumulating gold reserves, against the sterling area 'rules'. Sir Leslie Rowan, second secretary at the Treasury, in a draft paper on "Problems of the Sterling Area" in October 1955, suggested that if a country such as India did not comply with the rules it should be ejected from the area or its credit facilities should be limited¹⁰⁴. M.W. Stamp of the Bank of England responded that the political outcry in the UK from such a move would be considerable and furthermore that the rest of the sterling area was not much impressed by the free access to London's capital, especially given the high interest rates attached to borrowing in London¹⁰⁵. This exchange shows that the restriction of capital flows was no longer considered as effective a sanction to enforce discipline in the system as it had been when used against South Africa in 1949.

¹⁰⁴"Problems of the Sterling Area", 3 Oct. 1955. BoE OV 44/30.

¹⁰⁵Paper by M.W. Stamp, 19 Oct. 1955. BoE OV 44/30.

IV.E. CONCLUSION

The analysis presented above suggests that the UK had more to lose from restricting capital flows than the rest of the sterling area stood to lose from forgoing this capital. Such a policy would have threatened the international role of sterling, thus undermining Britain's position in the international economy. Imposing further exchange controls would put Britain out of step with the general international movement toward convertibility and would require a violation of her international commitments. This is all, of course, in addition to the loss to the UK of visible and invisible earnings associated with overseas investment. On the other hand while the RSA took more capital from the UK than any other foreign country, it comprised a relatively small part of their total fixed capital formation.

The evidence also suggests that while the UK thus had more to lose from such a policy, they also had less to gain than much contemporary opinion supposed in terms of easing balance of payments problems and stemming the drain on reserves. In this context, any policy of further restricting capital flows would have been irrational not just because of the political and economic considerations discussed at the time (ie. cohesion of the area and current account benefits) but also because these cuts would not have significantly helped the balance of

payments or the reserves position.

A counterfactual has been presented which suggests that the investment in the sterling area did not hamper the growth of the British economy because of the small size of capital flows to the sterling area relative to domestic investment and the relative inefficiency of Gross Domestic Capital Formation in Britain. Furthermore, until 1956 the part of sterling area investment which could not be financed out of domestic savings was available from the accumulation of sterling balances by the Colonies. The available empirical evidence suggests that the rate of profit and the capacity for generating exports was greater for investment in the sterling area than for investment elsewhere. The losses to the current account from a reduction in overseas investment would thus be exaggerated since any capital restrictions would have to be focused specifically on the sterling area as non-sterling area investment was already restricted. Finally, the system of pooling the foreign exchange earnings of the RSA and free capital flows to the RSA appears to have generated a surplus for the balance of payments from 1950 to 1955.

Chapter V. The Sterling Area and British Domestic and External Monetary Policy

In April 1956 George Bolton, Director at the Bank of England, wrote that the sterling area "inhibits a flexible monetary policy in the UK, is a permanent source of anxiety to HMG and, in terms of the annual service, is a constant threat to Capital account"¹. In this context, Bolton was most concerned with the effect of the sterling area sterling balances but the operations of the whole sterling area system have come under similar criticism from subsequent analysts. Thus, as noted in Chapter I, Sidney Pollard has asserted that the sterling area was a "specific point of vulnerability for Britain"². He argued that "since its reserve was held in the City, the sterling area could be a tower of strength to London, but in times of stress it could also be a source of weakness, exaggerating the amplitude of fluctuations to which London was subject"³. Furthermore, in order not to "disappoint those who used the City of London as their banking centre, devaluation was ruled out repeatedly and much more harmful measures to the economy

¹G.F. Bolton "Sterling Balances and Monetary Policy", 4 April, 1956. BoE C40/690.

²Sidney Pollard, The Wasting of the British Economy; British Economic Policy 1945 to the Present, Croom Helm, London, 1982. p.34.

³Ibid.

preferred instead"⁴. The extent to which these accusations were justified is the topic of the present chapter. This will be divided into the pursuit of answers to two questions, the contribution of the RSA to instability in the reserves of the system as a whole and the extent to which the sterling area system inhibited British policy with respect to exchange rates and interest rates.

V.A. The Sterling Area and Stability of the Central Reserves

The first issue is to determine the extent to which the rest of the sterling area (RSA) contributed to instability in the area's reserves. To achieve this an important but often overlooked distinction must be made between the reserves of the sterling area and those of the UK alone. As described in Chapter II, the UK was the designated holder of most of the foreign exchange earnings of the sterling area as a whole. Thus, the monetary authorities of the sterling area converted their foreign exchange earnings to sterling in London and held the surplus after settlement with the UK in short term assets as future calls on the central reserves. This 'dollar pooling' was designed to conserve the amount of foreign exchange in the system since the idle dollars of a member in balance of payments surplus with the non-sterling area could be withdrawn by another member in deficit.

⁴Ibid.

The reserves of the area as a whole, however, were often referred to as UK reserves in the official statistics and therefore in unofficial analysis. Thus a contribution to the reserves by a member of the RSA was more likely to be referred to as adding to the sterling area reserves while a subsequent withdrawal was seen as a drain on UK reserves. For example, in response to a Treasury request for statistics on the 'sterling area reserves' the Bank of England Statistics Office responded with a table entitled "Sterling Area Countries Contributing to or Drawing on the UK Gold and Dollar Reserves"⁵. Of course this point should not be overstressed since, as banker to the sterling area, the British economy was influenced by fluctuations in the economies of RSA members which resulted in contributions to or drawings on the central reserves.

Peter Oppenheimer, writing in 1966, argued that "it is not possible to measure the independent impact of the OSA on London's monetary position in any simple way"⁶. His objections centred on the difficulty of detecting influences unique to the UK and RSA balances of payments. Thus he asserted that

⁵"Sterling Area Countries Contributing to or Drawing on the UK Gold and Dollar Reserves" Bank of England Statistical Office, 9 August, 1957. BoE EID3/114.

⁶P.M. Oppenheimer, "Monetary Movements and the International Position of Sterling" in D.J. Robertson and L.C. Hunter eds, The British Balance of Payments, Oliver and Boyd, Edinburgh, 1966, pp. 89-135. p. 115. OSA = Overseas Sterling Area.

to measure the specific contribution of the OSA in a meaningful sense one would have to exclude any change in the OSA balance of payments caused either by an opposite change in the UK balance or by some third factor affecting both UK and OSA balances simultaneously. Otherwise the distinction between UK and OSA contributors remains arbitrary⁷.

I would argue, however, that the net result of the interdependence of UK and RSA balances of payments with the rest of the world is an interesting measure. It is not, of course, possible to infer from the available figures a picture of what the UK reserves would have been without the sterling area. An example of the interdependence of their balances of payments is RSA raw materials exported to the UK for sterling and then manufactured by the UK into dollar earning exports. In this way, the RSA exports have a dollar earning element that does not appear in their share of the reserves. The motive for reserve pooling was to capitalise on the interdependence of the members and on offsetting responses to changes in the rest of the world. Since the sterling area included primary producers and manufactures producers it was hoped that the fortunes of the various members might move counter-cyclically so that the system would reduce the amount of foreign exchange required to maintain sufficient reserves to satisfy current needs. Some attempt to analyze the observable contributions of the RSA and the UK to the reserves which was the result of this

⁷Ibid.

system is necessary to judge its success or failure.

In the Monthly Report on External Finance prepared by the Bank of England and the Treasury for the Cabinet Overseas Negotiations Committee, quarterly movements in gold and dollars held by the Exchange Equalisation Account were broken down into their constituent parts and changes due to the UK balance with the Dollar Area were separated from transactions of each member of the RSA with the Dollar Area⁸. Sterling area transactions in dollars with the non-dollar area were recorded separately. The figures included only gold and dollar transactions going through London and ignored changes in gold and dollar holdings of RSA countries separate from the central reserves. This series thus recorded the identifiable gold and dollar transactions of the sterling area. The difference between this and actual changes in the central reserves was due to net errors and omissions.

A simple first test of the relative instability of changes in reserves due to the UK and the RSA is a comparison of the standard deviation from the mean of changes in reserves due to the UK balance with the dollar area compared to that of the RSA balance with the dollar area. These are shown in Table V.A. The standard deviation of UK balances with the dollar area on a quarterly basis is significantly higher than that of RSA balances with the

⁸Monthly Reports on External Finance 1950-58. BoE EID3/98-107.

Table V.A.
Quarterly Dollar Balances of the RSA and UK

	UK \$ Bal	RSA \$ Bal	RSA+UK
Standard Deviation	69.6	31.7	90.9
Mean	-29.7	7.4	-22.3

Source: Data from Monthly Report on External Finance. BoE EID3/98-107.

dollar area. The observable effect of the UK on the reserves was thus more volatile than the contributions of the RSA. Moreover, the RSA net contributions to the reserves varied more narrowly around a positive mean while the UK balances varied more widely around a mean of net drawing on the reserves of £30m per quarter. The final column in Table V.A., however, shows that the volatility of the dollar balances of the RSA and UK combined was significantly higher than the UK balance of payments with the dollar area alone. On a quarterly basis, the fluctuations of the RSA and of the UK tended to move together so that movements in the RSA balance of payments with the dollar area was indeed "exaggerating the amplitude of fluctuations to which London was subject"⁹.

Figure V.A. shows quarterly changes in the dollar balances of the UK, the Colonies and the larger independent sterling area countries¹⁰. This shows that it was the consistent level of dollar earnings by the Colonies that was

⁹Pollard, The Wasting, p. 34.

¹⁰These countries are Australia, New Zealand, India, Pakistan, Ceylon, South Africa, Burma, Eire and Iraq.

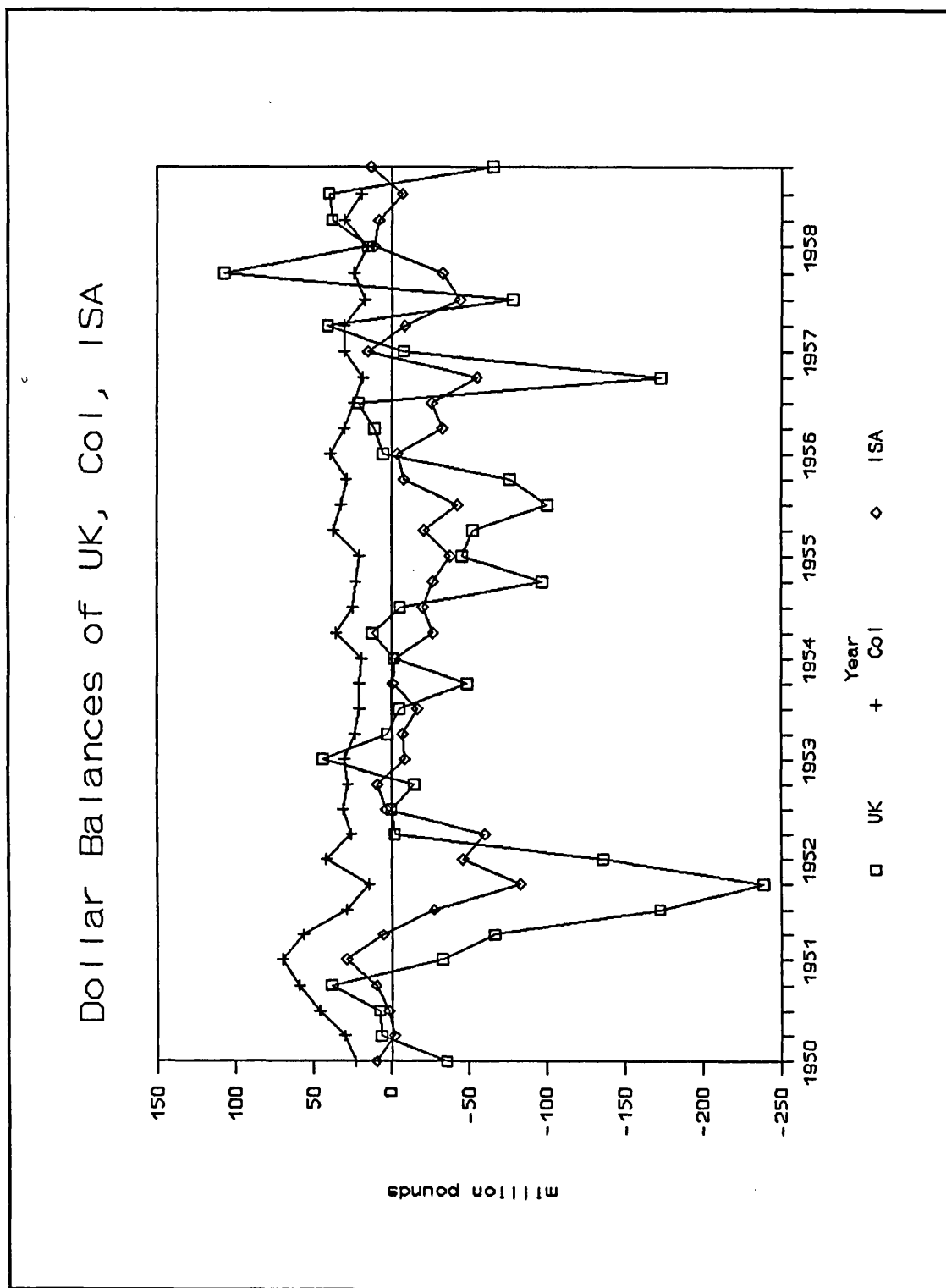


Figure V.A.

responsible for the net surplus of the RSA as a whole with

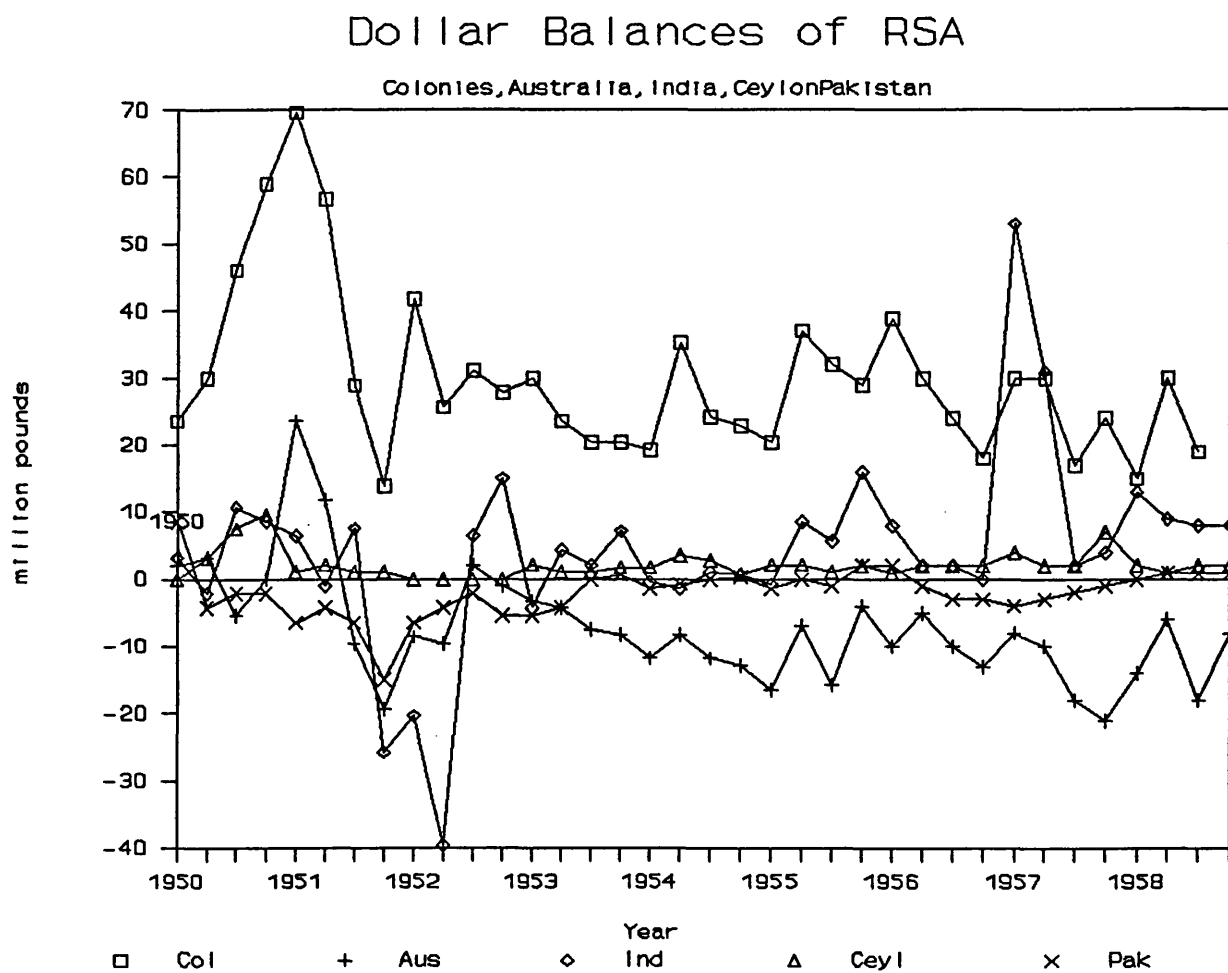


Figure V.B.

the dollar area from 1950-58. Figure V.B. shows the

experiences of individual countries in the sterling area. With the notable exceptions of Ceylon and India, the independent sterling area countries were in net deficit with the dollar area. Ceylon maintained a consistent if small dollar surplus and India was also in dollar surplus after 1955, mostly due to aid from the USA.

The drawings by these independent members of the sterling area were offset not only by Colonial dollar earnings but also by gold sales which are not included in Figure V.A. An average of £24m worth of gold was sold to the central reserves each quarter during the first five years of the 1950s¹¹. Once the London gold market was re-opened in 1954 more gold was sold and the average quarterly sales during 1955-58 was £53m¹². Almost all of this offsetting gold flow, however, came from South Africa with periodic contributions from Australia, Southern Rhodesia and British West Africa. Annual gold sales and purchases for 1950-56 are presented in Table V.B.

South Africa was never a formal member of the sterling area reserves pooling system. Instead, South Africa's hard currency deficits were settled out of her current gold production and separate gold reserves were kept for this purpose. In effect, however, she was a partial member of the central reserves since during the 1950s South Africa was

¹¹Monthly Report on External Finance 1950-58. BoE EID3/98-107.

¹²Ibid.

under various agreements to settle her balance of payments deficits with the UK in gold and also to reimburse Britain for the gold equivalent of her deficit in the EPU. As a result, South Africa's sterling deficits

Table V.B.
Gold Sales (+) and Purchases (-) in UK

\$m	1950	1951	1952	1953	1954	1955	1956
South Africa	205	187	192	220	349	465	526
Br.W.Africa	28	24	6	-	22	26	21
S.Rhodesia	18	12	2	-	14	18	18
Australia	30	6	-	-	-	-	56
Iraq	-	-	-	-	-	-8	-6
Pakistan	-	-11	-	-	-	-10	-
Persian Gulf	-	-	-	-	-	-	-3
Br.E.Africa	-	-	-	-	2	2	2
India	-	-	-	-	-1	-	-
Total	281	218	200	220	386	493	614

Source: "Radcliffe Committee: Sterling Area Countries Contributing to or Drawing on the UK Gold and Dollar Reserves" Statistics Office, Bank of England, 9/8/57. BoE EID3/114.

generated substantial amounts of gold for the central reserves in the same way that other RSA members' deficits with the UK generated dollars for the central reserves.

Most independent members of the sterling area were fairly consistent net drawers on the central reserves throughout the 1950s and the sterling area system allowed Colonial surpluses and South African gold sales to finance these deficits. In this sense the 'dollar-pooling' system was a success for overseas members of the sterling area. It did not, however, support British dollar deficits. This can be seen more clearly in the annual analysis which follows, in which the gold cost of the RSA through the EPU will be

included.

The annual UK Balance of Payments White Papers broke down the changes in gold and dollar reserves to their constituent parts on an annual basis. The changes attributed to the RSA cover net sales to or drawings on the central reserves due to

- a) Net transactions with the Dollar Area (including transactions through UK intermediaries)
- b) The dollar proceeds of gold sales regardless of the residence of the purchaser
- c) Gold and dollar settlements with non-dollar countries including the IBRD and IMF
- d) Gold sales in the UK for sterling.

The balance of the RSA with the EPU was not included separately in these figures although they are easily adjusted using the balance of the RSA as a whole with the OEEC on the basis that 40% of the sterling balance in the Union was settled in gold from 1950-54, 50% in 1955 and 75% in 1956-58. The figures are presented in Table V.C.

Here, the UK share of changes in the central reserves is calculated as the residual after identified RSA transactions are subtracted from the actual reserves changes in these years. As a result, the UK share will include errors and omissions. Bearing in mind this limitation, the figures are consistent with the quarterly results that the RSA was a net contributor to the central gold and dollar reserves throughout the 1950s, even including the deterioration of the RSA balance of payments with the EPU after 1955. The Colonial surplus and South

African gold sales were not sufficient, however, to support both the deficits of the independent sterling area and those of the UK in 1951, 1952 and 1955. In 1956, the reserves only increased due to a £200m IMF loan in response to the Suez Crisis.

Table V.C.
Analysis of the Central Reserves of the Sterling Area

	1950	1951	1952	1953	1954	1955	1956	1957	1958
Colonies									
a+b+c	131	165	136	101	100	121	111	101	88
Gold Sales									
	10	9	3	-	9	10	-	-	-
Total	141	174	139	101	109	131	111	101	88
ISA									
a+b+c	20	-63	-99	-14	-72	-98	-98	-38	51
Gold Sales									
	90	69	69	78	129	166	220	223	227
Total	111	6	-30	64	57	68	122	185	278
Total RSA									
a+b+c	152	102	37	87	27	23	13	63	139
Gold Sales									
	100	78	72	78	138	176	220	223	227
Total	251	180	109	165	166	199	232	287	366
Gold cost in EPU (-)									
	65	14	11	12	14	18	5	-83	-79
Total Contrib of RSA									
	316	194	120	187	180	217	237	204	287
Change in Central Res									
	575	-344	-175	240	87	-229	42	13	284
UK Share	259	-538	-295	53	-93	-446	-185	-191	-3

Notes: a = net transactions with the dollar area
b = \$ proceeds of sales of gold
c = gold and \$ settlements with non-dollar countries
ISA = Independent Sterling Area.'

Gold Sales include only those in London against sterling
Source: UK Balance of Payments White Papers. For the last three years the Balance of Payments data refer to total RSA only. For these years Monthly Report on External Finance data is used.

The essential conclusion from this analysis is that the RSA did not pose a measurable consistent burden on the central reserves. The dollar pooling system can be termed a success for the overseas sterling area since even without the gold sales of South Africa, the earnings of the Colonies balanced the drawings of the ISA until 1956 although the one-sidedness of this 'sharing' of reserves generated protests that the more developed members of the sterling area were exploiting the Colonies¹³. The system was less successful in offsetting the fluctuations of the UK because the balances of the RSA as a whole did not consistently move countercyclically to those of the UK. Still, the RSA as a whole was not overwhelmingly destabilizing to the reserves except perhaps during the reserves crisis of 1951-2. For most of the 1950s it was a case of the RSA surplus falling slightly when the UK deficit worsened dramatically rather than the RSA and the UK going into deficit and surplus together.

V.B. The Sterling Balances and Confidence

The second possible contribution of the sterling area to the vulnerability of the central reserves was the overhang of sterling area sterling balances over the foreign exchange reserves of the area. Because of the small ratio of reserves to short term liabilities, it was argued,

¹³For a critique of this view see Chapter II.

deteriorations in the balance of payments, temporary or otherwise, had to be met by 'stop' phases of heavy-handed constraints on the domestic economy. In this way the sterling balances restricted the flexibility of British policy-makers by exposing the reserves to the constant threat of speculative attacks. Thus Jim Tomlinson stated that "the great importance of the sterling balances for British policy was particularly in focusing so much attention on Britain's reserve position"¹⁴.

In the ideal functioning of the dollar pool, the sterling balances would have been accumulated alongside parallel contributions to the central reserves. The overhang of sterling balances in the immediate post-war period, however, was due to British wartime expenditure in the RSA and not from RSA foreign exchange earnings. This burden, however, did not manifest itself in the changes in the reserves because as the wartime assets of the ISA were rundown there was a convenient accumulation of sterling assets by the Colonies due largely to their 100% currency reserve requirement, the cautious development policy of Colonial governors and restrictions on Colonial dollar expenditure imposed by Britain. As seen in Chapter II, the overall level of sterling balances remained remarkably stable throughout the 1950s. The inflated value of the

¹⁴Jim Tomlinson, British Macroeconomic Policy Since 1940, Croom Helm, London, 1985. p. 51.

sterling balances during this period, however, gave the impression that if the RSA and the UK all went into deficit at one time, the RSA could try to cash in their sterling balances for gold or dollars from the central reserves. Since the sterling balances were three to four times the value of reserves in this period, the system as a whole would be bankrupted. Thus the very existence of large amounts of liquid liabilities, which by the 1950s were an integral part of the sterling area system, may have contributed to the general perception that the British reserves were unstable. In fact, a large part of the sterling balances were not very liquid since they included, for example, statutory currency reserves and sinking funds. In a serious crisis of a kind that did not arise in the 1950s, however, most of this 'hard core' of sterling balances could be liquidated. On the other hand, a more serious crisis than that which occurred in the 1950s may have been an opportunity for the UK to suspend sterling area convertibility. It will be shown later that it was believed by the framers of the ROBOT plan that this time had come in 1952 but as the crisis receded their case was weakened. Although the threat of a run on the reserves was not fulfilled, the sterling balances may still have restricted the freedom of British policy-makers.

There is little doubt that in the opinion of observers both in Britain and outside, the sterling balances posed a

serious burden on the British economy. Thus, there was periodic pressure from the American State Department for the British authorities to 'solve' the sterling balances 'problem' either by enforced funding or by agreements on their gradual expenditure, because they were considered an obstacle to Britain reestablishing a freer trade and payments policy. The Bank of England and the Treasury also subscribed to the view that the sterling balances presented an unpredictable burden on the British economy. George Bolton's assertion that the sterling balances restricted British policy and posed a threat to the reserves was cited at the beginning of this chapter. His view was echoed in the Bank by L.P. Thompson-McCausland who stressed that the ratio of reserves to sterling balances represented the true external 'position' of the British economy. In the Treasury, concern with the sterling balances centred around several unsuccessful attempts to estimate the 'hard core' of balances which could be relied upon not to be a potential drain on the central reserves.

Since, in the event, the sterling balances did not have a directly destabilising impact on the British economy in the 1950s, the main questions relating to the effect of the sterling balances on British policy are whether the existence of these liabilities actually made destabilising speculative capital flows larger than they would otherwise have been, and to what extent British policy was restricted

by the existence of the balances. The second aspect will be dealt with in subsequent sections of this chapter. With respect to the first question, it is impossible to construct a reliable counterfactual measure of speculative flows since speculators' opinion of the danger of the sterling balances is impossible to isolate from their reaction to other weaknesses of the British economy. Some insight, however, is possible from events in the 1960s.

As will be seen in Chapter VI, during the 1960s a network of short term central bank credits provided consistent support against unpredictable and destabilising drawings on sterling balances. Public awareness of these short term lines of credit, however, did not overcome the persistence of speculative flows. Thus, a guarantee of the UK's ability to survive an attempted run on the reserves would probably not have been enough to eliminate the strains on the balance of payments in the 1950s either. It is unlikely that it was the threat of the sterling balances being run down without an adequate cushion of short term assets that was the major destabilizing force for overseas speculators.

A further consideration in assessing the contribution of the sterling area to confidence is that the published reserves did not cover the total of official dollar assets held by the EEA. They excluded a small amount of non-dollar currencies, a significant amount of dollar securities which

had been accumulated during the war, and the British quota in the IMF. As of the end of October 1958, the market value of the dollar securities held by the EEA was \$875,219,941 distributed over 9.5m shares of 198 American corporations¹⁵. Of these, about half of the value were invested in the eight corporations shown in Table V.D.

Table V.D.
Dollar Securities Held by EEA
Market Value on 31/10/58

Company ('000s)	Number of Shares	Mkt Value
Shell Oil	1,917,777	134,244
General Motors	2,410,398	84,665
Amerada	681,912	61,372
Eastman-Kodak	465,126	48,605
State Oil New Jersey	662,954	34,142
Ingersoll-Rand	328,068	25,589
International Paper	271,772	24,799
State Oil Indiana	596,670	<u>24,314</u>
Total		437,730

Source: Note by Statistics Office of Bank of England, "Annex IV: Assets" for Dennis Rickett and the Radcliffe Committee, 25 February, 1959. BoE EID3/19.

These securities supplemented the published reserves by a full 28% in 1958. The Radcliffe Committee expressed its desire to have the value of these securities published periodically "so as to convey a more adequate picture of the reserve position"¹⁶. The Bank of England resisted such suggestions on the basis that there were no plans to

¹⁵Statistics Office, Bank of England, "Annex IV Assets", 25 February, 1959. BoE EID1/19.

¹⁶Report on the Working of the Monetary System, HMSO, 1956., p. 227. The Committee were only allowed to reveal that these securities amounted to between \$750m and \$1b.

liquidate the securities and their value would fall if they did. Also, a regular account of these assets might be embarrassing to the government since the value of British national reserves would be seen to be affected by the vagaries of Wall Street¹⁷.

The reluctance to publicise the real level of foreign exchange reserves on the basis that these assets were not really liquid mirrors the fact that the liabilities due to the sterling area had a significant (if unquantifiable) hard core of illiquid assets as well as those whose market value would fall in the event of large scale liquidation. Both the American shares and the hard core of sterling balances would presumably be sold off in an unprecedentedly severe crisis. In such a crisis the IMF quota would also be drawn on to forestall bankruptcy. The publication of the total sterling balances and the secrecy surrounding the total British reserves thus seem inconsistent. By 1958, \$318m of these securities were pledged as security to the American Import-Export Bank and a further \$91m to the IBRD against loans¹⁸. In the eyes of Britain's creditors, therefore, these assets were considered liquid enough to act as loan security. Still, this meant that only half of the value of the shares, or \$166m, was free to be set against the

¹⁷Statistics Office, Bank of England, "Annex IV: Assets" 25 February, 1959. BoE EID1/19.

¹⁸Ibid.

sterling liabilities to the sterling area.

V.C. The Sterling Area and Exchange Rate Policy

It is possible that the damaging demand management techniques used during the 1950s could have been avoided if the exchange rate rather than the reserves had been allowed to carry the burden of balance of payments. The Radcliffe Committee reviewed the fortunes of floating exchange rates in the 1920s and 1930s and concluded that

This experience has been sufficient to demonstrate both the inconvenience of a fluctuating pound and the impossibility of altering its value without regard to the interests of other countries which use sterling as an international currency. Either course of actions intimately concerns the other members of the sterling area and would confront them with awkward dilemmas of policy. The preservation of a fixed rate of exchange undoubtedly offers the best prospect of avoiding strains and stresses within the sterling area, except perhaps in highly abnormal conditions when the entire world economy is seriously out of balance and the area as a whole is under persistent pressure in its balance of payments with the non-sterling world¹⁹.

Despite this firm statement by the Radcliffe Committee there were two major episodes in the 1950s when a flexible exchange rate was seriously considered. The first was the now famous ROBOT plan of 1951-2 and the second was during negotiations for the Collective Approach at the end of 1952. After these two approaches to convertibility had been abandoned, the policy of the Bank of England and of the

¹⁹Report on the Working of the Monetary System, HMSO, 1956. p. 257.

Treasury turned to an administrative route to convertibility at fixed rates. This is discussed in Chapter VI. A closer look at the role of the sterling area in the abandonment of these flexible exchange rate policies will go some way to establishing to what extent the sterling area inhibited policy in this regard.

The history of the ROBOT plan for convertibility devised by George Bolton, T.L. Rowan and R.W.B. Clarke has been well described elsewhere²⁰. Briefly, ROBOT in its final form called for the establishment of external convertibility at a variable exchange rate which would be allowed to float around the par value of \$2.80/\pounds between unpublicised boundaries of \$2.40/\pounds to \$3.20/\pounds supported by the Exchange Equalisation Account. Only the central banks and governments of the Commonwealth would be informed of these boundaries. Non-resident sterling balances would be blocked except for 10% which would be classified as 'external' sterling and would be convertible. All current earnings of sterling after the implementation of ROBOT would also be freely convertible. Not less than 80% of sterling area sterling balances would be funded in low interest securities, making them unavailable for current transactions and inconvertible. The remaining 20% would be freely convertible subject to continued exchange control by

²⁰see e.g., Alec Cairncross, Years of Recovery; British Economic Policy 1945-51, Methuen, London, 1985. pp. 234-271.

sterling area authorities. There was to be no change in arrangements with Colonial members of the sterling area whose balances in any case were tied up for the most part in currency funds and other fixed obligations. Finally, the London gold market would be re-opened at a freely fluctuating market rate. Residents of the rest of the sterling area would be denied access to the market, except for gold producing members.

For present purposes the most interesting requirement was the funding of sterling area sterling balances. The Chancellor, R.A. Butler, when presenting ROBOT to the Cabinet argued that "the funding of sterling balances, though it may initially be a shock for the holders would remove the greatest potential danger to the sterling area reserves and would strengthen confidence in sterling"²¹. Enlarging on the disadvantages of the plan the Chancellor recognised that a unilateral decision to fund the balances "would be a shock to the Commonwealth members of the sterling area and might bring one or two of them to the point of deciding to leave the sterling area altogether"²². The Chancellor speculated that Pakistan, experiencing political difficulties, and Ceylon, a consistent dollar earner, might resist further restrictions on the use of

²¹Record of Cabinet meeting February 28, 1952 transcribed by Mr Forman-Brook, 21 March, 1952. PRO T236\3242.

²²Ibid.

their sterling balances and break their ties with the sterling area if not with the Commonwealth. It was expected that New Zealand would accept funding as a decision of the UK government, South Africa would welcome ROBOT for the re-opening of the gold market and India would agree if she were assured that she would still get sufficient capital for development plans. Australia was the major obstacle since her sterling balances were large and liquid. It was acknowledged at the Cabinet meeting that Australia "would be hard hit by it but her government must realise that she was over-spending and could not expect to go on doing so. It was conceivable though unlikely, that she might seek independence of the sterling area"²³. India, Pakistan, Ceylon and South Africa were under agreements blocking part of their balances, although generally not as much as the 80% called for in ROBOT. The Cabinet asserted that from the point of view of the sterling balances

the most significant gain would be the restraint imposed by this plan on Australia's use of her sterling balances; for her drawing rights were not at present the subject of any agreement and her overseas expenditure constituted the greatest current threat to the stability of the sterling area"²⁴.

In this sense, ROBOT was a convenient way to unilaterally solve the sterling balances 'problem'.

On the 24 March 1952 Prime Minister Churchill minuted

²³Ibid.

²⁴Ibid.

the Chancellor of the Exchequer suggesting that the UK should instead negotiate limits on the drawing down of sterling balances before looking to 'free' sterling²⁵. The blocking of sterling balances was thus suggested as an alternative response to the immediate crisis rather than convertibility at flexible rates. The advice from T.L. Rowan for the Chancellor's reply was that

if there was not mention of convertibility there could be no hope of any success of such negotiations and it would merely further weaken the pound, while on the other hand, there could certainly not be any mention of convertibility because this would result in major losses to the reserves through advance manipulation of funds etc²⁶.

Thus, any formula to block the sterling balances would have to be subject to protracted bilateral negotiations with the relevant members unless sterling convertibility was related to the proposals to show the necessity for the UK to act secretly and unilaterally. The sterling Commonwealth had shown themselves committed to early convertibility at the recent Commonwealth Finance Ministers' meetings in London and they were unlikely to accept a restriction on their freedom without a significant quid pro quo along these lines. This point was reiterated in a draft speech prepared for the Chancellor to present to the Cabinet at the

²⁵Minute from Winston Churchill to R.A. Butler, 24 March 1952. PRO T236/3242.

²⁶Memorandum from T.L. Rowan to R.A. Butler, 25 March 1952. PRO T236/3242.

beginning of April 1952. The Chancellor was to conclude "I think we should defer any action on the sterling balances until I have been able to put before my colleagues [in the sterling area], and secure their agreement to, proposals in the field of convertibility"²⁷. The prospect for blocking the sterling balances was thus transformed into a selling point for ROBOT.

Still, the possibility that the sterling area members would not accept unilateral 80% funding of their sterling balances was a serious obstacle to ROBOT when the plan was first presented to Cabinet in February 1952. One disadvantage of the 80% funding plan was that it required re-opening the hard-fought agreements with India, Pakistan and Ceylon with the possibility of losing Pakistan and Ceylon, at least, from the sterling area. Furthermore, Australia was not realistically in a position immediately to fund 80% of her balances since a large part was committed for import contracts concluded before the recent round of Australian quantitative import restrictions. Finally, any such funding agreement would require a catastrophe clause to allow members to draw on their sterling balances for 'unforeseen eventualities' such as pre-zero commitments and Indian food imports in times of famine.

In March 1952, after Robot had been deferred by the

²⁷"The Position of Sterling", Paper for Chancellor of the Exchequer, 4 April 1952. PRO T236/3243.

Cabinet, Flett, Thompson-McCausland, Jones and Snelling of the Bank of England devised an alternative to the funding proposal of Robot which avoided many of the difficulties raised in the Cabinet meeting in February²⁸. Their report proposed to leave the agreements with India, Pakistan and Ceylon intact and to get the other members to freeze their hard core of sterling balances in the same pattern. Most of this hard core was currency reserves and agreement would have to be reached on the proportion of sterling balances this comprised. The figures offered by Flett are presented in Table V.E. The total amount of sterling area sterling

Table V.E.
Alternative Sterling Balances Proposal

£m Country	Hard Core (to be blocked)	Total	%
Australia	140	337	42
New Zealand	25	50	50
South Africa	20	68	29
Southern Rhodesia	7	14	50
Ireland	50	68	74
India	520	568	92
Pakistan	54	143	38
<u>Ceylon</u>	<u>30</u>	<u>58</u>	<u>52</u>
Total	846	1306	65

Notes: India, Pakistan and Ceylon figures represent currency reserves and blocked balances existing at the end of February 1952 from "The Position of Sterling" Draft paper for the Chancellor of the Exchequer, 4 April, 1952. Others from M.T. Flett report for T.L. Rowan, "Robot and the Commonwealth Sterling Area", 31 March, 1952. PRO T236/3242.

balances blocked under this alternative scheme would be about £850m which was £200m less than under the original

²⁸Report by M.T.Flett to T.L. Rowan, "Robot and the Commonwealth Sterling Area", 31 March, 1952. PRO T236/3242.

Robot scheme. The disadvantages of this extra liquidity were outweighed by the advantages of avoiding fresh negotiations with India, Pakistan and Ceylon, avoiding the pitfalls of a catastrophe clause and, most importantly, the proposals were more liable to be accepted since they required only an acknowledgement that a hard core of sterling balances existed²⁹. With this proposal it was hoped the danger of the sterling balances posing a serious obstacle to a convertibility plan along the lines of ROBOT was reduced.

Whether the sterling area would have acquiesced to this restriction on their ability to use their sterling balances is, perhaps, doubtful. The final column of Table V.E. shows the different treatment which would have been accorded to members of the sterling area. Thus, South Africa was treated quite gently with only 29% of her sterling balances blocked while New Zealand and Southern Rhodesia would be requested to forego the use of 50% of their sterling balances. This disparity may not have been an obstacle to the agreement, however, since India, Pakistan and Ceylon had agreed to arrangements which treated each differently according to their circumstances. A more serious obstacle to the alternative formula for the sterling balances was the fact that there would have to be perhaps lengthy consultation with the members concerned in order to

²⁹Ibid.

establish an agreed proportion of illiquid assets before convertibility was announced. This released the threat that the plan for sterling convertibility would be leaked internationally causing speculation against the pound. There was also the danger that the sterling area countries themselves would take advantage of their knowledge to switch a large proportion of their balances out of sterling assets in anticipation of blocking agreements. The extent of necessary prior negotiations was minimised since the agreements with India, Pakistan and Ceylon would not need to be revised. New Zealand, Ireland and Southern Rhodesia were unlikely to present difficulties. South Africa, it was hoped, would welcome the re-opening of the gold market as a quid pro quo and was in any case under more or less formal agreement to restrict the use of her sterling balances to settle her dollar account. Australia still posed a serious obstacle but she was relatively gently treated in M.T. Flett's figures shown in Table V.E. with 42% of her sterling balances to be blocked. This alternative formula, then, offered some hope of success.

What should be emphasized when considering the role of the sterling area in this early plan for convertibility at a flexible exchange rate is that, far from providing a possible excuse for abandoning Robot, the prospect that ROBOT would solve the sterling balances problem was considered in the Treasury to be a positive encouragement

for ministers to accept the plan. In this sense the sterling area was an incentive rather than an obstacle to ROBOT.

The sterling area also featured positively in the early development of ROBOT. At the first stages of ROBOT planning in January 1952, Otto Clarke noted that "it was pretty clear from the Commonwealth Finance Ministers Meeting official discussions that South Africa and Ceylon would not continue permanently in an inconvertible sterling area; nor will Malaya and the Gold Coast when they get their freedom"³⁰. This argument was also taken up by C.F. Cobbold, Governor of the Bank of England, writing in support of convertibility at flexible rates to the Chancellor in early February. He argued that given the atmosphere at the Commonwealth Finance Ministers meetings and the deteriorating reserves position it was doubtful if the sterling area could survive on exhortations to 'put their houses in order' and on infrequent aid from the USA for the next eighteen months³¹. The UK was responsible for sterling and had a responsibility to the RSA as keeper of the central reserves. If the decision was that the sterling area was unable to survive in its present state, then it was up to the UK to take early action to protect the pound, perhaps by reviewing the fixed

³⁰R.W.B. Clarke, 25 January 1952. PRO T236/3240.

³¹C.F. Cobbold to R.A. Butler, 13 February 1952. PRO T236/3240.

parity to the dollar³². When it came time to present Robot to Cabinet the Chancellor reiterated this argument that "at the recent meeting of Commonwealth Finance Ministers it had clearly emerged that sterling could not survive on an inconvertible basis and this plan would be regarded as a major step on the road to convertibility"³³. The sterling area, therefore, featured in Robot in two positive ways. Robot offered to satisfy the growing pressure from the RSA for convertibility and it also promised a solution to the sterling balances problem which was considered the major drawback of the sterling area system for the UK.

The opponents of Robot were concerned less with the obstacles presented by the sterling area system than with the effect of flexible exchange rates on the domestic economy and on relations with the EPU. It was assumed that there would be little difficulty in persuading RSA members to continue to peg to a flexible pound. Members who refused would be removed from the list of scheduled territories and treated as foreigners with their balances completely blocked and restrictions placed on capital flows from the UK. The effect of flexible rates on the domestic economy, however, was seen as both an economic and political obstacle.

With the burden of adjustment to balance of payments

³²Ibid.

³³Mr. Forman-Brook's record of Cabinet meetings on 28 and 29 February, 1952. 21 March 1952. PRO T236/3242.

disequilibria borne by the exchange rate rather than the foreign exchange reserves, domestic price and employment levels would bear the brunt of adjustment. If the exchange rate fell very low, import prices would rise, disturbing inflation rates especially for food and raw materials. Lord Cherwell argued that exports were constrained by supply problems as much as price competitiveness so the depreciation of sterling would not have a balancing beneficial effect on export revenue and imports would have to be reduced further through quantitative restrictions to the point where industry would suffer³⁴. Domestic employment and prices would be squeezed until balance was achieved. This, according to Churchill, was the "main anxiety" about Robot³⁵. The abandonment of the government's public commitment to price stability and full employment would seriously undermine the government's political credibility. Lord Cherwell, the main opponent of the scheme, argued that this was politically impossible and that the government would eventually be forced to intervene to soften the strain on the domestic economy³⁶.

A second major objection was that with sterling a

³⁴Minutes of Cabinet Meetings, 28 and 29 February, 1952. Transcribed by Mr. Forman-Brook. PRO T236/3242.

³⁵Winston Churchill to Leslie Rowan, 17 April, 1952. PRO T236/3243.

³⁶Lord Cherwell to Winston Churchill, "Setting the Pound Free", 18 March, 1952. PRO T236/3242.

'hard' currency, other countries might discriminate against British exports as they did against American exports and the UK might have to respond by intensifying quantitative restrictions. The result would be a decline in trade among non-dollar countries. This reduction in world trade would be reinforced by the fact that the UK would have to pull out of the EPU after convertibility, probably causing the dissolution of the EPU and the reversal of Europe's trade liberalisation policies³⁷.

The third major obstacle was the disruption of Britain's international political relations. Europe and America were liable to be hostile to the damage to the EPU. Furthermore, Robot contravened the IMF rules of the adjustable peg. It was thought that the Americans would welcome the re-introduction of convertibility but would probably object to the flexible rate since it did not fit in well with these existing international economic institutions operating under American influence³⁸.

The Robot plan for flexible exchange rate convertibility could have foundered on any of these three obstacles as the urgency of the reserves crisis receded. The most decisive factor was the lack of unanimity at the

³⁷"External Sterling Plan" prepared by Overseas Finance division of the Treasury for the Chancellor of the Exchequer, 4 April, 1952. PRO T236/3243.

³⁸Mr. Forman-Brook's record of Cabinet meetings on 29 and 29 February, 1952. 21 March, 1952. PRO T236/3242.

outset, which made the adoption of a revolutionary and risky departure from current economic and political policy impossible. After the initial deferral of Robot at the end of February, the economic situation eased and the spirit of crisis passed, making a dramatic change in policy even more remote.

Interestingly, there is evidence that Mr. Menzies, the Australian Prime Minister, was briefed on ROBOT while on an official visit to Britain in May and June 1952. The plan was outlined in a secret brief prepared for the Chancellor's discussion with Menzies. Instead of compulsory funding of a fixed percentage of the sterling balances, the Overseas Finance divisions's alternative proposal to leave existing agreements with India, Pakistan and Ceylon in tact was coupled with the gentle proposal that "we might ask for public statements from Australia and the remaining dominions that each of them did not contemplate drawing down its balances below a stated minimum"³⁹. Unfortunately, there is no record of the meeting between Butler and Menzies on Robot.

The Collective Approach to convertibility developed in the second half of 1952 was the last significant attempt to devise a return to convertibility at a flexible exchange rate. The Collective Approach was devised out of the ashes

³⁹Brief prepared by T.L. Rowan for R.A. Butler, 26 May, 1952. PRO T236/3243.

of the ROBOT plan. Under the plan, European currencies and sterling would go convertible together to spread the burden of possible speculation and it was hoped that the USA would supply a support fund for the countries involved. The plan was devised in close consultation with the rest of the sterling area and the final proposal was presented in the conclusion to the Commonwealth Economic Conference of December 1952. The sterling area countries objected to the fact that only non-resident sterling was to be convertible, to the gradual removal of quantitative import restrictions and to the prospect of alienating the American government. Perhaps the most dangerous objection, however, was resistance to the plan to establish sterling convertibility at a flexible exchange rate. The Indian delegates, especially, refused to commit themselves to maintaining fixed parity between the Rupee and a floating pound. If sterling area countries chose to break the link to sterling, they were likely to be absorbed into an American sphere of economic influence, pegging to the dollar and re-orienting their trade toward America. At the end of the sterling area consultations in December 1952 the RSA authorized the British to approach the USA with the Plan but the future of a flexible rate in the Collective Approach was left unresolved.

The question of a flexible sterling exchange rate within fixed boundaries of 3% on either side was discussed

at the Commonwealth Finance Ministers Meeting at Istanbul in 1955. By this time Commonwealth delegates had received directions from their respective governments and were willing to give tentative commitments on pegging to a flexible pound. Only India refused to give positive assurance that they would peg their currency to sterling after convertibility achieved through a Collective Approach.

By this time, however, the Collective Approach was already effectively dead as a route to convertibility. Indian resistance to a flexible sterling exchange rate was no doubt a possible threat to the success of the Collective Approach but it was not the cause of its failure. The Collective Approach to convertibility was a non-starter because of its reliance on American and European cooperation to an extent that was not forthcoming. Thus, the Americans were told they would have to provide a support fund for convertibility through the IMF and were also required as a prerequisite to revise their national economic strategy by proving themselves committed to 'good creditor' policy and reducing their surplus with the rest of the world. The Europeans were expected to follow the UK and adopt simultaneous convertibility according to a British timetable to strengthen the chances of success for sterling. Not surprisingly, the Collective Approach met with a cool response when presented to America and Europe in early 1953.

The Americans had avoided commitment on the

Collective Approach pending the completion of the Randall Commission on External Monetary Policy which was finally presented to Congress in January 1954. In the short section at the end of the Report devoted to currency convertibility, the Commission concluded that
it does not favor a "dash" for convertibility, or letting the currency "find its own level", since such a method presents the danger of a vicious circle of inflation and would require larger reserves than may be available to prevent currency depreciation from getting out of hand⁴⁰.

The Report continued, however, to state that it was "sympathetic to the concept of a 'floating rate'" but qualified this with the proviso that "whether a country is strong enough externally and internally, to administer such a system effectively involves a judgment which only the country in question could itself responsibly make"⁴¹.

Furthermore,

a strong internal economy, willing and able to control its money supply and its budget as safeguards against inflation, sufficiently mobile to make the best use of its resources, and able and willing to save in order to increase its productivity and improve its competitive position in world markets, is a prerequisite to convertibility⁴².

That the UK economy did not meet these criteria was suggested in the conclusion that "to restore full convertibility in sterling, Britain's reserves must be

⁴⁰Report of the Commission on Foreign Economic Policy, Washington, D.C., January, 1954., p. 73.

⁴¹Ibid.

⁴²Ibid.

strengthened"⁴³. The Americans were hostile to the suggestion that sterling would adopt a flexible exchange rate because it represented a departure from the conditions of the international payments system designed at Bretton Woods in 1944⁴⁴. Thus, in the Randall Report it was stated that "the commission feels it should not sponsor any measures that might wreck the Union [EPU] before there is something better to put in its place"⁴⁵. The Commission, thus recommended "a gradual and controlled approach to full convertibility"⁴⁶. If floating convertible had been put to the test it is likely that American opposition would have proved more serious than Indian reluctance to maintain a fixed rate with sterling⁴⁷.

The purpose of examining these two episodes was to put into context the role of the sterling area as an inhibiting factor in the determination of exchange rate policy, by identifying the obstacles to adopting a flexible exchange rate policy. It has been shown that the sterling area figured only marginally in the failure of Britain to

⁴³Ibid., p. 74.

⁴⁴A.P. Dobson, The Politics of the Anglo-American Economic Special Relationship, Wheatsheaf, 1988., p. 149.

⁴⁵Randall Commission Report, p. 74.

⁴⁶Ibid.

⁴⁷There was a dissenting Minority Report by D.A. Reed and R.M. Simpson which advocated a speedy return to convertibility and the gold standard. Minority Report, Commission on Foreign Economic Policy, Washington, D.C., January, 1954.

adopt a flexible convertible pound. Taking the burden of adjustment on the domestic economy rather than on the reserves would require political sacrifices that were not acceptable in the 1950s. Trying to avoid this pressure on employment and prices by limiting the fluctuation of the pound and collecting an international foreign exchange reserve through a 'stabilisation fund' sponsored by the Americans required a level of cooperation from the Americans and the Europeans that was also not feasible.

This does not tackle the option of a devaluation to another fixed rate. This option was repeatedly dismissed by the British authorities, in part because it would mean a reduction in the value of RSA foreign exchange reserves held as sterling. While the rhetoric surrounding the resistance to devaluation centred on the need to consult the sterling area and the need to take their interests into account⁴⁸, it must be remembered that the UK had not found this to be an obstacle to the devaluation in 1949 nor were they to find it so for the devaluation of 1967.

In the environment of excess demand which characterised the British economy in the 1950s, moreover, it was very uncertain that a devaluation would have solved the problems of the British balance of payments. With only 1.5% unemployment during the 1950s, the prospects for increasing

⁴⁸See for example the quotation from the Radcliffe Committee at the beginning of this section.

the supply of exports to improve the current surplus seemed remote. A price adjustment would not improve the supply problems of the British economy which contributed to the weak competitive position of British exports. Meanwhile, increases in the prices of imports would contribute to inflationary pressure. Thus, in the 1950s "it did not require much imagination to foresee the risks of creating more inflationary pressure on the heels of a devaluation"⁴⁹.

Nor, indeed, could devaluation alone be considered a solution to balance of payments problems. A devaluation in the 1950s would have required accompanying measures to restrict demand in order to make the devaluation effective by preventing domestic inflation from eroding the price advantage. In this sense devaluation may have strengthened the need for deflationary demand management techniques rather than releasing the domestic economy from such restrictions. Nor, certainly, is devaluation to another fixed exchange rate a cure for speculative pressure since confidence in the new rate would depend on faith in the government's ability to effect more structural changes in the internal economy to avoid a further devaluation.

Finally, a devaluation to another fixed rate would have disappointed not only those who held sterling as their

⁴⁹A. Cairncross and B. Eichengreen, Sterling in Decline: The Devaluations of 1931, 1949 and 1967, Blackwell, 1983. p. 159.

reserves, but also the hopes for re-establishing sterling as an international currency. If the decision had been taken to abandon this goal, the sterling area system would not have proved an obstacle. Indeed, unilaterally blocking sterling balances and capital flows to the sterling area would have offered a quick way to retire from the international economy. The problem in the 1950s was that it was believed that the sterling balances could not be blocked without abandoning these external ambitions for sterling unless sterling was convertible, and convertibility was not immediately possible given the reserves position unless it was done at a flexible exchange rate. A flexible convertible exchange rate which might have allowed a solution to the sterling balances problem while maintaining an international role for sterling was rejected because of the domestic and international political obstacles this presented. Devaluation was ruled out, not because of Britain's obligations to the sterling area (indeed C.F. Cobbold argued that Britain's obligations to the sterling area meant that she should adopt a convertible currency system at flexible rates) but because it would mark the end of Britain's ambitions for sterling to regain its international status.

Having established that the sterling area was a very weak factor restricting the range of external monetary policy options it remains to analyse the effect of the

sterling area on domestic monetary policy in the 1950s.

V.D. The Sterling Area and Domestic Monetary Policy

V.D.i. The Sterling Balances and Government Debt

The sterling area affected the British monetary system through the practice of pooling foreign exchange reserves and holding sterling assets in return. These balances were held as UK Treasury Bills, UK Government securities, Dominion and Colonial securities or as deposits at commercial banks.

Table V.F.
Sterling Area Sterling Balances (£m)

		<u>Liquid Securities</u>				<u>Total</u>	<u>Dom/Col</u>
		0-5 yrs	6-10 yrs	11-15 yrs	>15yrs		
		<u>Central Banks</u>					
1954	1040	314	126	76	57	1613	
1955	896	384	74	73	41	1468	
1956	762	432	43	76	42	1355	
		<u>Crown Agents</u>					
1954	93	218	156	175	210	852	179
1955	79	230	215	216	171	911	178
1956	96	270	161	253	183	963	180
		<u>East and West African Currency Boards</u>					
1954	32	77	37	31	6	183	2
1955	61	74	40	21	2	198	2
1956	77	94	12	22	2	207	2
		<u>West African Marketing Boards</u>					
1954	36	9	-	37	31	113	
1955	18	12	32	22	12	96	
1956	3	11	31	22	12	79	
		<u>Totals</u>					
1954	1201	618	319	319	304	2761	181
1955	1054	700	361	332	226	2673	180
1956	938	807	247	373	239	2604	182
		<u>Percent of Total</u>					
1954	43	22	12	12	11	100	7
1955	39	26	14	12	9	100	7
1956	36	31	10	14	9	100	7

Source: 'Overseas Sterling Holdings of Certain Holders' BoE EID1/19.

In response to a request from the Radcliffe Committee in December 1957, the Bank of England prepared a schedule of the type of sterling asset held overseas from 1954-1956⁵⁰. Table V.F. shows the data collected. The figures cover about 75% of total sterling balances held by countries. Information on the other 25% was supplied in confidence to the Bank of England by commercial banks whose holdings were not broken down by type of asset for the 1950s. The proportions of the holdings of commercial banks were known, however, for the pre-war period. Assuming that these proportions held for the post-war period, Table V.G. shows the distribution of sterling area sterling balances in 1957.

Table V.G.
Breakdown of Sterling Balances by Type of Asset
As of 30 June, 1957

	Official	Bankers' Returns	Total
Curr and Dep a/c	6%	95%	28%
Advances	-	-15%	-4%
UK Treasury Bills	30%	11%	26%
Other Bills	-	-8%	-2%
HMG Securities	64%	17%	52%

Source: J.I. Mutch Statistics Office, Bank of England, 24/10/57. BoE EID1/19. Bankers' Returns are pre-war proportions.

From this analysis, the Bank of England felt confident that about half of the sterling balances were held as securities and half in liquid form. Of the liquid assets,

⁵⁰M.R.D., Statistical Office, Bank of England, 'Overseas Sterling Holdings of Certain Holders', 16 December, 1957. BoE EID1/19. Only the aggregate totals were passed on to the Treasury and the Radcliffe Committee.

half were deposit and current accounts and half were held as UK Treasury Bills⁵¹. The data do not allow a complete separation of sterling area and NSA holdings by type of asset so they include NSA sterling balances as well as sterling area balances. Chapter II, however, showed that by far the greater part of countries' holdings of sterling balances were held by the sterling area.

Table V.F. shows that overseas holders of British government securities provided a steady demand for medium and long term government securities. This is important in the context of the Government's attempts in the 1950s to fund the short term public debt. If any trend may be discerned from these three years alone, it is that there was an increased preference for short term securities, especially by the central banks. According to evidence submitted to the Radcliffe Committee by the Treasury, overseas official holdings of market securities accounted for 11% of the total outstanding in 1956 and 1957 compared to 2% in 1939⁵².

Overseas official bodies also provided a stable market for UK Treasury Bills. In 1951 overseas official holdings accounted for 45% of total outstanding bills outside the

⁵¹J.I. Mutch, Statistics Office, Bank of England, 24 October. 1957. BoE EID1/19.

⁵²"Debt Management", Memorandum of the Treasury for the Radcliffe Committee. Memoranda of Evidence, Volume I., p. 111. The volume of securities excludes nationalized industries.

public sector. This proportion declined to a steady one third for 1952-1957 and fell to one quarter in 1958⁵³.

Official overseas holdings of Treasury Bills maintained a fairly constant proportion of total sterling and non-sterling area sterling balances. The proportion varied between 21% and 27% of total sterling balances.

The effect of changes in sterling balances is described in the Radcliffe Committee Report and in evidence to the Committee⁵⁴. The Exchange Equalisation Account (EEA) routinely lent its sterling holdings to the Exchequer. When RSA countries exchanged their foreign exchange earnings for sterling the EEA reduced its holdings of sterling by drawing on their loan to the Exchequer. The Exchequer in turn offset the decline in its sterling assets by selling Treasury Bills or other securities to the RSA monetary authorities. In effect the Exchequer borrowed the sterling to purchase the foreign exchange from the RSA countries themselves. When the RSA cashed in their sterling holdings for foreign exchange, the EEA's and the Exchequer's holdings of sterling increased and the Exchequer could either reduce the floating debt or place a correspondingly smaller amount of debt with the domestic market⁵⁵.

⁵³Report of the Radcliffe Committee, p. 356, Table 35.

⁵⁴Ibid., p. 34 and Minutes of Evidence by C.F. Cobbold, P.K. O'Brien and H.C.B. Mynors Q. 962-971 26 July, 1957.

⁵⁵Memorandum by the Treasury, "Exchequer Management", Memoranda of Evidence, p. 82.

When increases in sterling balances were the result of sterling surpluses rather than foreign exchange surpluses, the transactions did not go through the EEA. Instead they allowed the Exchequer to raise net new debt outside the domestic banking system. If the sterling balances were cashed in for sterling through a direct sale of the assets, the domestic market would have to absorb the Treasury Bills or securities. This in turn could make it more difficult for the Exchequer to place debt in the domestic market. Thus the sterling area could affect the government's budget policy. In evidence to the Radcliffe Committee P.K. O'Brien, Chief Cashier of the Bank of England, asserted that

I think there is a prima facie probability if they [the sterling area] were selling Treasury Bills on a large scale we should have a problem, at any rate for a time, to replace those Treasury Bills, or, if they were selling gilt-edged securities, to find new holders⁵⁶

If the running down of sterling balances implied a British balance of trade surplus, however, there could be greater domestic savings to absorb the extra government debt. The effects of a rundown of sterling balances against sterling were, therefore, unpredictable.

An important goal of monetary policy in the 1950s was to reduce the burden of the floating debt and especially to reduce the liquidity of commercial banks by restricting the volume of Treasury Bills in the domestic banking system. In

⁵⁶Radcliffe Committee, Answer to Q 967, 26 July 1957, Minutes of Evidence, p. 56.

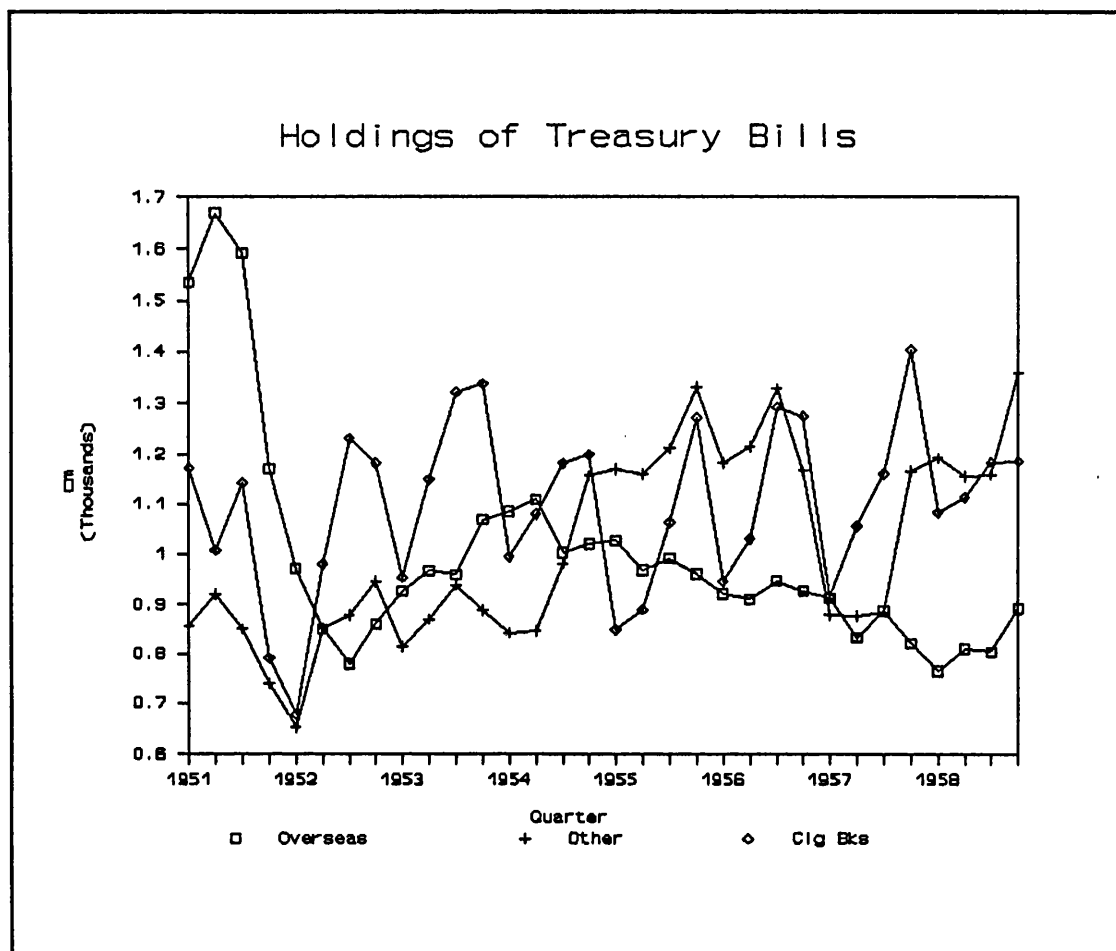


Figure V.C.

evidence to the Radcliffe Committee the Treasury alleged that it had been pursuing an active policy of encouraging the sale of Treasury Bills overseas as part of its deflationary policy⁵⁷. Increases in sterling balances were thus used to borrow outside the domestic banking system. Figure V.C. shows the levels of Treasury Bills held by overseas official holders, UK clearing banks and others. Only in 1951/2 were changes in overseas holdings very

⁵⁷"Monetary Policy and the Control of Economic Conditions", Radcliffe Committee, Memoranda of Evidence, p. 95.

dramatic. During the run on reserves in the financial year 1951/52, overseas official holdings of Treasury Bills fell £564m. Combined with a serial funding operation in November 1951, this allowed the Exchequer to redeem £1.3b of floating debt⁵⁸. India assisted the funding operation by taking £100m of securities in exchange for Treasury Bills⁵⁹. From 1952-1954 overseas bodies accumulated Treasury Bills to a peak of £1.1b worth in the second quarter of 1954. The pattern for the rest of the period is of a gradual but steady decline in overseas official holdings offset by an increase in clearing bank holdings and other holders measured from the annual peaks.

Overall, it seems that after 1954 the domestic market absorbed the overseas sales plus extra borrowing requirements of the Exchequer. The total private market Treasury Bills outstanding increased by £732m between December 1951 and December 1958, while overseas official holdings decreased by £280m over the same period. It is not possible, however to isolate the effects of sterling balance movements in the 1950s on the governments' borrowing power.

V.D.ii. The Sterling Area and Interest Rates

A more easily identifiable way in which the sterling

⁵⁸"Exchequer and Banking Figures" Radcliffe Committee, Memoranda of Evidence, Appendix 2, p. 56.

⁵⁹Bank of England, Statistics Office note 5 January, 1956. BoE EID3\32.

area could have affected British policy was with respect to interest rates. This question has two aspects; the cost to the balance of payments of servicing sterling area debt (an encouragement for lower interest rates) and the need to keep sterling assets relatively attractive to overseas investors, including the sterling area (an encouragement for higher interest rates).

Figure V.D. shows movements in the Bank Rate and in

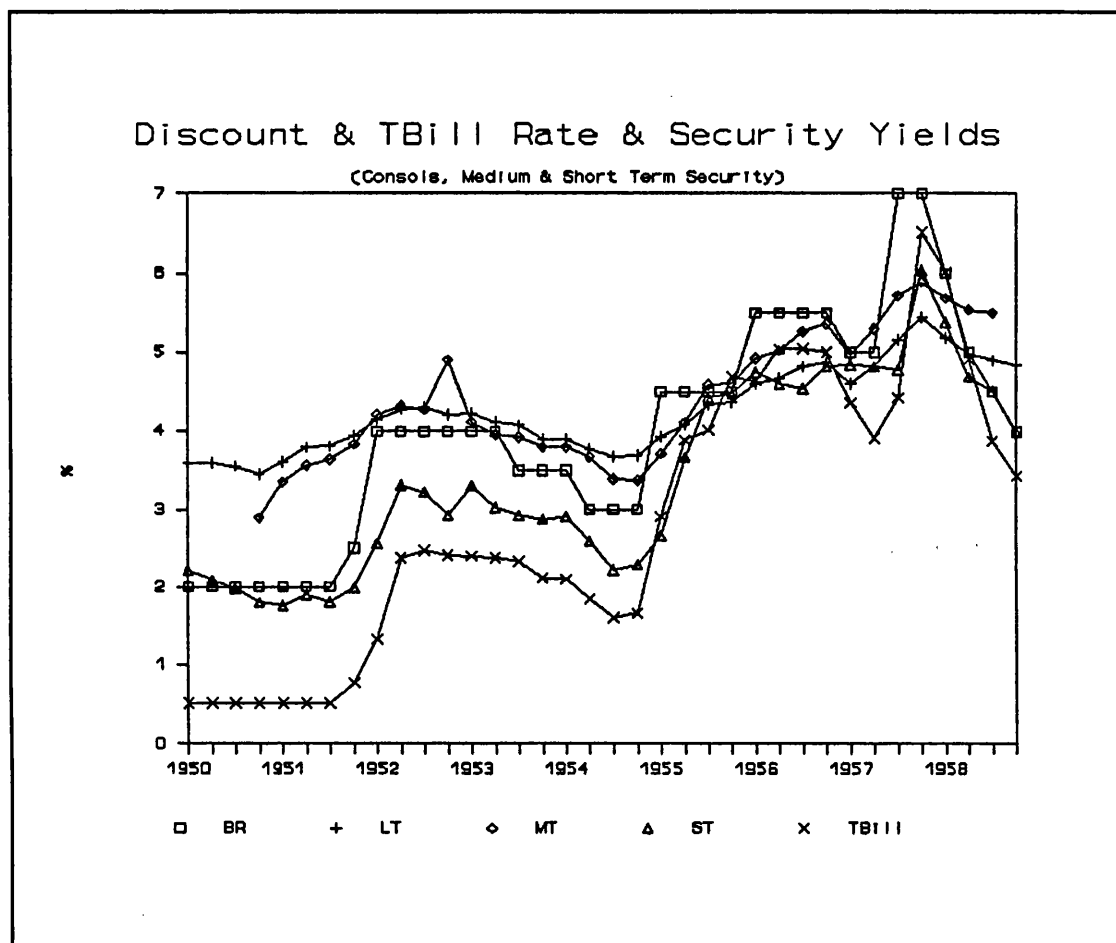


Figure V.D.

long, medium and short term government security yields and

Treasury Bill rates during the 1950s⁶⁰. The government's interest rate policy can be seen to have drawn both Treasury Bill and short term rates along, reflecting the tightening of the money market in November 1951, the subsequent relaxation from 1953-1955 and the violent tightening from 1955 to the end of 1957. Long term interest rates were much less volatile although these rates also responded to the rapid credit restraint from 1955-58.

Figure V.E. shows the volume of interest payable at an annual rate on official sterling balances based on the interest rates and yields in Figure V.D. The figures are based on the breakdown of the sterling balances by type of asset presented in Table V.F. Thus, Treasury Bills are assumed to comprise 30% of sterling balances throughout the 1950s, short term securities and medium term securities 25% each, and long term securities 10%. The final 10% is assumed to have resided in cash deposits and Dominion and Colonial securities. The graph shows that interest payable on medium and long term securities was fairly stable until 1955 when medium term yields responded to British monetary tightening. Altogether, amounts payable on this type of security amounted to about £35m p.a. until 1955. The cost of servicing overseas holdings of Treasury Bills is more

⁶⁰Long term rates are defined as 2 1/2% Consols; Medium rates are for 3% Savings Bonds 1965-75 for 1951-58 and 2 1/2% Savings Bonds 1964-67 for 1950; Short term rates are for securities maturing in 3-5 years.

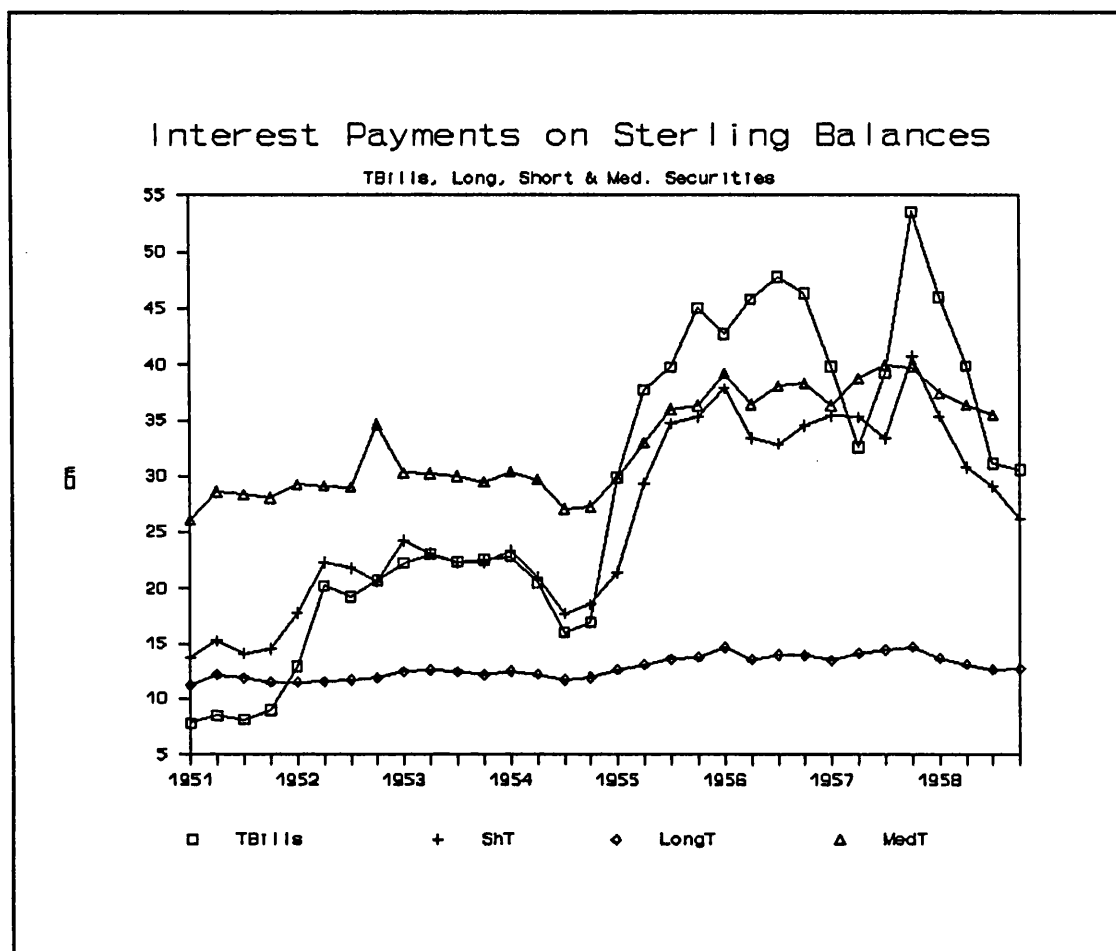


Figure V.E.

dynamic. The interest payable amounted to only about £8m p.a. in 1951 but reached a peak annual rate of £54m in the fourth quarter of 1957. As noted above the volume of overseas official holdings of Treasury Bills followed a gradually declining path from a peak of £1.1b in the second quarter of 1954 to a trough of £0.8b in the first quarter of 1958⁶¹. The increase in interest payable on Treasury Bill holdings after 1955 was therefore entirely due to the

⁶¹At the same time the proportion of Treasury Bills in total sterling balances remained fairly constant.

increase in interest rates from 1955.

Figure V.F. plots the total interest payable at annual

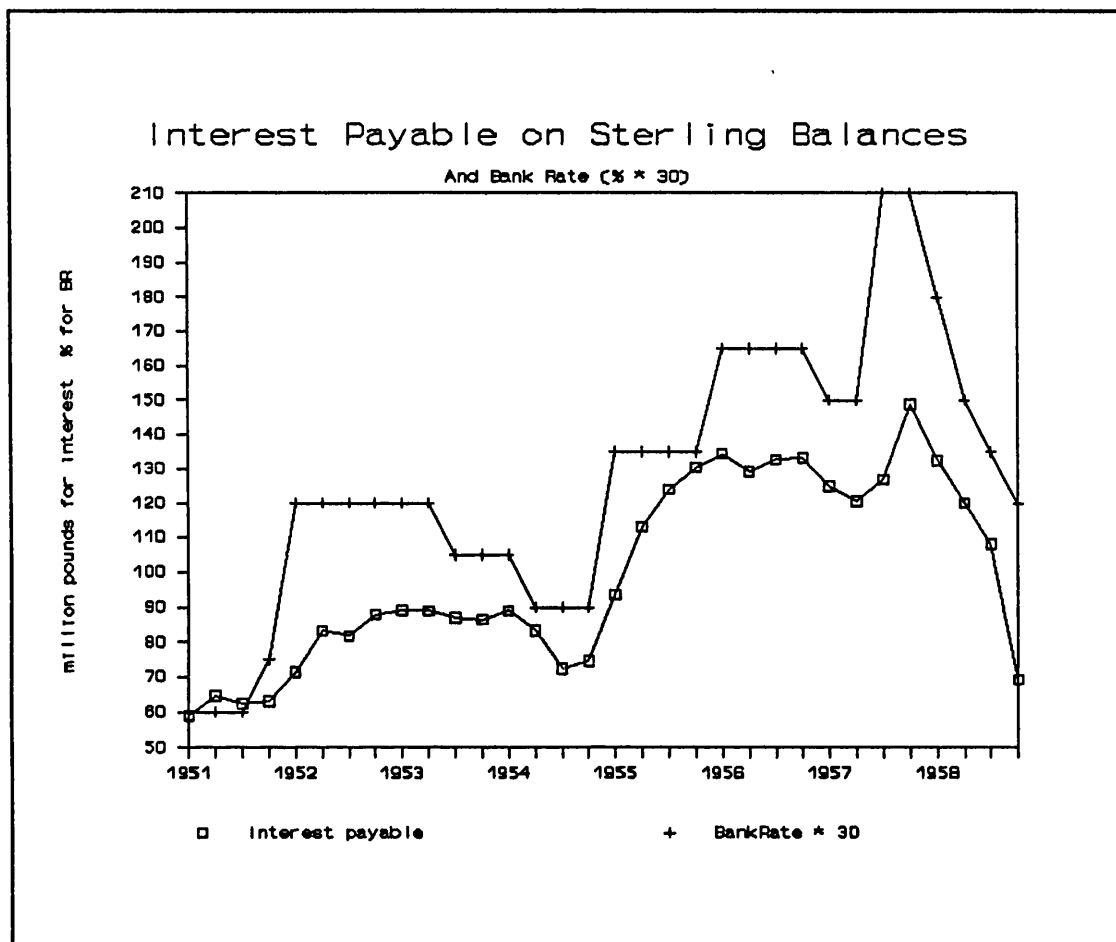


Figure V.F.

rates and movements in Bank Rate showing the close correlation between movements in short rates and the cost of servicing the sterling balances. In the Radcliffe Committee Report it was estimated that a 1% rise in Bank Rate immediately cost the balance of payments about £15m provided

that other short term interest rates followed⁶². This pattern can be seen to be roughly correct in Figure V.F. It was noted by the Committee that the short term capital inflow which might be expected to offset this cost to the current account generally failed to materialize because it was in turn offset by hedging in the forward exchange market⁶³. Capital would only flow to the UK if the interest rate differential between London and other centres was greater than the discount on the forward sterling market. General confidence in the strength of sterling was thus an equally important factor in generating capital flows.

The cost of servicing the sterling area debt can be broadly classified into four periods. In the years 1950-51, before monetary policy was reactivated, the annual cost of the sterling area liabilities amounted to about £60-70m p.a.. From 1952-54, after interest rates became more volatile and when sterling balances were rising, the annual interest payments to the sterling area rose to about £85m p.a.. The year 1955, with its dramatic increase in the cost of credit, was a period of acceleration in the annual rate of interest payments to the sterling area although the volume of sterling area sterling balances was declining by this time. By 1956-58 the annual cost of the sterling

⁶²Radcliffe Committee Report, p. 152.

⁶³Ibid.

balances was running at a rate of £130m p.a. or twice the amount in 1950-51 despite the declining volume of debt outstanding. These figures are generally consistent with the balance of payments estimates of interest, profits and dividends paid to the RSA⁶⁴. It should be noted that interest payments to the sterling area did not pose an immediate drain on the central reserves since they could be accumulated as additional sterling balances. They did, however, present a potential if not an actual burden on the reserves.

There was contemporary concern at the level of payments due abroad as a result of the governments' strict monetary policy. Thus, George Bolton at the Bank of England suggested in 1956, after the Bank Rate had reached 5 1/2% and interest payable was about £130m p.a., that an agreement should be negotiated at the upcoming Commonwealth Finance Ministers meeting to eliminate interest payments on monetary reserves held in sterling by RSA governments and central banks⁶⁵. His suggestion was to establish a fixed 1% rate of interest payable on monetary reserves with a gold guarantee of 250 shillings per ounce for existing Treasury Bill and cash holdings. This, he argued, would make the sterling balances more valuable to the holders since they

⁶⁴UK Balance of Payments, 1946-1957, HMSO, 1959.

⁶⁵George Bolton, "Sterling Balances and Monetary Policy", 4 April 1956. BoE C40/690.

could be considered as good as gold which in turn would make membership of the sterling area more attractive⁶⁶. It is hard to see the advantage for the RSA in this arrangement. The monetary reserves of the ISA were freely convertible for current purposes through the central reserves, subject only to their needs and their self-restraint exercised through exchange control. The gold guarantee would presumably also only be effective in the case of continued restraint in calling on the central reserves since a wholesale cashing-in would quickly exhaust London's gold supply.

The proposal seems to have fallen on deaf ears at the Bank of England. L.K. O'Brien, Chief Cashier, responded almost a month later suggesting that as the new assets would be limited to Treasury Bills rather than securities not much would be saved⁶⁷. At this time, Treasury Bills were costing the government about £50m p.a. according to Figure V.E. He also argued that holders of the balances would disinvest their holdings which would be an embarrassment to the government. Thus, the plan would encourage holders to move out of British government debt into the new gold-guaranteed, low interest asset, depressing the government's borrowing power. The third objection was that, having extended this privilege to the RSA, it might not be possible

⁶⁶Ibid.

⁶⁷L.K. O'Brien to George Bolton, 23 April 1956. BoE C40/690.

to refuse such guarantees to NSA holders as well⁶⁸.

In a memorandum to the Radcliffe Committee, the Treasury noted that the cost to the current account of increases in interest rates was indeed a consideration in deciding whether to rely on interest rates in conjunction with direct controls rather than interest rates alone⁶⁹. The sterling balances thus discouraged using interest rates in favour of direct controls on credit. Equally important, however was the fact that confidence in sterling was at least as important as interest rate differentials in attracting funds to London since most hot money was hedged in the forward market for sterling.

The second question regarding interest rate policy and the sterling area is whether the government was encouraged to have higher interest rates than otherwise to ensure that the RSA continued to find sterling assets an attractive form for their reserves. Such an argument seems to have more credence when referring to non-sterling area investors than with respect to the monetary reserves of sterling area countries. By far the greater part of the sterling assets held by the RSA were held by central monetary authorities or other official bodies. The primary motive for these countries to hold their assets in sterling was not to earn a

⁶⁸Ibid.

⁶⁹"Monetary Policy and the Control of Economic Conditions", Radcliffe Committee, Memoranda of Evidence, Volume I, p. 96.

competitive interest rate but rather as a future claim on the central reserves of the sterling area or the resources of the UK. This was especially true for the Colonial authorities whose reserves made up the greater part of total sterling area balances by the mid 1950s. These Colonial monetary authorities had no legal alternative but to hold their currency reserves and sinking funds in sterling.

It is more likely that the sterling area system may have encouraged higher interest rates than otherwise in order to price the RSA governments out of the London capital market in an effort to restrict the outflow of capital which was considered damaging to the UK balance of payments. In evidence to the Radcliffe Committee, R.S. Sayers suggested to C.F. Cobbold, Governor of the Bank of England, that

The fact that there is no other control by Britain of the investment of UK sterling in the sterling area might seem to be an advantage of using the interest rate rather than other weapons⁷⁰.

After some hesitation, Cobbold replied

I think it is a relevant consideration. I would not regard it as ever having been a major influence in anything we have done; not decisive, but certainly a factor in our minds⁷¹.

The sterling area system in this case, then, may have been a factor encouraging higher interest rates. This point should not be over-emphasized, however, given the many perceived domestic motives for raising interest rates in the 1950s.

⁷⁰Evidence to the Radcliffe Committee, 26 July, 1957, Q 875.

⁷¹Ibid, response to Q. 876.

V.E. Conclusion

This chapter has reviewed the effect of the sterling area system on the stability of the central reserves and on important aspects of UK external and domestic monetary policy. While the sterling area system did contribute to the instability of the central reserves, the practice of pooling reserves smoothed out fluctuations among RSA members. The destabilising effect was between the RSA as a whole and the UK. Throughout the 1950s, however, the RSA was a net contributor to the central reserves.

It is sometimes argued that the adoption of a flexible exchange rate or a devaluation would have allowed Britain to avoid many of the strains of this decade. The examination of the role of the sterling area in the proposals for such a policy revealed that it was political obstacles rather than Britain's obligations to the sterling area which ensured the rejection of these policies. Pollard's assertion that it was "those who used the City of London as their Banking centre" which inhibited external monetary policy is not, therefore, fully justified.

With respect to domestic policy, there is some evidence that the sterling area may have contributed both to a tendency to keep interest rates low and also to keep them high. The net influence on balance is not identifiable given the many other influences on the experiment of interest rate policy in the 1950s.

Chapter VI. Alternatives to the Sterling Area in the 1950s

When considering alternative policies which might have been chosen in the 1950s it is important to avoid launching into ahistorical speculation. It is no use stringing together a long series of 'what if' scenarios which do not take account of the historical context of the period if the purpose of this type of analysis is to give insight into what actually occurred and the context in which decisions were taken. In this sense, the present chapter does not set out to apportion blame or to describe what 'might have been' but merely to examine some of the alternatives available to policy-makers at the time and to determine why another course was not chosen.

During the 1950s there were almost persistent complaints about the management of the sterling area system. Mostly they asserted that the present system was unsustainable due to the overhang of sterling balances over reserves and the relative freedom of RSA members to call on the reserves to settle their foreign exchange needs coupled with the freedom of capital flows to the RSA.

The more imaginative of this group of critics offered a fairly wide selection of alternative policies for the governments of the time¹. Generally, these fell into three categories; dispensing with the international role of sterling

¹B.J., Cohen, The Future of Sterling as an International Currency, Macmillan, 1971. Chapter 10 offers a good summary of alternative policies suggested.

and the sterling area, reinforcing the sterling area into a more discriminatory bloc, and introducing more flexibility into external monetary policy while maintaining the sterling area system and the international role of sterling.

VI.A. Winding up the Sterling Area

The concern of those who advocated winding up the sterling area was the perceived strain that it imposed on the British balance of payments due to the persistence of the sterling balances problem coupled with the large volume of uncontrolled long term capital flows to the sterling area. This group hoped to eliminate the sterling balances 'problem' by dispensing with the reserve role of sterling. They also believed that restricting investment in the sterling area would reduce the current surplus necessary to bring the balance of payments into equilibrium and would release capital for domestic investment. Prominent among this group were A.C.L Day and Andrew Shonfield².

The sterling balances problem and long term investment were closely related since if capital flows to the sterling area had been restricted it was believed that this would reduce the willingness of RSA countries to maintain the level

²A.C.L. Day, "What Price the Sterling Area?", The Listener, Vol. LVIII, No. 1495, 21 Nov. 1957. pp 824-5, 846 and "The World Liquidity Problem and the British Monetary System", Memoranda of Evidence submitted to the Committee on the Working of the Monetary System, Vol 3, pp. 71-76. A. Shonfield, British Economic Policy Since the War, Penguin, London, 1958. Chapter Ten, 'A Way Forward', pp.251-280.

of their sterling balances. This reflects a view of the sterling area as essentially an informal exchange of interests between the RSA and the UK under which the RSA agreed to maintain their sterling balances and in return the UK offered privileged access to the British capital market for development purposes.

By the time Day, Shonfield and others were writing, the crisis of Suez and the exchange crisis of 1957, neither of which was directly related to Britain's balance of payments position, had highlighted the possibility that Britain's overseas interests were overextended. In response, proposals for alternative policies focused on insulating the British economy from external disturbances.

In a 1957 radio broadcast, written up as an article for The Listener, A.C.L. Day introduced his proposal for winding up the sterling area³. His plan was to impose exchange control on capital movements to the RSA in order to limit this drain on the balance of payments. In turn, the Government would have to negotiate funding arrangements to secure the sterling balances. Day argued that although the danger of a massive withdrawal of sterling balances had not been realized, the threat itself was destabilizing and liable to increase as Colonies attained independence. Therefore, the securing of sterling balances alone should have improved confidence⁴. The

³A.C.L. Day, "What Price the Sterling Area?".

⁴Ibid.

largest holders of the sterling balances (eg. Malaya and Ghana) would be offered privileged access to the London market in return for a funding arrangement. This would give the less developed holders an assured source of development capital and would allow the drains on the UK to be predictable and controlled, removing the element of uncertainty and speculation. The independent members of the sterling area (ISA) would be given a guarantee of the gold or dollar value of their sterling balances in return for an agreement to limit withdrawals. These funded balances would be drawn down over an agreed period of 10-15 years. British investment in these countries would then be closely restricted. There was, then, discrimination in the treatment of holders based on the size of their balances and their need for development as perceived by the British authorities. Day also envisaged repaying some of the balances immediately, "raising the dollars by calling up private British holdings of dollar securities, as we did early in the war"⁵.

Andrew Shonfield proposed his plan for winding up the sterling area as the background for a more general Five-Year Plan to expand production in the British economy⁶. The details for dealing with the sterling area system were generally the same as those presented by Day. Shonfield agreed that foreign investment "should be clawed back for

⁵Ibid.

⁶Shonfield, British Economic Policy Since the War, pp265-274.

domestic use"⁷ and also recognized that in the absence of capital from London, RSA countries would want to have fairly liberal access to their balances and that this would strain British resources. He therefore endorsed Day's suggestion for an exchange rate guarantee for RSA sterling balances in return for limits on their withdrawal.

Shonfield put more emphasis on reinforcing the reserves by "taking into the currency reserve the readily realizable [foreign] securities in British ownership"⁸. If the British government were to take control of existing private overseas investments, Britain would have a stronger "bargaining hand" to negotiate limits on withdrawals of sterling balances by announcing that British-owned assets in the RSA would be sold at the same rate as RSA sterling balances were run down⁹. As Australia, for example, ran down her sterling balances, the UK would sell an equal amount of British owned Australian assets in the USA to cover the drain on the central reserves¹⁰. Thus Australia would end up with either diversified reserves or fewer reserves overall depending on the circumstances of running down the sterling balances; the UK reserves would not be affected and the USA would acquire Australian assets.

⁷Ibid., p. 265. The possible benefits to UK domestic capital formation of cuts in overseas investment were dismissed in Chapter IV.

⁸Ibid., p. 269.

⁹Ibid.

¹⁰Ibid., p.272

Shonfield's vision of "A Way Forward" for the British economy entailed a level of Government intervention in British business that was not likely to be forthcoming. Confiscation of private foreign assets would have proved politically difficult in peacetime. Nor did the value of British investments in RSA countries always approximate the value of British liabilities. Furthermore, the nature of these assets, mostly direct private investment rather than securities, suggested that their value when sold in the third market would be significantly less than the compensation required from the government for the British owners.

These proposals would also have proved difficult to negotiate with the ISA. An exchange guarantee for the value of the sterling balances in return for limited access to their foreign exchange reserves would not have excited much enthusiasm in the 1950s. As noted in Chapter II withdrawals of sterling balances by RSA members tended to be in response to fluctuations in their own balances of payments rather than for exchange rate speculation or diversification. Furthermore, the arrangements with India, Pakistan and Ceylon immediately after the Second World War had shown that formal agreements limiting the amount of withdrawals were not enforceable in a time of crisis.

A.C.L. Day amended his proposal in a memorandum to the Radcliffe Committee in May 1958, adding a new solution to the

sterling balances problem¹¹. Day suggested that the liabilities could either be made less liquid for the holders (along the lines of his earlier suggestion) or alternatively another agent could be asked to take over the short term liabilities in return for a long term claim on the UK. He noted that the second option would be easier to negotiate and suggested either the IMF could play this role or, if America would not agree, a European/Commonwealth Bank developed out of the EPU could take over the balances. In Day's proposal the IMF would issue gold certificates in exchange for the foreign reserves of members and so create an international currency. This would eliminate the unstable influence of two major reserve currencies competing for the allegiance of international central bankers. In turn "the IMF would be able to issue more certificates than it held in gold, and would then be operating as a fully fledged international central bank"¹². Day explicitly designed this system on the pre-1914 gold standard model with the IMF at the centre rather than the Bank of England¹³.

The UK would exchange the short term liabilities to the RSA for a single long term liability to the new institution

¹¹A.C.L. Day, "The World Liquidity Problem and the British Monetary System", Memoranda of Evidence submitted to the Committee on the Wording of the Monetary System, Vol. 3, pp. 71-76.

¹²Day, Memorandum to Radcliffe Committee, 1958.

¹³Ibid.

which could be gradually extinguished without affecting the liquidity of the RSA's foreign reserves. Day recommended that the British argument to the IMF could be that nothing had yet appeared to replace the international banking function of sterling but that the burdens of central banking had become too heavy for the UK. On the other hand, the withdrawal or cancellation of the sterling balances would have a severe effect on world liquidity and payments. The time had come, therefore, for an international solution to the sterling balances problem¹⁴.

The possibility of expanding the role of the IMF to solve the problems of imbalance in the international economy was raised again after formal convertibility of sterling had been established. Immediately after 1958 the seemingly infallible strength of the American economy came into serious doubt as the American balance of payments fell into deficit for the first time since the recession of 1953-4. The strain on the American and British balances of payments of supporting the international reserve role of their currencies inspired several plans to eliminate the problem. In a statement to the Joint Economic Committee of the American Congress, Robert Triffin expounded his plan to get rid of national currencies in international reserves¹⁵. The plan was similar to Day's

¹⁴Ibid.

¹⁵R. Triffin, Gold and the Dollar Crisis; The Future of Convertibility, Yale University Press, 1960.

and in fact Triffin noted having discussed Day's proposals with him in Spring 1959¹⁶. As in Day's plan, countries would agree to keep their international reserves as deposits at the IMF with exchange rate guarantees and receive interest payments on these deposits. The new international reserve deposits would thus have the security of gold and the interest earning incentive of foreign currency reserves.

One year later James Meade published a similar proposal calling for the pooling of reserves in the IMF in return for gold certificates and an undertaking by members to hold only gold certificates as national reserves in the future. The IMF would affect exchange rates between currencies using its foreign exchange holdings to lift the burden of exchange rate control from domestic monetary authorities, allowing them to be free to pursue goals of full employment, price stability and economic growth without worrying about the balance of payments¹⁷.

In 1964, Meade amended his plan so that, unlike Triffin's proposals, the new system would specifically exclude the absorption of existing sterling and dollar balances into the IMF so there would be no increase in the scale of the Funds assets¹⁸. Instead, the national currencies contributed by

¹⁶Ibid., p. 158.

¹⁷J.E. Meade, "The Future of International Trade and Payments", Three Banks Review, June 1961, No. 50, pp 15-38. p. 33.

¹⁸J.E. Meade, "The International Monetary Mechanism", Three Banks Review, Sept. 1964, No. 63, pp. 3-25. p. 22.

members in the normal functioning of the Fund would be considered deposits of members and liabilities of the IMF, and would be used to settle imbalances between members by accounting adjustments of their deposits with the Fund. The risk of a run on existing sterling or dollar balances would be prevented by limiting the amount of the possible change in the gold exchange rate to 1/6% per month or 2% per year¹⁹. In addition, gold value guarantees might be made by the USA and UK for balances of their currencies held by other national monetary authorities²⁰. These examples of later proposals similar to those suggested in the 1950s are included to show the continuity of the type of plans offered as solutions to problems in the international payments system.

Attractive though this type of arrangement appeared both to contemporaries of Day and Shonfield and to later analysts, there are several problems with it. First, the UK position would not necessarily have been much improved by the exchange of short term liabilities to the sterling area for a long term liability to the IMF. Even if repaid over a period as long as twenty years, the drain on the balance of payments would have amounted to over £100m p.a.. This is considerably more than the UK had to settle with the RSA in any year during the 1950s except 1957²¹. In addition, there was the long run rate of

¹⁹Ibid., p. 23.

²⁰Ibid.

²¹In 1957 RSA sterling balances were drawn down by £161m.

interest to consider which may well have been even greater than the existing rate since the rate paid by Britain to the IMF would have had to meet or exceed the rate the IMF paid to the RSA except in the unlikely event that the RSA were persuaded to forego the interest on their assets.

Thirdly, there was the consideration that under the sterling area system it was fairly certain that the UK would never have to repay 100% of the sterling balances since a large proportion were currency reserves or statutory funds, some part of which at least would remain in sterling. A wholesale diversion of trade from the UK to the non-sterling area was unlikely to occur so the need for sterling reserves of some size would continue. If the sterling area were formally wound up, however, the entire burden would have to be borne within a fixed period.

The prospects for an international clearing union along the lines of Day's plan were not too promising in the 1950s. By this time there appeared to be consistent international debtors and creditors which would undermine the system²². This, for example, had emerged as an important problem of the EPU as Britain moved into consistent deficit against the surpluses of Germany and Belgium. With this precedent, such an international central bank would appear to surplus

²²The persistence of creditor and debtor status was subsequently thrown into doubt when the USA balance of payments deteriorated after 1958 but in the 1950s the perception was different.

countries, such as the USA and Germany, as merely a way to get them to finance the deficits of the UK and the sterling area. This type of proposal was to have greater international appeal after the USA began to suffer from the burden of maintaining a reserve currency with a weak balance of payments in the 1960s.

Finally, given the failure of the UK to fulfill the undertaking to fund, block or write off the sterling balances under the terms of the 1947 Anglo-American Financial Agreement, it was unlikely that Congress and the American public would support a plan that smacked of 'bailing out' the UK. During the 1950s the American public was believed to be suspicious of British motives in international economic negotiations, the perception was that the UK was trying to take advantage of her weak position to gain more money from the USA.

The Radcliffe Committee took note of A.C.L Day's proposal in its Report and agreed that an expansion of the role of the IMF "should be a principal object of policy"²³. The Report noted, however, that while a plan to expand the IMF into an international central bank was attractive,

an arrangement of this kind, requiring international agreement would be extremely difficult to negotiate and does not appear to us likely to be of immediate and substantial assistance to sterling.²⁴

²³Radcliffe Committee Report, p. 247.

²⁴Ibid. Para 663, P. 242.

The Report went on to conclude, as noted above, that such an arrangement "might, indeed, oblige the United Kingdom to discharge her external liabilities more quickly than would otherwise be necessary"²⁵. Furthermore, blocking or funding the sterling area sterling balances would reduce the liquidity of the RSA and, therefore, their ability to achieve relatively free trade and payments relations with the rest of the world. Since the Committee's concern was for the general liquidity of the international payments system they opted for increasing UK reserves through current account surpluses rather than decreasing liabilities as a longer term solution to the UK reserves position²⁶ and this remained official policy for the next ten years.

As for the second aspect of these proposals to wind up the sterling area, the imposition of capital controls on British investment in the RSA, the analysis in Chapter IV showed that these capital flows were not damaging to the British economy and that such controls might have had serious longer term effects on the UK balance of payments.

To conclude this discussion of the feasibility of winding up the sterling area it is necessary to examine the arrangements which effectively achieved this ten years later in order to see whether there was an opportunity for the UK to

²⁵Ibid.

²⁶Ibid., pp. 247-8.

organise such a solution in the 1950s. The Basle Agreement of 1968 was a formalisation and extension of arrangements operating under the auspices of the BIS through which the central banks of Europe and America had agreed to offer each other short term swap arrangements to cushion extraordinary capital flows. The UK was a primary beneficiary and was able to draw a total of £325m from foreign central banks in 1961 in return for sterling. In November 1964, the banks provided the UK with a swap limit of \$3000m, of which less than half was actually used. In the same year the UK then drew \$1.4b from the IMF to repay the central banks. In the next two years, further arrangements were agreed and further drawings made. Throughout the 1960s, then, the UK was 'insured' against destabilising drawings on sterling balances²⁷.

The Basle agreement of September 1968 represents the ultimate 'solution' to the sterling balances 'problem' and arguably marks the end of any pretensions of sterling to be a true reserve currency. Under the arrangements, the RSA countries agreed to maintain a specified proportion of their reserves in sterling in return for an exchange rate guarantee in terms of dollars. The BIS central banks in turn pledged an additional \$2b worth of support for drawings on ISA sterling balances due to reductions in their foreign exchange reserves

²⁷That this insurance did not eliminate speculative capital flows is noted in Chapter V.

as a whole. The credit was specifically not to be used for drawings of NSA holdings. In addition, the ISA was encouraged to put part of their diversified reserves on deposit at the BIS so that "the sterling area itself should make a contribution to the financing of the facility"²⁸. The agreements with the RSA governments were for three years with provision for an extension of a further two years in most cases. In effect, the Basle Facility removed the threat of a speculative rundown in RSA balances through diversification of reserves since a fixed proportion had to be maintained in sterling. At the same time, crisis funds were available in case the RSA's total reserves fell drastically due to balance of payments problems.

In the cases of Australia and New Zealand, the agreement was open to review if the UK imposed further restrictions on capital exports to these countries. In 1966 The Bank of England had announced a programme of voluntary restraint on direct British investment in Australia, New Zealand and South Africa. The restrictions were based on an American model designed to restrain capital exports without imposing further exchange controls. In February 1965, the Americans had imposed a similar policy of 'voluntary restraint' on capital

²⁸The Basle Facility and the Sterling Area, Cmd 3787, HMSO, London, October 1968. The participating countries were Austria, Belgium, Canada, Denmark, West Germany, Italy, Japan, Netherlands, Norway, Sweden, Switzerland and the USA.

investment in 'advanced' economies²⁹. American firms met with government officials to develop investment programmes and to review the essentiality or future export value of their planned investments.

By 1968, then, the UK had imposed controls on capital flows to the sterling area and had effectively removed the threat of a wholesale run on the sterling balances due to a diversification of reserves or to deterioration in the RSA balances of payments. The obvious question is why such international cooperative efforts at dismantling the sterling area's more dangerous aspects did not happen ten years earlier. The first obvious difference between 1967 and 1957 is the convertibility of sterling³⁰. The acceptance of de jure convertibility on the part of both Britain and Western Europe was probably a necessary prerequisite to such international currency cooperation. It must be remembered that the Basle Facility grew out of ad hoc arrangements to support all the newly convertible currencies of the early 1960s. Other countries made use of the lines of credit but sterling's special weaknesses put it in persistent danger and made a more permanent arrangement necessary. As noted above it is unlikely, given the atmosphere of the 1950s, that the US congress would have voted for such liberal support for an

²⁹The Economist, February 13, 1965, Vol. CCXIV, No. 6338. p. 667.

³⁰From 1955, sterling was de facto convertible but for political purposes the de jure convertibility is more important.

inconvertible pound.

The extension of longer term and more formal support was dependent on the UK negotiating agreements with the RSA countries to block their sterling balances. There were more obstacles to such negotiations in the 1950s than there were by 1968. One important consideration was the changed political structure of the sterling area by 1968. From the end of the 1950s and through the 1960s most of the Colonial members of the sterling area gained independent status (see Table VI.A.). By 1968 only some West Indian Colonies and Southern Rhodesia were under direct British control. In the mid-1950s over half of the RSA sterling balances were still in Colonial hands, accumulated under the Colonial monetary system and under the restrictions on dollar expenditure enforced by the British authorities. The largest holders of sterling balances were also those Colonies closest to independence,

Table VI.A.
Dates of
Independence of British Colonies

Malaya	1957
Ghana	1957
Singapore	1959-65
Nigeria	1960
Tanganyika	1961
Kuwait	1961
Uganda	1962
Jamaica	1962
Zanzibar	1963
Kenya	1963
Zambia	1964

such as Malaya and the Gold Coast. It would not have been politically possible to formally approach these territories on

the brink of independence and demand that they forego or delay plans for future development. Not only did the UK have a moral obligation to her dependencies but such an approach might itself have precipitated the move to independence and accelerated the running down of the balances. Giving exchange rate guarantees only to the ISA holders and excluding the Colonies would have posed political difficulties at home as well. Such a limited arrangement would not in any case have dealt with the major part of the threat of the sterling balances which was that the newly independent members would quickly take the opportunity to accelerate development spending. In this sense the British authorities were forced into inaction since negotiations to restrict the spending of these large and volatile sterling balances could not really begin until independence had been achieved. The 1968 solution to the sterling balances problem thus depended on the changed political structure of the sterling area.

The other achievement of the 1960s was the long-awaited imposition of restrictions on capital flows to the sterling area in 1966. At first glance the UK capital account with respect to the RSA seems remarkably similar in the 1950s and 1960s. In the period 1950-57 the official figures showed an average net outflow of private long term capital to the RSA of £180m p.a. In the 1960s it was somewhat higher, averaging £220m p.a., accelerating to 1965 as the UK's overall balance with the RSA deteriorated. There were, however, special

circumstances in the 1950s which would have undermined a programme of voluntary restraint such as that imposed in 1966. During most of the 1950s the 'advanced' members of the sterling area, which the 1966 programme targetted, still had some sterling balances which could be drawn on in the event of a forced decline in British investment. Furthermore, in the 1950s British investment was much larger proportion of foreign investment in the sterling area. For example, during the 1950s the UK supplied 60% of the capital inflow to Australia³¹ but by 1966 Britain supplied only 39% while the USA contributed 46% despite capital controls of its own³². What these changes in the sterling balances and investment patterns of the sterling area imply is that by the 1960s the restrictions imposed did not carry the same risks with respect to a run on the sterling balances both because the controls did not pinch as much and because the level of sterling balances of targetted countries was not as high as they had been in the 1950s.

The weakness of the voluntary restraint programme in the 1960s, however, does not recommend it to the 1950s. In 1964 and 1965, the two years before the restraint was announced, long term private capital flows to the RSA were about double

³¹Annual Bulletin of Overseas Investment: Australia 1960-61, No. 6, Commonwealth Bureau of Census and Statistics, Canberra, 1962.

³²S. Strange, Sterling and British Policy; A Political Study of an International Currency in Decline, Oxford University Press, 1971., p. 94.

the level of the previous three years (see Table VI.B.). In 1966, the year the programme began, the volume of investment fell considerably but recovered almost to the 1965 level in 1967 despite the continued call for restraint. Given some time lag between the planning and implementation of investment programmes, it seems that the voluntary restraint programme had little effect on the UK balance of payments.

Table VI.B.
UK Long Term Private Capital Flows to the RSA
1961-1968

£m	1961	1962	1963	1964	1965	1966	1967	1968
	133	117	124	216	252	187	244	263

Source: IMF Balance of Payments Yearbook.

The most important difference between the 1960s and the 1950s was the position of the United States. Throughout most of the 1950s the USA was able to run balance of payments surpluses with a relatively comfortable ratio of reserves to short term liabilities. By the 1960s, however, the American situation looked less secure and by 1966 short term assets no longer covered short term liabilities. Susan Strange argues that the growing weakness of the American balance of payments was an important incentive for the Americans to prop up sterling³³. If the RSA countries continued to diversify their reserves into dollars, America would end up accumulating overseas liabilities which would prove difficult to repay if the USA was in deficit. Instead "to leave the prime liability

³³Ibid., p. 283-84.

with Britain, leaving it to Britain to borrow (if necessary) to meet the liability was a prudent defensive or precautionary measure of economic policy for the United States"³⁴. She concluded later that such direct American assistance in recurring sterling crises in the 1960s "would not have been so prompt had the dollar itself not been comparatively weak"³⁵. In the 1950s this prerequisite was not met.

VI. B. Reinforcing the Sterling Area

The proposals to reinforce the sterling area were generally related to a desire to solidify the Empire into a stronger and more cohesive economic and political bloc. The policies were also a defensive response to the failure of the UK to perform as well in the post-war international economy as in the pre-war period. Leo S. Amery's alternative policy, for example, was based on the assumption that the American economy had grown to such a size that its dynamic pattern of economic fluctuations created an "international imbalance"³⁶. The solution which he sought was the creation of a second economic bloc strong enough to correct this imbalance. The natural bloc for Britain to develop in this regard was the Commonwealth. Europe was not a viable alternative since it

³⁴Ibid, p. 284.

³⁵Ibid, p. 293.

³⁶L.S. Amery, A Balanced Economy, Hutchison and Co., London, 1954., p. 8

was considered 'over-industrialized' already and its production was competitive with that of the UK so that the potential benefits for the UK of this association were not great³⁷.

The consolidation of the Commonwealth into a powerful economic bloc would be achieved by denouncing GATT and the "procrustean policy of non-discrimination"³⁸ and pursuing instead a closer discriminatory relationship with the Commonwealth and secondarily with Europe. This could be achieved first by encouragement of emigration from the UK to the Commonwealth to hasten development there and secondly by establishing a system of preferential tariffs. Amery linked capital flows to preference by noting that "if the Dominions want the investment it is to their interest to help create that surplus [in the UK] by their own purchases from this country" and that "to assure the market for the production resulting from the investment by giving preference to those products is only a prudent insurance on our investment"³⁹.

Amery was certainly not alone in his desire for closer Commonwealth links to counter influences from the American economy. In December 1951, the Assembly of the Council of Europe set up a Working Party of journalists, bankers and officials to pursue

³⁷Ibid., p.194.

³⁸Ibid., p. 202.

³⁹Ibid., p.196.

a study of methods for achieving a closer coordination between the economies of Member States of the Council of Europe and those of the overseas countries having constitutional links with them⁴⁰.

The proposals which were developed became known as the Strasbourg Plan which recommended greater integration of Europe and the Commonwealth in both trade and payments. On the trade front the Council recommended the establishment of a new preferential system within GATT whereby the Commonwealth and the OEEC would offer each other secondary preference, more beneficial than to the rest of the world but not as preferential as among members of the Commonwealth⁴¹. As in Amery's proposal, it was argued that the Most Favoured Nation clause in the GATT, while designed to promote trade liberalization actually inhibited the reduction of tariffs by making selective tariff relaxations impossible⁴². The Plan also recommended the establishment of a European Bank to work closely with the IBRD to channel development funds to the Commonwealth. This would include contributions from European countries that did not have their own dependent territories.

The final recommendation of the Plan perhaps gives away

⁴⁰Council of Europe, The Strasbourg Plan, 27 August, 1952., p. 9.

⁴¹Recommendation and Order of the Assembly of the Council of Europe, The Strasbourg Plan, p. 128. This system of graduating preferences was modelled on a proposal by L.S. Amery in the forward to the Preparatory Documents for the Commonwealth Conference organized by the European League for Economic Cooperation, May 1951. The Strasbourg Plan, Report of the Working Party. p. 32.

⁴²Ibid., p. 32.

its purpose most clearly. This was the provision to extend long term bulk purchase contracts for Commonwealth raw materials. The aim was to increase production of food and raw materials by guaranteeing a market for producers and, of course, to guarantee a supply of these products at stable prices for European consumers⁴³. This was an important concern in 1951 when the shortages of raw materials and the resulting high prices were pinching the industrialized economies of Europe. By order of the Assembly of the Council of Europe, the Ministers of the Commonwealth were to be presented with the recommendations of the Strasbourg Plan at the upcoming Commonwealth Economic Conference in November 1952⁴⁴. When the time came, however, the Commonwealth ministers were preoccupied by the Collective Approach to convertibility and the meeting refused to meet with the representatives of the Council of Europe, claiming pressure of time⁴⁵.

These two proposals give examples of the type of plans offered for reinforcing the sterling area into a competitive, defensive economic bloc. The goal was to insulate the members from fluctuations in the American economy through protective, discriminatory restrictions. The plans varied in their

⁴³Ibid., p.34.

⁴⁴Ibid., p. 129.

⁴⁵Minutes of the Third Meeting of Ministers, Committee on Finance and Trade, 1 December, 1952. PRO T236/3094.

attitude to Europe, some including and some excluding it from the Commonwealth bloc. The common thread, however, was the use of preferential tariffs and increased exchange control restrictions to create a barrier behind which it was hoped the UK and its partners would flourish.

The promotion of Imperial Preference and the strengthening of Commonwealth ties had been an important plank in the Conservative Party's political platform for some time. The Conservative Party policy paper for 1950, This Is The Road, declared that

the greatest possible development of Empire Trade is our aim. We offer Empire producers a place in the United Kingdom market second only to the home producer. We claim the right to maintain whatever preferences or other special arrangements may be necessary⁴⁶.

The last provision was a specific attack on the No New Preference (NNP) rule of the GATT which prevented the UK from increasing Imperial Preference by increasing tariffs on non-Commonwealth imports only. The election program for the 1951 election, Britain Strong and Free, declared the Conservative party "the Party of Empire", pledged to "retain Imperial Preference and uphold the right to grant and receive such preferences as are mutually agreed with Empire countries"⁴⁷.

By the 1955 Election, however, Conservative Party policy

⁴⁶This is the Road: The Conservative and Unionist Party's Policy, General Election 1950, the Conservative and Unionist Central Office, 1950. p. 18-19.

⁴⁷Britain Strong and Free, Conservative and Unionist Central Office, London, 1951. p. 12.

emphasized the "move towards a world-wide system of freer trade and freer payments" in order to "re-establish sterling in a position so strong and respected that it can play its full part as a major international currency"⁴⁸. There was no mention of Imperial Preference but it was noted that "this policy is in harmony with our Commonwealth trade relations and the Commonwealth countries themselves pursue it"⁴⁹.

There had been strong political support for the abolition of the NNP Rule in both the House of Commons and the House of Lords from the beginning of 1952. In April, Lord Balfour of Inchrye called for an end to the GATT limitations on increasing Imperial Preference. He suggested that this be done unilaterally, without consulting the rest of the Commonwealth or other members of the GATT but that this should be followed by an 'Imperial Economic Conference' and a detailed investigation into the resources of the Commonwealth and Empire⁵⁰. Lord Ogmores responded from the Labour side warning that the interests of the Dominions did not necessarily lie in Imperial Preference, although he asserted that "we on this side believe that Imperial Preference should be retained"⁵¹. Lord Hawke raised the possibility of

⁴⁸Conservative and Unionist Central Office, 1955. p. 15.

⁴⁹Ibid.

⁵⁰House of Lords Official Report, Hansard, 2 April, 1952, Col. 1296.

⁵¹Ibid., Col. 1300-01.

combining greater Imperial Preference with a pledge to convertibility to satisfy the USA and the sterling area countries, concluding paradoxically that "if we are to move in any way towards convertibility... It is absolutely necessary that we should have the power to discriminate"⁵². Lord Cherwell, Paymaster General, also spoke of the possible reluctance of other members to increase Imperial Preference given the high international demand for their exports, concluding that "it is by no means certain that all the other members of the Commonwealth are itching to increase Imperial Preference"⁵³. After Cherwell's speech, Lord Balfour withdrew his motion.

Without even entering into debate over whether such measures would inhibit or expand the growth of the members of such a defensive bloc, or, indeed, if Europe would be willing to join if invited, this type of alternative policy founders on the obvious obstacle that by the 1950s, the rest of the sterling area would not have agreed to reinforce relations with the UK and each other at the expense of North America and Europe.

The Imperial Preference system had been established in 1931 in an atmosphere of general economic depression when there were international surpluses of the raw materials produced in the Empire. A preference in the British market

⁵²Ibid., Col. 1313-14.

⁵³Ibid., Col. 1322.

which encouraged purchases from the Empire could be of significant benefit to the producers of these goods when the UK had a choice of sources of raw materials. In this environment, the preference offered to British manufactured exports by overseas Empire countries was worthwhile and the system could operate as a mutual support group in times of slack demand. During the Korean War boom, this motive for preference disappeared. With the increased demand for raw materials, it became a sellers' market and preference in the British market meant little to producers. In return the preferences offered on imports of British manufactures appeared more costly.

In the 1950s the reactivation of Imperial Preference to create a meaningful protective barrier was never truly feasible. At the Commonwealth Economic Conference of December 1951 the members of the sterling area resolutely set their future on the liberalization of trade and payments. Thus, while agreeing to impose discriminatory restrictions on trade to meet the immediate balance of payments crisis the statement from ministers at the end of the conference declared that

It was agreed that while emergency measures to stop the immediate drain upon the gold reserves were necessary and inevitable, they could only be palliatives. A lasting solution of the sterling area's problems must be found in order to prevent the recurrence of crises, to make sterling strong and to establish the economies of member countries on a sound and stable basis. These aims can best be achieved when the world-wide trade of the sterling area is on a substantially higher level than at present, when sterling is freely convertible into all the main currencies of the

world and its position need no longer be supported by restrictions on imports⁵⁴

In the newly independent members of the sterling area such as India, Pakistan and Ceylon, there was a distaste for Imperial Preference for political reasons. To the population of these countries the system smacked of Colonial exploitation to support British industry⁵⁵. During trade negotiations between the UK and Pakistan in 1951, for example, Pakistan had insisted on a reduction of the level of preference between the two countries⁵⁶. Pakistan's exports at the time were limited to raw jute, raw cotton, tea, hides and skins, all of which were in great demand internationally so a preference in the British market was not of much benefit.

In Australia, a broad campaign among Australian businessmen began around 1952 to lobby for a reduction of preferences offered to British manufactured exports. The arguments were that the preferences offered to Australian goods in the British market mostly took the form of specific duties which had eroded with inflation since 1932 while the preferences granted on British goods tended to be ad valorem. Furthermore, the preference on British manufactured imports presented an obstacle to the aspirations of Australian

⁵⁴Report of the Preparatory Meeting of Officials, Annex I, January 1952., 15 October, 1952. PRO T236\3086.

⁵⁵'The Views of the Commonwealth on Commonwealth Integration', 16 July, 1952. PRO BT11\4976.

⁵⁶'Effect of GATT on UK-Pakistan Negotiations of 1951', 18 April, 1952. PRO BT11\4976.

business and government to develop secondary industry to establish a more balanced economy⁵⁷. The campaign was finally successful in 1957 when negotiations with Britain reduced preferences on British goods. As for the other independent members of the sterling area, New Zealand tended not to express strong views on Imperial Preference and South Africa offered very few preferences to British goods in any case.

At the end of 1952, the ISA got the opportunity to express their views on Imperial Preference. The Commonwealth Economic Conference of November 1952 and the Officials' Preparatory Meeting which preceded it in September are illustrative of the resistance of the ISA to reinforcing the discriminatory economic relationship of the Commonwealth. As part of the Collective Approach to convertibility, quotas were to be replaced by tariffs. If quantitative restrictions were to be eliminated after convertibility Britain would have to increase tariffs on non-sterling imports at least in the short run which would require new tariffs on imports from the Commonwealth under the No New Preference (NNP) rule of GATT. At the time, the UK imposed no tariffs on a wide range of Commonwealth imports and to introduce tariffs would require new legislation which, it was believed, would provoke considerable opposition in Parliament. To solve this problem the British delegation called on the Commonwealth members to

⁵⁷The 'Anti-Ottawa file'. PRO BT11\4982.

support an application to GATT to abolish the NNP Rule to allow an increase in the preferential margin on trade within the Commonwealth⁵⁸.

As might be predicted, the response of the ISA was not favourable. Jayawardena of Ceylon began the discussion by noting that increasing preferential margins was inconsistent with the aims of the Collective Approach, which were to enhance multilateral trade and payments. Also, as a primary producer, Imperial Preference was unnecessary to the Ceylon economy⁵⁹. Duetsch of Canada noted that other preferential trading blocs might develop if the NNP Rule were abolished, which would not be in the interests of the sterling area⁶⁰. Ashwin of New Zealand and Van de Waal of South Africa, although supporting the removal of NNP in principle, raised the objection that including such an amendment of GATT in the Collective Approach would jeopardise the negotiations with the USA, thus endangering the success of the Collective Approach itself⁶¹. Melville of Australia argued that increased preferences for Australian exports was not very appealing for the Australian population since exports outside the sterling

⁵⁸Minutes of Commonwealth Economic Conference, Preparatory Meeting of Officials, Committee on Trade Policy, 26 September, 1952. PRO T236\3085.

⁵⁹Preparatory Meeting of Officials, Commonwealth Economic Conference, 26 September, 1952. PRO T236\3085.

⁶⁰Ibid.

⁶¹Ibid.

area were becoming more important and her producers must be prepared to face world competition⁶².

Despite this fairly consistent lack of enthusiasm for enhancing Imperial Preference as part of the Collective Approach, the Cabinet insisted that the proposal be pressed again at the Commonwealth Ministerial meetings. At the last meeting of officials Cohen, speaking for the British delegation, noted the disapproval of the proposal among ISA representatives but told them that

he would judge that his Ministers would regard the removal of the No New Preference Rule as an essential part of those proposals. They could not contemplate having to explain to their public that, as a first result of the convertibility operation, it would be necessary to put duties on Commonwealth goods and that Commonwealth countries would have to put duties on UK goods, wherever tariffs had to be adjusted upon the removal of quantitative restrictions.⁶³

In a letter to R.A. Butler, Peter Thorneycroft, President of the Board of Trade noted that he and Butler were agreed that the case for abolishing the NNP Rule must be put very strongly to the ministerial conference as a measure to strengthen sterling and British exports and to be consistent with Conservative party policy⁶⁴.

Accordingly, the sixth meeting of Ministers was devoted

⁶²Meetings of Heads of Delegations, Commonwealth Economic Conference, 3 October, 1952. PRO T236\3085.

⁶³Minutes of Preparatory meeting of officials, Committee on Trade Policy 26 September, 1952.

⁶⁴Letter, Peter Thorneycroft to R.A. Butler, undated (late November/early December 1952). PRO T236\3098.

entirely to the question of Imperial Preference⁶⁵. The attitude of the ISA governments had not changed since the end of the Officials' meetings a month before. The representatives of New Zealand, South Africa, Pakistan and Ceylon repeated that an increase in preferential margins was inconsistent with the goals of the Collective Approach and that this was liable to provoke the USA and jeopardise the success of the negotiations. Sir Chintamen Deshmukh of India went on at some length that the Indian government preferred quotas to tariffs in general and that Imperial Preference was politically unpopular in India. Also, he objected to making a permanent change in GATT to cover a transitional period in the Collective Approach. He also took up Canada's point that the removal of the NNP Rule would encourage other preferential blocs and undermine the freeing of trade barriers. Menzies of Australia gave a lengthy if inconclusive speech emphasizing the need to maintain or increase the freedom of adjustment of preferences to correct inequalities which had emerged over the years since 1932. He obviously alluded to the need to adjust Australian preferences toward the UK. Only Southern Rhodesia came down firmly on the British side, praising the Imperial Preference system and supporting the abolition of the NNP rule. In the end, the issue was relegated back to a committee of officials and Commonwealth support was won for a limited

⁶⁵Sixth meeting of Ministers, Commonwealth Economic Conference, 3 December, 1952. PRO T236\3094.

approach to GATT to allow that if the UK needed to raise duties on goods that were currently entering duty-free from the Commonwealth, the UK would not have to introduce new tariffs on Commonwealth trade⁶⁶. This was done at the GATT meeting in Geneva in 1953 and was accepted on the condition that no Commonwealth country would gain a competitive trade advantage thereby⁶⁷.

The lack of enthusiasm for Imperial Preference reflected an antipathy to reinforcing the economic ties of the Commonwealth at the expense of trade with the rest of the world. What the Conference showed was that where Imperial Preference conflicted with the eventual achievement of multilateralism in trade and payments, it was the latter which took precedence. The reluctance of the RSA to broach the topic in GATT reflected a desire not to antagonise important future trading partners and sources of development capital. Thus the 'Confidential Annex' to the Commonwealth Economic Conference, designed to inform British ministers, noted that "at one time some Commonwealth delegates actually seemed to admit that they would prefer to see the UK impose duties on Commonwealth goods at present admitted free rather than risk raising in GATT the principle of the No New Preference

⁶⁶Minutes of the Ninth meeting of ministers, Commonwealth Economic Conference, 8 December, 1952. PRO T236\3094.

⁶⁷Amery, A Balanced Economy, p. 188.

Rule"⁶⁸.

This unwillingness to antagonize the non-sterling area had been recognized in an earlier report by R.W.B. Clarke submitted to the Cabinet in June 1952⁶⁹. Clarke asserted that the only condition where Imperial Preference would be attractive was if the American market were closed for ISA goods. He concluded, "the hard fact is that the US is economically more important to them [the ISA] than the UK, for USA can provide for their development while UK cannot"⁷⁰. The 'community of interest' for the sterling area lay in promoting the strength of sterling and therefore convertibility, and in promoting development by cooperating to attract American investment and a high level of world trade to benefit all⁷¹. P.Liesching of the Commonwealth Relations Office, commenting on earlier drafts of this paper, argued that Clarke had not gone far enough. Thus he minuted that

it seems to be very clear that intensification of discrimination within the sterling commonwealth as a long term policy would contribute practically nothing to the objectives of other sterling area countries and that it would not appeal to them at all.⁷²

⁶⁸'Confidential Annex' to the Commonwealth Economic Conference, December 1952. PRO DO35/6489.

⁶⁹Report on External Economic Policy, 24 June, 1952. PRO DO35/6488.

⁷⁰Ibid.

⁷¹Ibid.

⁷²Letter P. Liesching to Otto Clarke 26 June, 1952. PRO DO35/6488.

This rather strongly worded policy paper does not seem to have influenced ministers very much in their expectations for the Commonwealth Economic Conference four months later.

With Imperial Preference facing such opposition in 1952, it is unlikely that deeper economic integration of the Commonwealth could have been successful. Nor did the prospects for Commonwealth integration revive as the demand for raw materials slackened after 1952 and a buyers' rather than a sellers' market returned. The political resistance of India, Pakistan and Ceylon to Imperial Preference persisted as did Australia's determination to lower preferences on British goods. The reduction in raw material prices only strengthened the determination of most ISA countries to develop balanced economies. As the British capital market grew tighter, so access to the American market became more important. Whatever the economic advantages or disadvantages of reinforcing the sterling area for the UK, the political and economic interests of the ISA denied this alternative policy any chance of success.

VI.C. The Administrative Approach to Convertibility

The two major proposals to alter the international payments system while maintaining the sterling area and ambitions for strengthening the role of sterling have been discussed in Chapter V. The ROBOT plan of early 1952 was

dropped from the policy agenda relatively quickly, essentially because of the political as well as economic obstacles it faced. The Collective Approach to Convertibility which replaced it was retained in the vocabulary of British policy through the 1950s but it had ceased to be a viable alternative by March 1953 when the Americans and Europeans failed to support it. The policy chosen by the British authorities was what might be termed an administrative approach to freer trade and payments. Thus, the obstacles to external convertibility were gradually removed from 1953 to 1955 until sterling held by non-residents was de facto convertible. This section of this chapter will trace the progress of this ad hoc approach, highlighting the alternatives abandoned along the way.

VI.C.i. Unification of Transferable Sterling

With the growing respectability of the transferable market and after the disappointing international response to the Collective Approach in March 1953, British policy increasingly began to focus on the transferable market as the next step to freer trade and payments. Even before the Collective Approach was submitted to the rest of the sterling area, however, the cumbersome and inconsistent nature of the transferable and bilateral areas had been attracting attention within the Bank of England.

On 24 November 1952, E. Crawshaw, who was to take up the cause with missionary zeal, wrote to Bloomfield,

If convertibility is not to come as a result of the Commonwealth Conference, I suggest that we should tidy up our present arrangements by scrapping the Transferable Account system and bilateral accounts for most countries and merge them all into a non-dollar area within which sterling can be transferred for all purposes⁷³.

The existing system posed a considerable administrative burden, offered little real protection for sterling, hindered UK traders while providing easy profits for bogus traders and was a discredit to UK Exchange control⁷⁴.

No direct response to Crawshaw's paper is available but he does not appear to have been discouraged and papers on the same theme continued to appear through the next twelve months, in which increasing emphasis was laid on the disadvantages under which UK merchants operated because of the transferable market discount. Thus in October 1953 Crawshaw expressed the despair now common in the Bank that

we already have a non-dollar area and all that remains is for the Treasury to decide whether it shall be recognized that our own merchants may do what other merchants are doing or whether we should maintain the present facade and leave our own merchants under a permanent competitive disadvantage⁷⁵

By the time that Crawshaw submitted this last plea to Bloomfield, the idea of a non-dollar, non-sterling world had

⁷³Letter from E.Crawshaw to Bloomfield, 24 November 1952. BoE OV44/9.

⁷⁴Ibid.

⁷⁵Note by E. Crawshaw, 16 October 1953. BoE OV44/9.

been more fully developed. On 26 March, 1953, in the fallout from the failed mission to the US for support for the Collective Approach, George Bolton drew up a list of immediate policy suggestions to sustain the momentum toward convertibility. The international suggestions were four. First, hardening up the system for EPU settlements by increasing the gold:credit ratio. The second was to allow free transferability of sterling among members of the EPU (Belgium, Switzerland, Portugal and France were still under bilateral sterling arrangements). The third suggestion was to allow free arbitrage among EPU currencies and the fourth was to widen the transferability of sterling in the non-dollar world generally⁷⁶. This set of proposals became known as 'Operation Momentum' which emphasizes that their purpose was to salvage the convertibility drive from the rubble of the talks in Washington.

Of these proposals, the first and second met with Treasury opposition. The British were already under pressure from the European creditors of the EPU (Germany, Switzerland and the Low Countries) to increase the gold:credit ratio of EPU payments but they apparently felt such a step would be too costly to the reserves since the UK was in deficit with Europe and a significant hardening of the EPU would represent de

⁷⁶Note by George Bolton, 26 March 1953. BoE OV44/60.

facto convertibility of sterling to gold for Europe⁷⁷. The Bank of England disagreed but the Treasury prevailed⁷⁸. The second proposal, free transferability of sterling within the EPU was greeted as a less provocative step. Sterling was already fairly freely transferable through the Treasury's powers to grant administrative transferability to bilateral accounts. Furthermore, the German Deutsche Mark had become freely transferable on 19 February, 1953. The Treasury, however, held back on the grounds that this step would have been a purely technical change which would not improve the payments situation but might have had adverse effects on confidence in sterling. The bilateral European countries were, in any case, not very willing to accept sterling and increased transferability might have leaked more sterling to the cheap markets.

The third international component of 'Operation Momentum' was the only one immediately brought into practice. On 18 May 1953, the UK concluded a set of agreements with European banks to allow arbitrage among the currencies of Britain, Germany, Switzerland, Belgium, France, Denmark and the Netherlands⁷⁹.

⁷⁷See J. Kaplan and G. Schleiminger, The European Payments Union: Financial Diplomacy in the 1950s, Clarendon, Oxford, 1989. p. 191-3 for the European debate on the hardening of the EPU.

⁷⁸'Progress on Operation Momentum', 10 September 1953. BoE OV44/61.

⁷⁹Kaplan and Schleiminger, The EPU, suggest that the main effect was to train foreign exchange dealers in advance of convertibility. p. 194.

The arbitrage was originally limited to spot transactions but was extended to the forward market in October. The fourth suggestion, widening the transferable sterling area, at first appeared destined for the limbo category of policies 'under discussion'⁸⁰.

On June 6, 1953 as the US evasions on the Collective Approach continued, Bolton submitted a note on 'The Next Stage' in which he recommended that if the US had not come to a decision on the Collective Approach by the September IMF/IBRD meetings, the UK should go off on another tack to bring freer trade and payments. He made clear that his thinking was increasingly focused on a possible dollar/non-dollar world⁸¹. Five days later L.J. Menzies, deputy chief cashier at the Bank, had sketched out a plan which condensed sterling into two categories: American account sterling and Transferable sterling. This step was to be accompanied by the re-opening of the London gold market for transactions in American account sterling. The danger of an increase in cheap sterling transactions was dismissed on the grounds that sterling would have become a more useful and attractive currency which would offset the effects of increased supply in the transferable markets⁸².

⁸⁰Note on Progress on Operation Momentum, 19 June 1953. BoE OV44/61.

⁸¹George Bolton, 'The Next Stage', 6 June 1953. BoE OV44/60.

⁸²Note by L.J. Menzies, 11 June 1953. BoE OV44/60.

Of the two parts of Menzies' plan, the reopening of the London gold market was the least controversial. London was the traditional centre of the world's gold trade but it had been spread across New York and various European centres since the closure of the London market. The move would also get operators back in practice for the eventual move to convertibility and it was expected that sterling would be strengthened⁸³. These advantages were all in addition to the most obvious one, that the earnings from such transactions would return to the six London firms which traditionally ran the London gold market. The British authorities were also under pressure from South Africa which, frustrated with the lack of progress on convertibility, was making noises about opening its own free gold market in June 1953.

In a status report on Operation Momentum in mid-July 1953, the Treasury emerged as the major obstacle to Bolton's proposals⁸⁴. The Treasury had held back on the unification of the non-dollar, non-sterling world and had authorized transferability within the EPU only to the extent required to give effect to the May arbitrage arrangements. George Bolton's frustration was expressed in a note to the Governor in October 1953 entitled 'The Consequences of Inaction' in which he stated that "although it is not a characteristic of

⁸³Telegram to T.L. Rowan and Robert Hall in Washington, 27 January 1954. BoE OV44/61.

⁸⁴Status of Operation Momentum, 15 September 1953. BoE OV44/61.

the British to make a virtue of consistency, the growing freedom in foreign trade is completely inconsistent with the inflexibility of the controls over the use of non-resident sterling"⁸⁵. He alleged that this inconsistency frustrated exports and encouraged disrespect for British administration. Furthermore, the multilateral circulation of sterling, which was essential to convertibility, was impeded and UK merchants suffered a competitive disadvantage.

Meanwhile, in November 1953 Bolton submitted to the Treasury a plan to achieve convertibility which was an alternative to the Collective Approach⁸⁶. In a note to E.W. Playfair, Bolton suggested a two stage approach. In Stage I, authorized banks would be notified of the unification of all non-resident, non-dollar sterling. Payments with the Dollar Area would continue under the existing restrictions while all payments among non-residents outside the dollar area could be freely made in sterling or local currency for current and capital transactions. As part of Stage I, the UK would "call off the hunt against cheap sterling"⁸⁷. Thus, there would be no exchange control barrier on transactions among non-residents at less than the official rate. Sterling area

⁸⁵'The Consequences of Inaction' by George Bolton, 23 October 1953. BoE OV44/61.

⁸⁶Letter from G.Bolton to E.Playfair (HMT) 'Steps Toward Unification of Non-Resident Sterling', 3 November 1953. BoE OV44/19.

⁸⁷Ibid.

merchants would not be prohibited from transactions where cheap sterling was somewhere involved as long as the merchant himself was not dealing at less than the official rate. UK merchants would also be allowed to purchase goods from any origin, including the dollar area, for sterling payable to transferable account as long as the goods were then sold outside the sterling area. UK merchants would thus be allowed to buy dollar goods from the transferable account area for sterling for re-export if that was the cheapest source of supply. In this way the sterling area was still obliged to deal at official rates but could take advantage of cheap sterling transactions among non-residents. This somewhat hypocritical position was justified on the grounds that controls on non-resident transactions were not working anyway and UK merchants might as well get their share of the profits⁸⁸.

Stage II of Bolton's plan provided for the unification of the expanded transferable area and the dollar area, which he prescribed should occur within six months of the completion of Stage I. In the meantime, the Bank would intervene unofficially in the transferable market in New York to bring the rates together⁸⁹. Stage II was somewhat more controversial than Stage I so discussion focused on Stage I in isolation. By being separated from the second part of Bolton's plan, the unification of non-resident, non-dollar

⁸⁸Ibid.

⁸⁹Ibid.

sterling was no longer considered an alternative to the Collective Approach. This was the formal position insisted on by the Treasury. In the paper recommending unification to the Chancellor on 19 November 1953, Rowan emphasized that

we have agreed with the Bank that these proposals about non-resident sterling do not by themselves imply any need to modify the objectives of the Collective Approach or the methods by which the Collective Approach is brought into operation⁹⁰

By 19 November 1953, the Bank and the Treasury had agreed on the desirability of unification of the bilateral and transferable sterling areas. The Chancellor was advised that the move was consistent with what were now termed the UK's 'long term' objectives for convertibility via the Collective Approach⁹¹. It was clearly in the direction of establishing one external value for sterling and would probably reduce the risk of the major move to convertibility when it came. It was also expected to have a beneficial effect on sterling's international status. The markets were buoyant at the end of 1953 so it would represent a movement from strength. This had always played a large part in the UK's plans for convertibility and was considered an important prerequisite for success. It was also hoped that unification would eliminate the complicated network of restrictions and simplify the use of sterling, making sterling more useable and

⁹⁰Paper for the Chancellor by T.L. Rowan, 19 November 1953. BoE OV44/19.

⁹¹Ibid.

attractive and therefore more valuable, perhaps increasing the buying power of UK importers. Sterling area exporters stood to benefit from a hardening of the transferable rate since this would reduce the competitive edge at which continental exporters could offer sterling goods. No objections were expected from the RSA or Canada. The report also noted that unification would benefit UK exporters because they would no longer be so restricted in the payment they could receive⁹².

The Treasury accepted that unification posed some risk of an increase in cheap sterling transactions. This was dismissed, however, on the basis that the volume of such transactions was determined by the supply of "loose sterling" on the market which was a result of the sterling area's balance of payments. The supply of sterling to the transferable market was constantly replenished through the extension of sterling credits through the EPU to cover the sterling area's deficit with Europe. The Bank requested that all mention of a possible increase in cheap sterling deals be removed from the paper sent to the Chancellor although this was not in fact done⁹³.

Rowan's paper also addressed the danger that establishing a single transferable market for sterling might make it more difficult for the UK to avoid intervening in the unofficial exchange markets to prevent the rate going too low. If the

⁹²Ibid.

⁹³Ibid.

rate fell, cheap sterling transactions would increase and the pressure on reserves might force the UK to react. Presumably this pressure would be increased after unification because attention would be focused on this one rate as a rival to the official rate and because it would be easier for the authorities to intervene against a single rate. This danger was dismissed, however, on the basis that the strength of sterling could be expected to increase rather than otherwise after unification as long as sound internal policies were continued⁹⁴. The unification of bilateral and transferable sterling, then, was accepted by the Treasury on the understanding that intervention in the market would not be necessary. This, certainly, was the impression that the Bank was trying to sell.

Unification was to be presented as a technical reorganization rather than a significant departure from current practice. It did not actually affect the convertibility of sterling since payments from transferable account to dollar account were still restricted. There was, then, no need to consult the sterling area on the decision and no grand announcement would be made. The announcement was to be camouflaged by the re-opening of the London gold market at the same time. It was hoped that such an approach would ease the transition and prevent any shocks to confidence⁹⁵.

⁹⁴Ibid.

⁹⁵Ibid.

The Bank and Treasury immediately pushed ahead with the Plan. On 24 November Rowan cabled the British embassy in Washington about the proposals and by the end of the month the final drafts of cables to the Dominion central banks and to the transferable sterling countries were ready to be sent out. By 30 November 1953, the plan could have been implemented within a week of authorization by the Government⁹⁶. At this point, the plan was stalled. A Commonwealth Economic Conference had been called for January 1954 and the Chancellor decided to delay unification until after the conference. It was considered undesirable for such a policy to appear to have emerged from the Commonwealth talks so the announcement was postponed to February or March 1954⁹⁷. The Treasury, without any objections from the Bank, wanted the decision to be viewed as an exclusively British one and not as a joint sterling area decision. This was in part due to the desire to avoid publicity for the move. It was also meant to signify the independence of the UK in determining sterling policy. Sterling, after all, was the national currency of the UK and rules governing its use were the sole domain of the British government. This contrasts with the policy a year earlier of presenting the Collective Approach proposals for convertibility as a product of sterling area discussions.

⁹⁶Final Draft of Cable to Dominion Central Banks, 30 November 1953. BoE OV44/19.

⁹⁷Letter from E.Playfair (HMT) to E.Cohen (BoT), 18 December 1953. BoE OV44/19.

This contrast reflects the different nature of the two proposals. The Collective Approach depended on a widely spread base of support which sterling area unity behind the plan would reinforce. Unification on the other hand was a unilateral decision by the UK to remove UK payments restrictions in the general interests of freer trade and payments. The sterling area did not play a significant role in the chances for the policy's success nor, therefore, in its development. In fact, however, unification would affect the sterling area through relaxation of the controls on their merchants, as well as through the possible impact on sterling area reserves and the international status of sterling. Given that sterling area merchanting was centred in London, most of the effects of external convertibility on the RSA were indirect.

The timing of the Commonwealth Economic Conference in Sydney provided an opportunity for the Chancellor to mention the proposal discretely to the rest of the sterling area and a brief was prepared by Coppleston of the Bank on 17 December 1953⁹⁸. The administrative nature of the change was emphasized to the sterling area delegates. It was not to be considered a part of the Collective Approach or any move to convertibility and so was "not in any case a matter for joint

⁹⁸Brief for Sydney Delegation on Unification of Non-Resident Sterling, 17 December 1953. PRO T231/699.

Commonwealth decision"⁹⁹. The delegates were assured that the effect on sterling area exports would be favourable and that the transferable sterling rate would be firmer. No great objections were recorded among the sterling area members, perhaps because, contrary to the Chancellor's advice, they did consider it to be progress toward convertibility at last. In any case, the conference was preoccupied with development finance. In the final communique the delegates reaffirmed their commitment to the Collective Approach and in the short term they pledged to maintain firm internal policies to strengthen the reserves¹⁰⁰.

On 26 January 1954, in a discussion between E.W. Playfair of the Treasury and George Bolton, the date for unification was tentatively set for the last week of February so as to precede the March budget and the OEEC meeting of the same month¹⁰¹. Bolton later remarked that there were signs of considerable progress on freedom of payments among other members of the OEEC. Germany had already unified DM accounts and was reducing dollar discrimination. The Dutch were allowing traders to retain foreign exchange for longer periods and there was talk of removing exchange control between the

⁹⁹Ibid.

¹⁰⁰Telegram from Sydney to London, 15 January 1954. BoE OV44/61.

¹⁰¹Report of a discussion between Playfair and Polton, 26 January 1954. BoE OV44/62.

Dutch and Belgian monetary areas¹⁰². These developments brought pressure on the UK to act so "that the UK should not find itself in the position of apparently following European initiative"¹⁰³.

By 9 February, the Treasury had postponed the date again until 22 March. The Chancellor seems to have been influenced by advice from Strath and Robert Hall who wanted to delay the plan for a further year. A note on a Bank visit to the Treasury on 11 February reported that "Strath and Hall are now campaigning against unification on the grounds that we shall need all the weapons of control if an American recession develops"¹⁰⁴. At the end of this T.R. Siepmann scribbled "somebody should go down in a bathosphere and see how much of unification can be salvaged from these depths"¹⁰⁵. Since the existing exchange controls were not effective, the Bank argued, the dangers of removing them were not particularly great and would not represent the real loss of a defence against fluctuations in the American economy¹⁰⁶.

Finally, at a meeting between Treasury and Bank officials

¹⁰²'Sterling and Western Europe', 23 February 1954. BoE OV44/62.

¹⁰³Report of a discussion between G.Bolton and T.L.Rowan (HMT), 4 February 1954.

¹⁰⁴GMW (BoE) note of a visit to HMT, 11 February 1954. BoE OV44/19.

¹⁰⁵Ibid.

¹⁰⁶Report of a meeting between the BoE and HMT, 2 March 1954. BoE OV44/62.

with the Chancellor on March 2 1954, the date to introduce unification and to re-open the gold market was firmly set for March 22. On 12 March the Dominion finance ministers were cabled that the plans discussed at Sydney were to be implemented as of that date. Supportive telegrams were sent in reply including one from Graham Towers of the Bank of Canada reading simply "Congratulations"¹⁰⁷.

Unification was introduced, as planned, with a minimum of fanfare. By the end of March, the transferable rate had strengthened, fulfilling the optimistic predictions of the Treasury and the Bank. The rate climbed three cents to \$2.78 in March and then to a decade peak of \$2.79 through April and May. Reserves were bolstered by sales of Russian gold to the re-opened London market and the balance of trade through the Spring was improved over the same period in 1953. The trade deficit for the first six months of 1954 was £46m compared to £146m in 1953.

VI.C.ii. De Facto Convertibility

On April 26 1954, one month after unification, Bolton warned Rowan at the Treasury that, while official and unofficial rates were close for the time being, a widening between them would have serious consequences for confidence in sterling and the UK authorities would be forced to intervene.

¹⁰⁷Telegram Bank of Canada to Bank of England, 17 March 1954. BoE OV44/19.

Since this would contravene IMF rules, the UK should apply immediately to the USA and IMF to release the UK from her fixed rate obligations and take advantage of the healthy economic atmosphere to take the further 'technical' step of intervening in the gold and exchange markets to manage a fluctuating Transferable sterling exchange rate¹⁰⁸.

On May 5, Bolton faced a rather hostile meeting at the Treasury on his suggestions and he was asked why he appeared to be advocating a floating rate¹⁰⁹. Bolton's reply was that before the unification of transferable and bilateral sterling, floating inconvertible might have been viewed as an alternative to convertibility. Now that unification was completed and the Treasury was committed to convertibility, it could only be considered a transitional step. Intervention thus got tangled up with the ongoing battle over fixed versus flexible exchange rates. Intervention would be tantamount to a floating rate for sterling since the transferable rate would not need to be restricted within the 1% margins enforced under the IMF agreements. Bolton saw intervention in the transferable market as an intermediary stage toward flexible rates as well as convertibility "thus slowly moving by degrees from a fixed control system into a convertible and fluctuating

¹⁰⁸Note from Bolton to T.L.Rowan 'Sterling Exchange in the Transitional Stage', 26 April 1954. BoE OV44/62.

¹⁰⁹HMT/BoE meeting on 'Sterling Exchange in the Transitional Stage', 5 May 1954. BoE OV44/63.

system"¹¹⁰.

In the May meeting, the Treasury objected to intervention on the grounds that the Commonwealth would have to be consulted over a fluctuating rate and, as had become apparent in the Collective Approach negotiations, many members might not be supportive. Furthermore, the Chancellor objected that when unification had been sold to him, he had been "assured that this would not commit us to intervening in the transferable account market"¹¹¹. A week later Rowan expanded on the Chancellor's position, writing that the Chancellor was

concerned that further significant moves towards convertibility should be timed with full regard to the need to maintain accord with our Commonwealth and European collaborators and to secure adequate fulfillment of the conditions for convertibility laid down at the Commonwealth Economic Conference¹¹²

There were also moral implications involved. Supporting the transferable market was in part rejected "since this appears tantamount to assuring a relatively favourable rate for unauthorized conversions"¹¹³.

By June, the buoyancy of the transferable market had evaporated under the pressure of rumours of a devaluation and

¹¹⁰Letter from Bolton to Cobbold, 24 September 1954. BoE OV44/64.

¹¹¹Meeting on 'Sterling Exchange in the Transitional Stage', 5 May 1954. BoE OV44/63.

¹¹²Letter from T.L.Rowan to G. Bolton, 11 May 1954. BoE OV44/63.

¹¹³Ibid.

the indefinite postponement of convertibility. From June to September, the reserves fell by £116m and the transferable rate in New York fell to \$2.74. There was a brief reprieve in September after the Chancellor's speech to the IMF/IBRD denying rumours that convertibility at a fluctuating rate was imminent but by November the transferable rate was down to \$2.71, allowing commodity shunting to take place. On October 6, the Governor of the Bank of England reported to Playfair that he "had impressed upon the Chancellor the importance of taking explicit action on Exchange Control relaxations etc. and giving up the writing of long memoranda upon convertibility"¹¹⁴. Bank impatience with the Treasury intensified as the external position of sterling deteriorated.

On December 21 1954, M. Stevenson of the Bank wrote to Rowan summarizing the Bank's position on the recent developments in the transferable market¹¹⁵. The unification of the transferable and bilateral areas was evidently not sufficiently thorough to remove completely the disadvantages under which UK merchants continued to suffer. Business was being diverted from those London commodity markets which were still prohibited from accepting sterling in exchange for dollar goods. When unification was completed in 1954, there had been some relaxation in the controls governing the London

¹¹⁴Note of a conversation between Playfair and Cobbold, 6 October 1954. BoE OV44/64.

¹¹⁵M. Stevenson note to T.L. Rowan, 'Points made in Discussion with Bank on 17 Dec. 1954', 21 December 1954. PRO T236/3969.

commodity markets. Those commodity merchants which had been authorized to accept sterling from EPU countries were allowed to extend this to all of the transferable area but the commodities concerned were primarily coffee and cocoa which tended to be sterling area commodities anyway. No new allowances had been made for sterling sales of cotton, sugar or grains. The London wheat market, especially, seems to have suffered from competition of continental markets dealing in Transferable sterling¹¹⁶. One final drawback of the existing system was that if the transferable market continued to grow, there would be de facto convertibility at a freely floating rate outside the control of UK authorities.

Stevenson's note went on to suggest a series of possible policy options. The UK could take a step backward by making illegal the settlement of invisible debts to the sterling area using transferable sterling, or by restricting the rights of transferable account countries to use sterling only for current transactions. Both these options represented significant departures from the road to freer trade and payments and might shake confidence in sterling. A third option was to restrict credit to foreigners both to reduce the supply of sterling and restrict speculation. This, however, would conflict with the need to promote UK exports. Another group of policy options would liberalize exchange controls in the UK to attract sterling to London and away from markets in

¹¹⁶Ibid.

New York and Europe. Thus the UK commodity markets could be allowed to deal in sterling against dollar goods to divert sterling back to the UK. Secondly, the UK could allow purchases of gold against transferable account sterling in the London market. This would attract transferable sterling to London but would offer a means for converting all non-resident sterling through gold. Thirdly the Government could open a transferable market in London. This posed insurmountable technical difficulties in first obtaining permission from the IMF for dealing in multiple exchange rates, then maintaining the distinction between the two markets in London and it involved official recognition of the unofficial market in sterling. One final policy option was the resurrection of Bolton's suggestion to intervene in the market to bring the transferable rate up to the official rate. This, it was noted, would be tantamount to government supported convertibility and "would certainly need IMF approval"¹¹⁷.

In an attached note, Stevenson reported that he had been approached by Woodrow of Australia regarding the UK attitude to the transferable market. The Australians had expressed a desire to sell their gold for transferable sterling where the price was five to seven shillings more per ounce than the official market. This appears to have startled both the

¹¹⁷Ibid.

Treasury and the Bank¹¹⁸. Woodrow was told that while exchanges of gold for transferable sterling would be tolerated among foreigners such practice by members of the sterling area "would clearly be upsetting", since it represented a breach in discipline and threatened the central reserves of the sterling area. Woodrow was also warned that entering the transferable market would divert gold and dollars from Australian reserves and the UK would not feel obliged to allow Australia to exchange sterling on the official market to make this up¹¹⁹.

In the third week of January, 1955, the Bank came back on the offensive with a bundle of three policy papers for the Treasury. In the first, Governor Cobbold noted that the conditions for the Collective Approach were not realizable in the next year "and probably not for some time after that"¹²⁰. In the meantime, the exchange position was "beginning to lag behind what is actually happening in foreign exchange markets throughout the world"¹²¹. Cobbold estimated that the resulting weakness of sterling was sustainable for perhaps two or three months but certainly not for a year or longer. He suggested a series of immediate measures which included keeping the official and transferable rates together without

¹¹⁸Report of a discussion of M. Stevenson with Woodrow (Australia), 20 December 1954. PRO T236/3969.

¹¹⁹Ibid.

¹²⁰Paper by C.F. Cobbold 'Exchange Policy', 20 January 1955. PRO T236/3969.

¹²¹Ibid.

a formal act of commitment to avoid embarrassing the government. The rates of both types of sterling should be allowed to fluctuate within the range of \$2.70 - 2.90. The IMF should be approached for informal permission to extend the flexibility of sterling in this way "as an installment of the Collective Approach"¹²². Cobbold further suggested parallel steps for security sterling to facilitate capital movements and resurrected the idea of limiting the amount of sterling credit passing through the EPU to the transferable market.

A second paper, prepared by L.J. Menzies gave startling examples of the growing strength and respectability of the transferable market¹²³. Apparently, not all London banks were aloof from the market and an example was given of a financial delegation from the Netherlands Antilles that had recently quoted offers for transferable sterling which had been made to them by a London bank. Also, in mid January 1955, a London merchant bank had been allowed to establish an agency in London to deal in transferable sterling for non-residents. Foreign central banks were also patronizing the market. Japan and Uruguay had both been reported to be reducing their sterling shortage through the market and France had been buying transferable sterling. In February 1955 Fred Connolly at BIS wrote that "the thought arises whether it is

¹²²Ibid.

¹²³L.J. Menzies 'The Outlook for Transferable Sterling', 20 January 1955. PRO T236/3969.

not a very strange thing for the main market in sterling to be left to the mercy of the international dealers while all the official ammunition in cash and know-how is spent in the minor field of operations in London"¹²⁴.

The Bank's third paper reviewed the position of security sterling. Security sterling was the blocked proceeds of non-resident sales of sterling securities and was quoted on the New York market. The Bank suggested opening a market in London to allow non-residents to purchase foreign securities through security sterling. This would then allow London to take over the lucrative security business which was currently passing through the free markets in Hong Kong and Kuwait. To allow the market to function, UK bankers and stockbrokers would have to be allowed to deal in transferable sterling against dollars¹²⁵.

The conflict between the Bank and the Treasury on further steps toward supporting the Transferable sterling rate was due to the Bank's belief that the strain in the transferable market was primarily due to technical obstacles rather than the underlying balance of payments troubles of the sterling area while the Treasury tended to attribute the difficulties in the transferable market in early 1955 to the sterling area balance of payments. There was no disputing that the balance

¹²⁴Letter from R.G. Connolly to Parsons, 4 February 1955. BoE OV44/10.

¹²⁵HMT paper 'Capital Sterling', 24 January 1955. PRO T236/3969.

of payments position of the sterling area deteriorated in 1954. In the second half of 1954, the rest of the sterling area incurred a deficit with the non-sterling world of £15m. This was the first appearance of such a deficit since the disastrous winter of 1951. Over the whole of 1954, the rest of the sterling area incurred a current account deficit of £308m with the UK compared with £160m in 1953 and a surplus with the non-sterling world of only £22m against £212m in 1953. This left a deficit in 1954 of £286m with the rest of the world. The Bank believed that this weakness in the sterling area balance of payments could only manifest itself in foreign exchange markets after a six month delay. The weakness of sterling must therefore have been due to the technical problem posed by the transferable market. Thus Cobbold asserted that "the strength of sterling is being sapped away, materially, because payment to the sterling area is increasingly made through cheap sterling and psychologically because of the existence of an active market in cheap sterling at a considerable discount"¹²⁶. By February the Treasury was convinced.

On February 16, Bank Rate was increased by 1% to 5.5% and the next day hire purchase arrangements were further restricted and the Capital Issues Committee was advised to consider only urgent applications. On the same day authority

¹²⁶C.F. Cobbold 'Exchange Policy', 20 January 1955. PRO T236/3969.

was given to the British negotiators in the EPU to acquiesce to an increase in the gold credit ratio to 75%. One week later, after the Transferable sterling rate had continued to fall, the Chancellor cabled the UK Treasury and Supply Delegation in Washington that permission had been given for the EEA to bring the transferable rate up to meet the official rate and the Commonwealth Dominions were informed of the decision. By the end of February the transferable rate had been raised four cents to \$2.76\£1.00. Fred Conolly of the BIS described the operation as "some monster pulled up from the depths" with the "seaweed and barnacles" of various black markets clinging to its back¹²⁷. De facto sterling convertibility at the fixed official rate had been achieved.

VI.D. Conclusion

This chapter has reviewed the major categories of alternative policies that the British government might have chosen in the 1950s and described the path toward sterling convertibility that was actually followed. A dramatic and assertive policy of either winding up the sterling area or reinforcing it into a discriminatory bloc must be dismissed. Winding up the sterling area unilaterally by defaulting on the sterling balances was not politically possible and the international economic implications were not necessarily

¹²⁷Letter from F.G.Connolly (BIS) to G. Bolton, 15 February 1955. BoE OV44/10

favourable. This would have invited retaliation in trade policies and probably seizure of British assets abroad. The type of negotiated settlement which was finally achieved in the 1960s through the Basle Facility was not possible in the 1950s given the structure of the international economy at the time. The Americans had yet to feel the burden of supporting a reserve currency with a chronic balance of payments deficit and they had little to gain from supporting the pound as an alternative to the dollar. Furthermore, the acceptability of such an arrangement for the RSA countries depended on the changed structure of the sterling area system by the 1960s.

Reinforcing the sterling area into a more discriminatory Imperial bloc would not have been acceptable to other members of the sterling area. In the early 1950s this was due to the strong international demand for their raw material exports. After the Korean War boom, when it was accepted that there would not be a perpetual shortage of raw materials and when the advantages of preference in the British market reappeared, the RSA resisted reinforcing sterling area relations at the expense of their connections with the USA. The interests of the RSA lay in development of industry and the attraction of American capital, neither of which were consistent with a division of the international economy into a 'Two World' system.

In the end, British policy might appear to have followed an ad hoc approach to freer trade and payments. The final

section of this chapter, however, shows that the policies taken were chosen deliberately and with a continuity of purpose by the Bank of England based on the belief that one way to strengthen the British balance of payments was to remove the restrictions on the use of sterling. If sterling were easier to use and more attractive, this in itself was assumed to help British exporters since if more countries were willing to hold sterling and settle their international transactions in sterling, British exports would become more attractive. The administrative measures of 1954 and 1955 also relieved British importers and merchants from the disadvantages that the system of controls had imposed.

The policy to re-establish sterling as an international currency was not merely for the benefit of London's financial sector and the prospect of invisible earnings. Although the interests of British merchants were frequently cited, the strength of sterling was also believed to be important to visible earnings on the current account and the willingness of overseas holders to maintain their sterling balances which would ease the pressure on the capital account. In the Bank's view, strengthening sterling thus promised to strengthen the balance of payments on current and capital account. By 1955, the Bank's contention that the periodic weaknesses in sterling were due to these technical obstacles as much as the underlying balance of payments of the sterling area was accepted in the Treasury.

Given that freer trade and payments was the goal of British policy, the administrative approach to convertibility bore several advantages. By following a series of technical steps, this approach avoided an open confrontation with the rest of the sterling area and so did not upset sterling area relations. In the end the rest of the sterling area did not play a part in the gradual achievement of convertibility. After asserting this as their goal at the end of 1951, they were excluded from the process except for their negotiations over the fated Collective Approach. After the Collective Approach, therefore, sterling policy ceased to be a genuine sterling area issue.

Chapter VII. Conclusions

This final chapter will draw together the conclusions of the various aspects of the sterling area investigated in earlier chapters and fit the general picture which emerges into the traditional view of the sterling area. The evidence of this study points to the necessity for a revision of the traditional judgement of the effect of the sterling area on British policy.

A general weakness of the UK economy in the 1950s was the instability of the balance of payments. As noted in Chapter I, the balance of the existing literature has been firmly of the view that short term sterling liabilities were excessive and destabilizing to the British economy. Based on more complete and detailed data of the volume and distribution of the sterling balances than has hitherto been available, the analysis in Chapter II showed that fluctuations in the RSA sterling balances were not the unpredictable or volatile element in the British balance of payments that most writers on the topic have suggested. From these figures it is apparent that increases in holdings by the Colonies offset declines in the sterling assets of the independent sterling area. Of the Colonial sterling balances, about 70% were either statutory currency reserves or government reserves which indicates that the increase was to a large extent due to Colonial monetary and fiscal policy.

Britain's failed attempts to reduce the volume of

these outstanding liabilities through ammendments to Colonial monetary systems and increased development spending, outlined in Chapter II, suggested that these liabilities were generally illiquid and thus did not present a continuing danger to the adequacy of the central reserves. The conclusion must be, therefore, that the stability of the overall total of outstanding UK liabilities was not accidental. In fact, the inter-relation of the sterling area 'rules' and Colonial economic policy provided for the stability of the system to an extent that was underestimated by contemporaries.

Since the sterling balances were associated with Colonial policy, however, they did not reflect a genuine reserve role for sterling. The analysis has thus supported Susan Strange's conclusion that the sterling area system allowed sterling to retain the appearance of a reserve currency role after the reality had disappeared¹. The review of British policy toward the sterling balances and the preoccupation of the authorities with finding a way to secure them has shown, however, that the Bank and the Treasury were not lulled into a false sense of security and that they were aware that the sterling balances did not reflect an ongoing reserve role for sterling.

The analysis of movements in sterling balances in Chapter II also revealed that it was the UK's balance of payments with the non-sterling area that led to

¹S. Strange, Sterling and British Policy; A Political Study of an International Currency in Decline, Oxford, 1971. p. 69.

deteriorations in the ratio of reserves to liabilities. This was due to the RSA's persistent balance of payments surplus with the non-sterling area and deficit with the UK. Increases in sterling balances were accompanied by equal contributions of foreign exchange to the central reserves by RSA members. When sterling balances were drawn down, they were used to settle in sterling with the UK. Given the consistent surplus of the RSA as a whole through the 1950s, reductions in sterling balances improved the ratio of reserves to liabilities. A worsening of the reserve to liability ratio would only have occurred if the RSA had been running down their sterling balances in order to diversify their reserves. While Australia began this process in the 1950s, this did not occur on a large scale until after sterling was devalued in 1967. The external 'position' of the British economy thus depended on the UK's own balance of payments with the non-sterling area.

The question of stability was also addressed in Chapter V using quarterly balance of payments data. Again, it was determined that it was the UK's own balance of payments rather than the balance of payments of the RSA as a whole that created most of the instability in the central reserves. Furthermore, the sterling area made a net contribution to the central reserves over the period, thus contradicting the common perception that the RSA was a burden on the reserves. The RSA did exaggerate the adverse movements in 1951-2 but in the crises of 1955, 1956 and 1957, the RSA was a net contributor to the central

reserves. It was noted that this surplus was increasingly dependent on sales of Middle Eastern oil and South African gold. The evidence presented in Chapter V suggested that the adverse effect of the sterling balances on confidence in sterling may have been exaggerated both by contemporary observers and by subsequent writers. This leaves the underlying weakness of the British economy as the main generator of destabilizing capital flows.

The long term capital flows from the UK to the rest of the sterling area were shown in Chapter IV not to have been the significant drain on the British economy that many commentators have assumed. Empirical evidence suggested that it was the low productivity of British capital investment rather than its volume that inhibited British economic growth. Furthermore, the volume of investment going overseas was small relative to domestic capital formation. In this context it is unlikely that any long term advantages would have accrued from the imposition of capital controls. This is especially true given the evidence that investment in the sterling area generated greater returns than investment in the rest of the world. For controls to have been effective in the short term, it was seen that a virtual embargo on investment in the sterling area would have been required. This, in turn, would have had severe effects on the longer term prospects for the UK balance of payments.

The relation of investment flows to sterling balances was examined in Chapter IV and the evidence undermined the

allegation that enforced Colonial savings financed investment in the independent sterling area and also the suggestion that investment flows merely financed increases in short term British liabilities through increases in sterling balances. Investment tended to flow to those members with small liquid resources at their disposal so a restriction on capital flows from the UK would not have decreased sterling liabilities. The apparently illiquid nature of most of the sterling assets during the 1950s also suggests that the accusation that the UK was borrowing short term and lending long term is misleading. In fact, most of the outstanding 'short term' liabilities were considered longer term assets by their holders.

Finally, on the issue of trade relations, the balance of evidence supported the position that the importance of UK trade to other members of the sterling area declined during the 1950s and discrimination in favour of the UK became the exception rather than the rule. The increasing competitiveness of the overseas sterling area markets suggests that after the mid-1950s, the prospect of UK exporters being 'featherbedded' by soft markets was fading.

It was asserted in Chapter I that the UK economy was undergoing a fundamental realignment in its relationship with the rest of the world during the 1950s. The evidence in this thesis has suggested that this is especially apparent with respect to the UK's relationship with the rest of the sterling area. By the middle 1950s a change was apparent in the structure of the sterling balances, in

the trade relationships of the sterling area and in the direction of British sterling policy in general. From 1955 the process of accumulation of sterling balances was reversed, the reliance on the UK as an export market was declining for most members, the London capital market tightened up and, although the volume of investment continued to expand, the members of the RSA were encouraged to look elsewhere for foreign capital. Thus, the traditional components of the sterling area system were all eroded through this period and the tools of British management of the sterling area became obsolete. The mid-1950s also marked the beginning of the deterioration of the RSA balance of payments with the non-sterling area so that the surplus necessary for the proper functioning of the system came to depend on South African gold sales and Middle Eastern oil exports rather than on more traditional RSA raw material exports. By this time, the British authorities had abandoned hopes of coordinating sterling area trade policy or sterling area-wide programmes of domestic demand management. The course of efforts to coordinate sterling area trade and domestic demand policy was surveyed in Chapter III which showed the declining interest of both the RSA and the UK in this pursuit after the second round of trade restrictions in 1952. After the Collective Approach collapsed, UK balance of payments policy focussed increasingly on getting the British economy in order independently of the RSA by relying on fiscal and monetary controls to affect the external balance. The

increasing reliance on domestic restrictions after 1952 was thus due to the virtual abandonment of a common sterling area policy rather than part of Britain's management of the system. Through the mid-1950s convertibility became the driving force of British external economic policy. Convertibility of sterling at the existing exchange rate was encouraged by the RSA but it was primarily a policy goal of the UK and it was pursued and achieved independently of the sterling area system.

It was noted in Chapter I that the sterling area had many of the characteristics of a currency area discussed in the theoretical literature. The benefits of such a system include the elimination of speculative capital flows, reserves pooling and increasing the usefulness of money by reducing transactions costs. With respect to the first benefit, speculative capital flows among members were virtually eliminated except for a brief period in 1949-50 when it was believed that the Australian pound would revalue to a par with sterling. Chapter V showed that the overseas members of the sterling area enjoyed the benefits of reserve pooling and economized on the volume of reserves necessary to support their surpluses and deficits as a whole. This was because movements in their balances with the rest of the world in part offset each other so that while some members were consistent drawers on the central reserves, others were consistent depositors. The UK benefitted from the system insofar as the RSA were net contributors to the reserves since the UK was a persistent

drawer. Still, much of the 'economy' in reserves was forced through restrictions on dollar expenditure due to the general preoccupation with the absolute size of the central reserves.

The question of improving the usefulness of money is less easy to assess. Certainly, there would be some economies of scale through having half the world's trade denominated in sterling and there were no doubt fewer transactions costs associated with trade between sterling area members where there were no exchange controls, compared with trade with the rest of the world. Chapter III showed, however, that there is little evidence that the system generated new trade relationships amongst RSA members. Most of the trading relationships were on a bilateral basis with the UK and with regional trading partners. It is possible, however, that trade along the lines of these traditional patterns was expanded due to lower transactions costs.

Against the benefit of lower transactions costs for members must be set the costs of enforcing the restrictions on the non-sterling area. Thus the sterling area system can be seen either as allowing the freer use of sterling among some countries or as necessitating cumbersome controls against the rest of the world. Without the sterling area it would still have been necessary for the UK to maintain exchange controls in the post-war period and this thesis has shown that the sterling area did not inhibit the process of relaxation of restrictions on trade

and payments. The first interpretation of the sterling area, that it allowed greater freedom in the use of sterling and thus reduced transactions costs, must thus dominate. Certainly, one of the justifications for the sterling area system used by the British authorities was that it allowed for greater use of sterling in international transactions than would otherwise have been the case.

If the sterling area system had not emerged from the Second World War, it is likely that the independent members of the sterling area would have pegged their exchange rate to another major currency such as the US dollar, thus joining a different currency area. Only India briefly considered floating their national currency against both the dollar and sterling. This was in the context of the Collective Approach discussed in Chapter VI and can be seen more as a political bargaining tool rather than a viable economic plan. Through the end of the 1950s and the 1960s it became apparent that some Australians believed that they were part of the wrong currency area and made efforts to realign the Australian economy to the USA. There was no serious consideration, however, of any member defining a currency area by their own political boundaries in the way that Canada did during this period. Whether this implies that being part of a currency area was optimal for members of the RSA, however, requires further research.

Among the costs of a currency area, the most important is the loss of economic sovereignty associated with fixed

exchange rates. Chapters II, III and IV have shown that the tools of British management of the sterling area (free capital flows from the UK, acceptance of short term liabilities and unrestricted imports), did not impose major costs on the UK economy. Chapter V showed that the sterling area system did not significantly inhibit UK economic policy. The balance of payments constraint of the UK economy during the 1950s was the effort to maintain the fixed exchange rate between sterling and the dollar rather than between sterling and the various currencies of the RSA. Furthermore, as by far the largest economy in the sterling area, the UK could lead policy as a 'key currency' country and it was up to the RSA countries to adjust their economic policy to that of the UK. The growing unwillingness of the RSA countries to do this was beginning to drive the system apart by the end of the 1950s. The interesting aspects of the cost of the currency area association are thus in the policy choices of the RSA members rather than those of the UK. This issue is beyond the scope of this thesis but suggests that research into the experiences of the RSA members will provide some interesting insights into the functioning of the sterling area in this period.

The most important aspect of the sterling area as a currency area is where it fell short of the theoretical prerequisites. A primary weakness of the sterling area was the lack of common economic policy goals after the end of the dollar shortage. The RSA's ambitions for developing

secondary industry, especially in Australia and India, and for more basic economic development in the case of the Colonies, did not coincide with the British interest in maintaining these countries as a source of supply of raw materials and foreign exchange. This was especially evident in Chapter III which described the end of the hopes for a triangular balance of trade, the abandonment by the RSA of discrimination in favour of the UK and the increasing emphasis in UK policy on restraining internal demand. The efforts at coordinating sterling area demand management failed because the policies appropriate to a developed industrial economy like the UK, which emphasised price stability and balance of payments equilibrium, were not appropriate for countries which put more emphasis on development and growth. Of course, the British economy may have been better served if growth had been higher on the list of priorities but this debate must centre on the ranking of British policy options. Chapter V and VI showed that the sterling area system did not interfere with the choice of UK policy priorities.

The experience of the sterling area emphasises the importance to the successful functioning of a currency area of common economic goals with respect to growth rates and development. The institution of a currency area itself cannot be expected to generate complementary economic policy among its members. Rather, a commitment to common economic goals must be a prerequisite to the formation of the system. Even in this case, however, these goals may

change with time. In the early post-war period the sterling area members shared a common need to contend with the international dollar shortage but as this receded, the motivation of the sterling area association eroded. Members continued to maintain fixed exchange rates but the exceptions to the freedom of current and capital transactions multiplied and the policy emphasis of some members shifted to Europe and the USA. To the list of prerequisites for a successful currency area should perhaps be added that they have a similar level of economic development. Although this may lessen the complementarity of members' production and trade, the coordination of policy in the longer term will be more assured.

Implicit in most of the critiques of the sterling area is the recommendation that the system should have been avoided in some way. Only a minority of writers have suggested detailed proposals for how this might have been accomplished. The main categories of suggested alternatives were reviewed and dismissed in Chapter VI. The negative assessments of the sterling area have not, in general, taken into account the dismantling costs to the British economy that would have been necessary to have effected a swifter break from the pivotal role that Britain had historically played in the international economy. This thesis has concluded that the abandonment of the sterling area system would have incurred costs which would not have been compensated for by the benefits from such an abrupt change in policy.

The impression is left that the contemporary observers and subsequent writers have expected too much from the sterling area system and that this has coloured their assessment of its merits. Underlying their critiques is a cost benefit approach based on the assumption that the sterling area should have offered a positive return to justify its continued existence. The fact that there was little evidence of substantial economic benefit has led them to look for ways in which the system must have undermined the British economy. The sterling area did not solve the problems of the British balance of payments but the evidence in this thesis has shown that the sterling area did not have a consistent detrimental effect either.

The literature surveyed in Chapter I showed that many critics of the sterling area system have suggested that the only apparent advantage of the system was international prestige, but the archival evidence presented has indicated that the Treasury and the Bank of England were aware that the sterling area system did not generate prestige for the British economy and that the controls on the use of sterling which defined the system brought sterling into disrepute. This was reflected in the continued search for ways to introduce sterling convertibility and by the gradual abandonment of discriminatory trade controls as an instrument of sterling area policy after 1953.

Also apparent in the archival material, however, was the belief that the sterling area system was the economic

arm of the Commonwealth. Still, predictions that individual RSA members might leave the sterling area (for example, in connection with ROBOT) did not imply that they would leave the Commonwealth. Sterling area issues did provide an opportunity for regular consultation among members of the Commonwealth, but the declining relevance and increasing banality of the Commonwealth Economic Conference pronouncements suggests that these meetings did little to reinforce Commonwealth solidarity by the end of the 1950s.

An alternative view that is more consistent with the evidence is that the sterling area was seen as an obstacle to the re-establishment of confidence in sterling rather than the basis for this ambition. Thus, the problems of the sterling area balance of payments needed to be 'overcome' before the international usefulness of sterling could be re-established. As the 1950s progressed, the interests of the UK and the RSA diverged and the prospects that this goal could be achieved through a coordinated policy became more remote. As economic development became a priority for the independent members of the sterling area, they grew more resistant to restrictions on foreign exchange expenditure and less willing to accept higher priced British goods. This was reflected in declining trade discrimination and a slower rate of accumulation of sterling balances.

The sterling area system allowed an international role for sterling beyond that which it might have had if these

countries had pegged to the dollar, but the sterling area was not the basis from which it was hoped that sterling would regain a truly international status. Suggestions that the sterling area should be expanded as a way to increase the use of sterling internationally were quickly dismissed. The route to convertibility, on which the international role of sterling depended, was eventually achieved by UK administrative measures. The other members of the sterling area were left watching events from the sidelines after the death of the Collective Approach in 1953.

It is important for the conclusions of this thesis that it is based on an acceptance of the status quo in 1950. There has been no attempt, therefore, to postulate the possible effects on the history of this period if radically different choices had been made in the immediate post-war period. How the British authorities faced the challenges of the postwar era cannot be divorced from the history of Britain's pre-eminence in the international economy. The historical role of the UK as the centre of international capital and trade flows makes the conclusions of the present study even more relevant since the decline of the UK as a major trading power and as a capital market is particularly striking in this study of sterling area relationships in the 1950s.

After the Second World War, the leadership of the UK in the international economy was reduced to a regional role centred on the sterling area. Previous studies have

assumed that the UK maintained its leadership within the sterling area at some cost to the domestic economy and to the freedom of policy choices. This thesis has presented evidence that the effect of the sterling area system on the British economy and on British policy has been exaggerated. Furthermore, the essential instruments of British management of the sterling area became ineffective through the 1950s, thus causing the erosion of British leadership during this decade. The main conclusion is that after the middle of the 1950s the UK was no longer 'managing' the sterling area. The balance of payments problems that were the focus of British economic policy in this period cannot be attributed to the existence of the sterling area.

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