C.P.(47) 233

16th August, 1947.

CABINET

BALANCE OF PAYMENTS

Memorandum by the Chancellor of the Exchequer

The attached Memorandum shows a sudden acceleration in the exhaustion of the U.S. Loan

I should like to consult my colleagues at once about the immediate action which must clearly be taken.

H.D.

Treasury Chambers, S.W.1.

16th August, 1947.
Memorandum

1. A delegation of officials of the Treasury, Foreign Office, Board of Trade and the Bank of England, led by Sir Wilfred Eady, left for Washington on Saturday, 16th August. The instructions settled for Sir Wilfred Eady by the Ministers in charge of the Departments concerned were as follows:

Sir Wilfred was to tell the Americans that when the Loan ran out in October, we should find ourselves in an untenable position in respect of our foreign obligations, not only to the United States but to other countries as well, if nothing were done. He had therefore come, not to challenge philosophies nor formally to raise Article 12 of the Loan Agreement, but to explore the possibility of some immediate relaxations which would enable us to avoid taking more drastic action. Unless such relaxations could be made, world trade would be retarded and the drain on American finance increased.

On convertibility, Sir Wilfred was to say that we wanted to maintain it and it was in our own and the United States' interest that we should do so. But if this was to be done, it was essential that there should be a limit on the demands for dollars which other countries put on the U.K. Without asking for formal abrogation of the convertibility clause, we wanted to be in a position to reduce the dollar drain on this country, arising out of our convertibility obligations, by ad hoc negotiations with each of the countries concerned. These negotiations would also involve some elasticity in the interpretation of our non-discrimination obligations on e.g. the lines under discussion in Geneva.

The first step would be to see whether the Americans would agree that we should go ahead on these lines without any formal action on their part. They might, however, insist on formal consultation under Article 12 of the Loan Agreement, which refers to "modifications for presentation to the respective legislatures". But there was some reason to think that when Congress is not sitting, the President has power to act in a case such as the present.

2. Since these instructions were settled, only a few days ago, the dollar drain has accelerated. In the last six weeks it averaged £115 millions a week, compared with £77 millions a week in the second quarter. In the last five working days £175 millions has been lost. Further particulars are given in Annex I.

3. The accelerated movement shows that the position as regards foreign holders is getting out of control. They are exercising very great ingenuity in transferring sterling into dollars or dollar goods even in anticipation of subsequent needs. It is only prudent judging by past experience to expect this acceleration to continue; in which event the rest of the Credit will be rapidly exhausted and the country will have very little to show for it.
The Treasury and the Bank therefore consider that immediate and drastic action is imperative. The necessary orders are being prepared, and if Ministers agree could be put into force at the shortest notice.

The first step in any practical action is to limit the convertibility of sterling. A technical note is attached (Annex II). The effect of the proposal is to allow convertibility for any country only up to the amount of a ration fixed by ourselves. This would be applied to all non-sterling-area countries; the appropriate treatment for the sterling area is different in character, and will take more time to prepare, because it is most desirable to carry the area controls with us, rather than to take unilateral action against them. They would at once be asked to exercise the utmost restraint in their dollar expenditure; and behind such a request lies the protection that London banks would immediately cease to give effect to exchange transactions approved by area controls if the Bank of England notice which at present authorises such transactions were to be withdrawn. This request would be followed in due course by consultations over dollar rations.

This involves breach of the Anglo-American Financial Agreement and of the payments agreements which we have signed. But it is the only way of checking the present drain which is far greater than anything that could possibly be attributed to the normal flow of current transactions.

It is proposed that at the opening of his discussions in Washington on Monday morning (Monday afternoon, British time), Sir Wilfred Eady should explain what we are proposing to do and why. It would be extremely valuable to carry the Americans with us in this and a public statement of their agreement would greatly strengthen our position. Moreover, if we acted without consultation with the U.S. government we should increase the risk that they would stop us from drawing the remaining $850 millions of the Credit. We propose, therefore, that the new order should not be made until Sir Wilfred Eady has been able to ascertain the American reaction. It would also be necessary to inform the Canadian Government, to whom we have similar obligations and who will in addition be seriously affected by our action.

The immediate effect of the action proposed will be felt world-wide; countries which have ordered goods from U.S.A. in the expectation of being able to pay for them in dollars acquired from us may be unable to pay for them; the shock to trading operations of all kinds will be considerable. On the other hand, there is a general expectation that something of this kind may happen, and it would of course have been necessary in any case in a few weeks' time when the Credit was exhausted.

Our action is bound to be a shock to the Paris Conference, and there is some danger that leading representatives will be recalled for consultation, and that the shock to confidence will impair the coherence of the Conference. This would risk delaying the final report. On the other hand, our action would clearly indicate the critical development of the world dollar crisis, and would underline to the Conference both the key position of the U.K. and the urgency of agreeing an effective report as the only means in sight of securing dollar aid. In any event, we could avoid this difficulty only by postponing action for two or three weeks, and the situation does not permit this delay.
10. There is a danger that some of our suppliers will retaliate, insisting on being paid in gold or dollars in advance. We expect difficulty from Argentina (who have taken £54 millions from us in the last six weeks). There may be some interruption of supplies, and we may have to do some quick negotiation.

11. We should have to fix dollar rations arbitrarily to cover the next few weeks; the next step must be to negotiate payments agreements and make definite plans to secure our supplies for the next few months. This will involve hard bargaining all over the world, in which our negotiators will have only a limited amount of money to spend, and will have to buy as much as they can with it. We shall have cards in our hand. But it will be impossible to play them unless we are prepared to face substantial loss of supplies which have in the past eight years been regarded as essential. This will involve curtailment of the import programme and some cut in rations.

12. In essence, what is now proposed is based on the same principles as the instructions already approved by Ministers for Sir Wilfred Eady. But it is more drastic and widespread and the tempo is far more urgent. The dollar drain must be stopped, and unless we take action immediately we are running a serious risk that the Credit will be used up very rapidly and for purposes from which this country will derive little benefit. If this happens we lay ourselves open to the accusation that we have allowed the loan to be frittered away.

We therefore propose that Sir Wilfred Eady should be authorised to act as in paragraph 7.
## ANNEX I

<table>
<thead>
<tr>
<th>Week ending:</th>
<th>Net Drawings:</th>
<th>£ millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 5</td>
<td></td>
<td>94.6</td>
</tr>
<tr>
<td>12</td>
<td></td>
<td>112.1</td>
</tr>
<tr>
<td>19</td>
<td></td>
<td>155.0</td>
</tr>
<tr>
<td>26</td>
<td></td>
<td>91.9</td>
</tr>
<tr>
<td>August 2</td>
<td></td>
<td>114.5</td>
</tr>
<tr>
<td>9</td>
<td></td>
<td>124.5</td>
</tr>
<tr>
<td>5 days ending August 15</td>
<td></td>
<td>175.9</td>
</tr>
</tbody>
</table>

The previous peak figure of £155 millions for the week ending July 19th included £10 millions for India and £40.5 millions for Germany.
ANNEX II

TECHNICAL NOTE ON ACTION PROPOSED

1. Foreign holders of sterling on Transferable Accounts now have the right to pay such sterling to any country in the world (with unimportant exceptions). By means of transfers to American Account they can not only pay sterling in settlement of current transactions with the United States, but can obtain dollars for their sterling either on the New York market or in London. By the measures now proposed, sterling on Transferable Accounts will be convertible only in London and only to the amount of the ration allocated to each country.

2. This will require a modification of the Payments Order so as to cut off American Accounts from other non-resident accounts, including Transferable Accounts. It will also require the allocation of dollar rations to individual countries. At the outset an arbitrary ration will be allotted; some countries will have no claim to a ration. At a later stage the ration may be adjusted, by ourselves.

3. Negotiations will have to be set in hand at an early date for more permanent arrangements with the object of maintaining transferability to the fullest possible extent.