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STERLING'S RECURRING POSTWAR PAYMENTS CRISES[1]

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Recurring payments difficulties every other year, with improvements in the intervening year, characterized the postwar history of the sterling area until 1952. Difficulties occurred in 1947, 1949, and 1951–52, while 1948 and 1950 were years of recovery. This pattern was largely the consequence of periodic depletion of inventories, resulting from drastic import restrictions imposed to check reserve losses, and of excessive liquidity throughout the sterling system, which facilitated overimporting by member-countries. Recurring speculation against sterling helps to explain the biennial pattern of the payments difficulties. This speculation, which largely took the form of leads and lags in sterling payments by merchants in connection with their normal trading operations, could magnify an external difficulty into a serious payments crisis within a matter of weeks.

Since 1952 there has been no sterling payments crisis, although substantial relaxations in Britain's exchange regulations have increased the vulnerability of the pound in the foreign-exchange market. This stability is associated in part with the improvements in Britain's terms of trade and also with recent developments that have attacked the main roots of the previous cyclical pattern. The liquidity of the outer sterling countries has been reduced, and thus the position of the United Kingdom as the foreign-exchange banker for the sterling area has been strengthened. These developments were closely connected with the shift in economic policy within the sterling countries from reliance on import and exchange controls toward the utilization of more traditional monetary and foreign-trade policies.

THE PATTERN OF RECURRING CRISIS

Professor Fleming has suggested that the pattern of biennial payments difficulties which characterized sterling's early postwar history can be primarily attributed to two kinds of administrative difficulties: (1) the problem of organizing a "continuous common policy" for the sterling-area countries and (2) the problem of the time lag "which inevitably occurs between taking decisions on import policy and seeing the effects of these decisions on the balance of payments."[2] This argument has been characterized by Professor Haberler as "the only plausible explanation of this curious regularity of crises."[3]

The former chancellor of the exchequer, Mr. Gaitskell, has confirmed the existence of these two types of administra-

[1] The conclusions of this study represent my personal opinion and do not reflect the view of the Federal Reserve Board. The substance of this paper (with the exception of the final paragraph) was presented before the International Economics Seminar, Harvard University, in November, 1954. I am indebted to Mr. J. H. Furth for criticism and suggestions.

[2] J. Marcus Fleming, "Regional Organization of Trade and Payments," *Papers and Proceedings, American Economic Review*, XLII (May, 1952), 350.

[3] Gottfried Haberler, *Currency Convertibility* (Washington, D.C.: American Enterprise Association, Inc., 1954), p. 20, n. 1.

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tive difficulties during the 1951–52 crisis. For example, he has described his difficulties in getting the sterling countries together during the latter half of 1951 to fashion a common policy to cope with the sterling area's deteriorating dollar position in these words:

> I do not think anyone concerned would deny that it is a pity that we could not get, for instance, an agreed sterling policy at once. It was not possible. I asked the Finance Ministers to meet me last September but for various reasons they could not do so. There was no way of getting any decisions taken in the absence of such a conference, and six months will, therefore, have gone by before agreement or action is possible.[4]

With reference to the time-lag difficulty, he stated that "in 1950 not only the United Kingdom but the whole sterling area was still operating cuts in imports decided on in July 1949 at the Finance Ministers' Conference in London."[5]

Despite this authoritative corroboration of Fleming's hypothesis, however, it should be recognized that each of the individual incidents originated in different factors of disequilibrium. In 1947, for example, the pound was made convertible at a time of external and internal economic unbalance in each of the sterling countries and also in their trading partners. In 1949 foreign importers curtailed purchases of sterling-area raw materials and other exports because of two coincident factors: (1) the inventory recession in North America and (2) the availability of "cheap" or discount sterling for making payments for sterling-area merchandise, which established in the foreign-exchange market the opinion that the pound was overvalued and encouraged trade speculation against sterling. The 1951–52 crisis was largely produced by overimporting by all the sterling countries.

PERIODIC DEPLETION OF INVENTORIES

The regularity with which the United Kingdom depended upon drastic import restrictions to meet these payments difficulties, regardless of the major contributing cause of the drain on reserves, helps to explain the biennial pattern of sterling's difficulties. Since output both for the home market and for exports was uninterrupted,[6] the reduction in imports led to a running-down of inventories, which had to be replenished as soon as the loss of reserves had been terminated. So far as inventories of imported raw materials are concerned, the United Kingdom tended to hop from one foot to the other, alternating between a shortage of reserves and a shortage of inventories. These swings in the quantity of imports were accentuated by the general expectation in commercial circles that purchases from abroad would be restricted, which produced a tendency to anticipate the application of restrictive measures, and by the availability of bank credit under the easy-money policy, which made it possible for traders to finance accumulations of imported materials when they so desired.

Evidence of the consequences of this import policy upon the quantity of Britain's imports of foodstuffs and raw materials is found in Table 1. The quantity indexes of these imports show only small aggregate increases during 1948 and 1950 and a substantial decrease during 1952; by contrast, sharp rises in the quantity of imports occurred during 1949 and 1951, when reserves were being lost. When the

[4] Hugh Gaitskell, "The Sterling Area," *International Affairs*, April, 1952, p. 176.

[5] *Ibid.*, p. 173.

[6] Except for the minor recession in 1952, which was confined to textiles and a limited number of other consumer industries.

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changes in Britain's imports, measured in constant pounds (of 1950 purchasing power), are compared with the trend for the period 1947–53 as a whole, it is found that the change in actual imports was invariably substantially smaller than the average yearly increase for the period as a whole (£86 million) in the years when reserves were rising, and (before 1953) very substantially larger than the average in the years when the pound was in difficulty.

TABLE 1

QUANTITY OF IMPORTS OF FOOD AND RAW MATERIALS, UNITED KINGDOM, 1947–53

Year	Quantity* (1950=100) Food Imports	Raw-Material Imports	Value of Food and Raw-Material Imports† Value	Annual Change in Value	Difference between Average‡ and Annual Change in Value
1947	95	81	−£1,780	......	......
1948	96	85	− 1,830	−£ 50	+£ 36
1949	104	93	− 1,992	− 162	− 76
1950	100	100	− 2,021	− 29	+ 57
1951	110	111	− 2,228	− 207	− 121
1952	98	104	− 2,039	+ 189	+ 275
1953	111	116	− 2,293	− 254	− 168

* Quantity index from *Annual Abstract of Statistics* (London: Central Statistical Office, 1954).

† Value for 1950 (in millions of pounds sterling of 1950 purchasing power) from *Trade and Navigation Accounts* (London, 1950).

‡ Annual average increase in the value of imports (in constant pounds of 1950 purchasing power) amounted to £86 million. A plus sign for a given year means that the annual change in imports between that year and the preceding year was less than the average for the entire period.

It is true that the statistics in Table 1 refer not to the volume of inventories in the United Kingdom but only to the physical volume of imports of foods and raw materials. Except for the minor recession in 1952, however, the United Kingdom has had a continuous expansion in industrial production; this fact makes it appear likely that fluctuations in import volume were largely paralleled by fluctuations in inventories of imported products. Inventories seem to have dropped markedly during 1950, when imports were reduced and reserves were expanding. For example, the *Economic Survey for 1952* notes that the 1951 increase in the volume of imports occurred "not so much because of an increase in consumption of imported food and materials as because stocks were heavily run down in 1950."[7] The following year's *Survey* records that "stocks of imported commodities continued to rise during 1952,"[8] and the *Survey* for 1954 reported that "stocks of coal and steel and recorded stocks of imported commodities all increased."[9]

Finally, in an analysis of the relationship between the fluctuations in stocks of imported products and fluctuations in Britain's gold and dollar reserves, the late Sir Henry Clay recently pointed out that, "in the past five years, exchange reserves . . . and stocks have varied on the whole inversely—as they tend to do in private business."[10] And he then added:

[7] *Economic Survey for 1952* (Cmd. 8509; London, 1952), pp. 8–9.

[8] *Economic Survey for 1953* (Cmd. 8800; London, 1953), p. 22.

[9] *Economic Survey for 1954* (Cmd. 9108; London, 1954), p. 24.

[10] Sir Henry Clay, "A Note On Stocks," *Journal of Industrial Economics*, April, 1954, p. 87.

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If they are taken together, the apparent improvement of the country's position in 1950 is much less than was inferred at the time from the growth of gold reserves alone, nor was the deterioration in 1951 so bad; the improvement in 1950 was largely explained by the Government running down its stocks, and the deterioration in 1951 by companies having to build them up again at higher prices. On the other hand, 1952 appears even worse than the movement of reserves suggested, and 1953 better. On the whole, taking reserves and stocks together makes the external position of the country since 1947 almost continuously stronger than the gold figures suggested.[11]

Yet it must be recognized that the United Kingdom had in common with its European neighbors the rigorous system of administrative licensing of imports referred to in Fleming's hypothesis. As a general proposition, Britain's restrictions against dollar goods were probably not significantly more severe than those in effect in Germany, France, the Netherlands, or the Scandinavian countries. For example, the Bank for International Settlements has estimated that the United Kingdom (following extensive relaxations during 1952 and 1953) had liberalized something like 50 per cent of its imports from the dollar area, while West Germany had liberalized only 28 per cent.[12]

Where Britain differed from its neighbors was in its repeated failure to anticipate world price trends, which led the United Kingdom to pursue the costly policy of selling at a lower and buying at a higher level of world prices. Particularly during the latter part of 1950, the United Kingdom chose to push exports when prices were lower and had to replenish stocks of imported materials at the higher level of prices ruling in the following year. This erroneous estimate was particularly striking when Britain's performance is compared with the "excessive" importing that took place in West Germany and in the United States immediately after the Korean invasion.

Part of the explanation of this difficulty must be found in the hard choice of policy confronting the United Kingdom during the "good" years of 1946, 1948, and 1950: whether to rebuild reserves or to expand imports. The critical level of gold and dollar holdings gave a high priority to reconstituting the official reserves. However, the United Kingdom also tended to run down stocks on rising markets in the expectation—general in both official and commercial circles—that inventories could be replenished on falling markets. Commenting on the 1950 situation, for example, Mr. Richard Fry has noted: "Another type of shortage is the result of an error of judgment in delaying to buy forward last summer. . . . The wool trade is only one of a number which allowed raw material stocks to run down because they did not believe that the abnormal price rise would continue."[13] Gaitskell repeated the case of wool as a debating point in a parliamentary defense of the government's policies. He noted that

> wool . . . is a commodity imported on private account on open general license, and in fact the stocks of wool have fallen a good deal further than most. . . . It is, of course, a plain fact . . . that of course private enterprise on the whole was expecting a fall in prices at the end of 1949 and did not import on the necessary scale in 1950.[14]

Britain's import procurement policy of selling goods at low prices and buying

[11] *Ibid.*

[12] Bank for International Settlements, *Twenty-fourth Annual Report* (Basel, 1954), p. 12.

[13] R. H. Fry, "The Prospect before Us," *District Bank Review*, March, 1951, p. 13.

[14] *House of Commons Debates* (Hansard), June 27, 1951, col. 1518.

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materials at high prices was the outgrowth of a misjudgment of world price trends as well as of the administrative inflexibility of import restrictions.

Evidence that fluctuations in imports of foodstuffs and raw materials were primarily responsible for the fluctuation in the current account of the United Kingdom is summarized in Table 2. In this table, year-to-year changes in the current account and merchandise trade statistics of the United Kingdom are compared with the differences in value between the *average* change in Britain's imports of primary products and the actual change. The changes in current account and in merchandise trade, while not strictly identical, clearly move in the same direction, except in 1953, and in roughly comparable magnitude. Yet the fluctuations in Britain's imports of foodstuffs and raw materials (as shown in the last column of the table) are also in the same direction as and roughly comparable in magnitude with the changes in current account and in merchandise trade, except in the devaluation period around 1949 and 1950.

TABLE 2*

DIFFERENCE BETWEEN AVERAGE AND ACTUAL CHANGE IN IMPORTS OF FOOD AND RAW MATERIALS COMPARED WITH CURRENT ACCOUNT AND TRADE BALANCE, UNITED KINGDOM, 1946–53

(In Millions of Pounds)

Year	Current Account† Balance	Current Account† Change	Merchandise Trade Balance	Merchandise Trade Change	Imports of Food and Raw Materials Total	Imports of Food and Raw Materials Change	Imports of Food and Raw Materials Difference between Average and Actual Change‡
1946	−£298	......	−£ 336	......	−£1,029	......	......
1947	− 443	−£145	− 597	−£261	− 1,371	−£342	−£105
1948	+ 1	+ 444	− 431	+ 166	− 1,567	− 196	+ 41
1949	+ 31	+ 30	− 431	0	− 1,745	− 178	+ 59
1950	+ 300	+ 269	− 352	+ 79	− 2,021	− 276	− 39
1951	− 389	− 689	− 1,197	− 827	− 3,006	− 985	− 748
1952	+ 134	+ 523	− 788	+ 409	− 2,615	+ 391	+ 628
1953	+ 123	− 11	− 656	+ 132	− 2,685	− 70	+ 167

* Sources: Current account statstics from balance-of-payments white papers; merchandise trade and imports of foods and raw materials from official trade returns of the United Kingdom.

† Excludes United States aid.

‡ The average annual increase in imports for the entire period is £237 million; a minus figure for a given year means that the actual increase in imports during that year exceeded the average of £237 million; a plus sign means that the actual expansion in imports fell below the average annual figure.

TWO-YEAR TRADE PATTERN OF OUTER STERLING COUNTRIES

The habit of depending upon import restrictions to meet reserve drains, and the periodic running-down of inventories of imported materials which this policy produced, was more characteristic of Britain's economic difficulties than it was of the payments difficulties of the other sterling countries. Being important raw-material and food exporters, however, the outer sterling countries have historically been familiar with a two-year cycle as a traditional pattern in which a period of booming export prices would be succeeded by a period of large import deficits. For example, Professor Paish has noted that

> one normally finds a two-year cycle, because after a particularly good year there is a time lag of anything from six months to over a year before there is a corresponding rise in imports. The rise in imports always comes, but it comes anything up to a year later, so that first very

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large foreign balances are accumulated and then, in the following year, they are spent.[15]

The outer sterling countries experienced a single fluctuation of this type in the postwar period. As a result of the post-Korean raw-materials boom, the sterling exporting countries benefited from enlarged export earnings late in 1950 and early in 1951; this period was followed, within six to nine months, by heavy import surpluses. The quarterly exports and imports of Australia and India, in the two upper sections of Figure 1, show a time-lag reaction typical of the outer sterling countries' response to the Korean inflation. Both Australia and India had export booms during the first half of 1951 and import deficits during the first half of 1952. The reverse of this foreign-trade pattern may be seen in the chart of United States exports to, and imports from, the outer sterling countries shown in the bottom of Figure 1. United States imports from these countries reached a peak in the first quarter of 1951, and our exports expanded rapidly toward the end of the year.

While the 1951–52 payments crisis can be explained by this lagged response to an export boom, the 1947 and 1949 difficulties were not the result of overimporting due to export booms but can be directly attributed to the liquidity of the outer sterling countries. Because the outer sterling countries had ample foreign-exchange resources during the postwar period, they were not dependent upon an export boom to finance enlarged imports. With adequate sterling balances, they were able to shift "the crisis which under other conditions would have fallen upon the countries concerned . . . upon sterling."[16] The substantial rise in United States exports during 1947 was thus financed largely out of the wartime accumulations of foreign-exchange (sterling) reserves of these countries. The 1949 difficulties were in large measure due to fluctuations in payments associated with market opinion that the pound was overvalued rather than to trade deficits (since purchases from the United States were cut back by the sterling countries at about the same rate during 1949 as were United States purchases of sterling-area merchandise); yet both India and South Africa had substantial trade deficits with this country during the latter part of 1948 and early 1949.

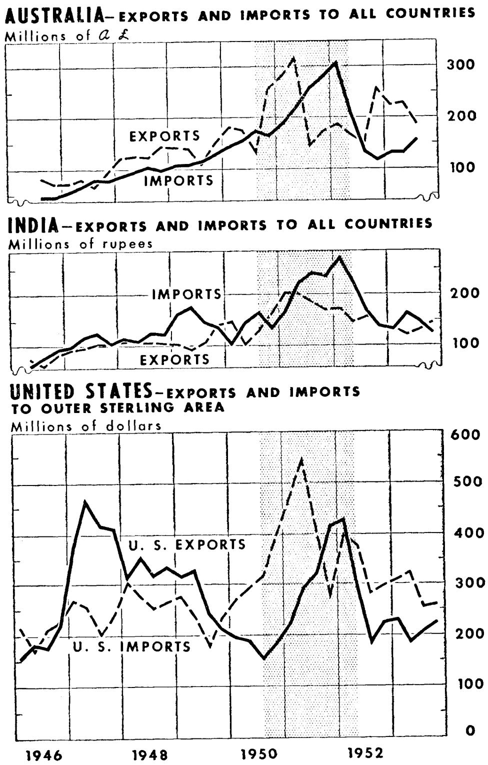

Fig. 1.—Selected aspects of the foreign trade of the outer sterling area, 1946–53.

[15] F. W. Paish, "The Sterling Area Crisis," *International Affairs*, July, 1952, p. 326.

[16] *Ibid.*

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Fluctuations in the imports of the outer sterling countries reached substantial magnitudes during several postwar years. For example, their imports declined by $315 million during the good year of 1950 and expanded by $580 million during the 1951 difficulties, according to British balance-of-payments estimates found in Table 3. Unfortunately, this series does not go back to 1947, when the import procurement of outer sterling countries from the United States reached the postwar peak, as may be seen in the bottom section of Figure 1.

TABLE 3*

REST OF STERLING AREA: IMPORTS FROM DOLLAR AREA, 1948–53
(In Millions of United States Dollars)

	Colonies		Other Sterling Countries†		Total Outer Sterling Area	
Year	Imports	Change‡	Imports	Change‡	Imports	Change‡
1948	−$310	......	−$ 875	......	−$1,185	......
1949	− 220	+$90	− 805	+$ 70	− 1,025	+$160
1950	− 130	+ 90	− 580	+ 225	− 710	+ 315
1951	− 210	− 80	− 1,080	− 500	− 1,290	− 580
1952	− 190	+ 20	− 1,140	− 60	− 1,330	− 40
1953	− 170	+ 20	− 705	+ 435	− 875	+ 455

* Source: United Kingdom balance-of-payments white papers.
† Excludes South Africa.
‡ A plus sign indicates a drop in imports; a minus sign, a rise in imports.

Confronted with a balance-of-payments drain from whatever source, the United Kingdom would attempt to establish a "continuous common policy" within the sterling area. Britain sought through the process of negotiation to get the outer sterling countries to refrain from making use of their available foreign-exchange (sterling) resources, especially for the purchase of dollar goods. As a result, the "continuous common policy," formulated under emergency conditions, always included intensified restrictions against dollar merchandise. In retrospect, the United Kingdom attempted through negotiation to correct a fundamental defect of the postwar sterling system; namely, the existence of "too much compensatory finance in the system—too little pressure on members from the side of the balance of payments to correct domestic inflation."[17] With excess liquidity quite general, it is not altogether surprising that the process of holding conferences with the other sterling countries proved to be a clumsy means of overcoming this structural weakness of the sterling area's payments arrangements and that the policy of negotiation was unsuccessful in fashioning a common program for effective economic stabilization throughout the sterling system.

EFFECTS OF SPECULATIVE CAPITAL MOVEMENTS

The recurring import deficits of the outer sterling countries, combined with Britain's policy of periodically depleting import inventories, were the two factors mainly responsible for sterling's recurrent postwar difficulties. However, the fluctuations in reserve holdings caused by these factors were amplified by recurring speculative movements against the pound; these movements could make any weakness in the balance of current payments into a serious crisis within a few weeks. These speculative movements chiefly took the form of shifts in the timing of sterling payments by merchants in

[17] Fleming, *op. cit.*, p. 350.

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connection with their normal trading operations.[18] For example, the movement against the pound in mid-1949 was an important factor in the September devaluation; there followed first a heavy movement into sterling during the fall of 1950, which tended to reinforce the effect of the raw-materials boom on Britain's gold reserves, and then an outflow in the latter half of 1951, which aggravated the consequence upon the central reserves of the general overimporting by all the sterling countries.

RECENT STRENGTHENING OF BRITAIN'S POSITION

Recently the economic position of the United Kingdom within the sterling system has been strengthened. Two factors are largely responsible for this development: (1) the improvement in Britain's terms of trade with the outer sterling members and with raw-material and food-exporting countries in general and (2) the reduced foreign-exchange liquidity of the outer sterling countries, resulting in part from the introduction of effective monetary restraint in the United Kingdom in early 1952.

Until recently, the postwar fluctuations in the terms of trade (between industrial and primary products) have always had an unfavorable aspect for the United Kingdom. When raw-material prices were rising, the United Kingdom benefited from additional dollar earnings from export sales by the outer sterling countries but found that its own debt to these countries grew as the terms of trade deteriorated. On the other hand, when raw-material prices were declining, the improvement in Britain's terms of trade was associated with a fall in dollar receipts from export sales by the outer sterling countries. The recent declines in the price of foodstuffs (including wheat, which is Britain's largest import item) represent a gain to the United Kingdom with no offsetting disadvantage. Britain loses no dollars from exports by the outer sterling members; on the contrary, since she is an importer from North America, lower prices in foodstuffs tend to reduce Britain's own trade deficit with North America at the same time that Britain's terms of trade with the outer sterling area also improve. The absence of any direct external loss to Britain in recent world price developments represents a new and favorable circumstance for the United Kingdom.

The easy-money policy, maintained in the United Kingdom in spite of postwar inflationary dangers, contributed to the postwar instability of the sterling system by making it easier for foreigners to borrow in the London market.[19] With funds in ample supply and with the cost of financing in London below rates prevailing in other financial centers, foreign traders were encouraged to borrow sterling in order to postpone payments for

[18] For a discussion of this type of speculation see I. A. Bloomfield, *Speculative and Flight Movements of Capital in Postwar International Finance* ("Princeton Studies in International Finance," No. 3 [Princeton, N.J., 1954]), esp. 23 ff., and my article, "Leads and Lags in Sterling Payments," *Review of Economics and Statistics*, XXXV (February, 1953), 53.

[19] The easy-money policy was probably less harmful in its effect on Britain's domestic economy than it was on the balance of payments of the sterling area, largely because postwar domestic credit creation by the British banking system was neutralized by budgetary policy: surplus tax revenue was used to retire bank-held government debt at about the same rate as the clearing banks were creating new private credits. The consequent stabilization of deposits in the United Kingdom is to be attributed to the use of fiscal restraint in the place of effective monetary restraint. However, the availability of private credit augmented the periodic fluctuations in Britain's imports in that traders were able to obtain credit to expand inventories when they so desired.

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normal commercial transactions during periods when the pound was under pressure in the foreign-exchange market.

Second, the easy-money policy facilitated the outflow of capital from Britain to the outer sterling area. With virtual freedom of capital movements within the sterling area, the absence of effective monetary control in the central London market contributed to the excess liquidity prevailing throughout the sterling system. By replenishing the sterling holdings of member-countries, this capital movement postponed the day when these countries found it necessary to limit their import requirements to their current foreign-exchange earnings. The United Kingdom had hoped that at least some sterling countries could be counted on to exercise restraint in drawing on their London balances; but these hopes proved to be inconsistent with the wide movements in the balances of virtually all these countries since 1945 and in particular with the widespread running-down during 1951–52.[20]

However, this capital outflow was no immediate drain on Britain's resources; on the contrary, because the sterling countries immediately invested their sterling accruals in the London market, the outflow actually reduced the domestic credit expansion in the United Kingdom. Since the increased sterling balances were used to purchase Treasury bills, the volume of such bills placed by the British Treasury on the money market—and financed ultimately by the British clearing banks—was correspondingly reduced. It was only at a later stage, when they found that their foreign-exchange (sterling) holdings were in excess of their permanent requirements, that the outer sterling countries would draw upon these receipts to finance additional imports.

The development of a sterling shortage among the independent sterling countries during the spring of 1952 indicated that a new stage had been reached in the postwar history of the sterling system. For the first time in the postwar period, several sterling countries found it necessary during the 1951–52 crisis to restrict sterling imports to a significant extent. This sterling scarcity was confined to the independent member-countries and did not affect the British colonies, which were at all times more responsive to United Kingdom policies. Among other factors, it reflects the check to Britain's capital outflow as credit conditions in London were tightened in 1952. Since 1952, the outer sterling countries have rebuilt their balances, but they have not regained their earlier liquidity. For example, the independent member-countries ran down their balances from £1,980 million at the end of 1950 to £1,606 million at the end of 1952, a decline of nearly £375 million; at the end of 1953, their balances were £1,774 million, or still nearly £200 million below the 1950 peak.

RELAXING CONTROLS OVER STERLING PAYMENTS

Britain's strengthened position within the sterling system has enabled the United Kingdom to undertake additional commitments to foreigners in the use of their transferable sterling which have increased the vulnerability of the pound in the foreign-exchange market. In a series of relaxations announced on March 22, 1954, the United Kingdom abandoned most of the technical devices formerly used to restrict foreign use of sterling, ex-

[20] See, for example, my article, "Sterling Instability and the Post-war Sterling System," *Review of Economics and Statistics*, March, 1954, pp. 83–84, for a discussion of the fluctuations in the sterling balances of the independent sterling countries.

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cept for the maintenance of a formal distinction between accounts of dollar- and nondollar-area residents and between accounts arising out of security and other transactions.[21]

Despite the increased vulnerability of sterling resulting from these changes, there has been no sterling payments crisis since the early months of 1952. On the contrary, the United Kingdom has been able to achieve a substantial amount of *de facto* convertibility through the foreign-exchange market. At present, Britain maintains both a fixed and a "floating" dollar rate for the pound sterling. The "floating" pound rate, reflected in the discount quotations for transferable and security sterling, is being used for current and capital transactions between Europe and North America. The ease with which foreigners can use sterling for any type of transaction not requiring direct British authorization means that a smoothly functioning halfway house to full convertibility has been achieved. For example, funds can now be switched between (spot) sterling and dollars and gold; it is also possible to obtain forward quotations on discount sterling as well as on convertible sterling.[22]

The United Kingdom has contributed to this stability by limiting the supply of sterling in foreign hands, on the one hand, and by enhancing the competitiveness of Britain's exports, on the other. The outer sterling countries, in their turn, have recognized their commitment made at the Commonwealth Economic Conference held at Sydney in December, 1952, that "an adequate and stable external balance must be a first objective of all Governments."[23] The improved performance of these outer sterling countries reflects in part their reduced foreign-exchange (sterling) liquidity and in part the influence of Britain's own example.

The reduced liquidity within and among all the sterling countries can itself be attributed in large part to the introduction of effective monetary restraint in the United Kingdom in early 1952. The sterling countries have thus shifted away from the policies that tended to encourage periodic inventory fluctuations and excessive liquidity within the sterling area. Both individually and as a group, these countries have materially reduced their reliance on import restrictions and increased their reliance on more traditional monetary policies and more liberal foreign-trading principles. Periodic inventory liquidation has been avoided as these countries have moved from restrictive to more liberal import policies, which encouraged procurement in the cheapest market regardless of currency. Because of these developments, the pattern of regularly recurring external payments difficulties every two years, which marked the postwar history of the sterling system, seems to have been brought to an end with the 1951–52 crisis.

The first trial of these monetary and foreign-trade principles came in the early months of 1955. To counter the deterioration in Britain's external position re-

[21] A description and appraisal of these measures may be found in the *Banker* (London), April, 1954, pp. 181–93 and the *Economist* (London), "Freer Gold and Sterling," March 27, 1954, pp. 965–67.

[22] The present *de facto* convertibility is discussed at some length in "How Convertible Is Sterling?" *Economist*, July 17, 1954, pp. 211–13. It may be noted, in passing, that the present flexibility in the use of sterling has attractions for foreigners and, in view of the minimal risks, also for the United Kingdom. For example, Britain is able to maintain a fixed rate for merchandise imports and exports and a fluctuating rate for capital and service transactions by foreigners. In addition, Britain's liability to purchase sterling for gold or dollars under present arrangements is rather limited.

[23] Commonwealth Economic Conference, *Final Communique* (Cmd. 8717; London, 1952), par. 6.

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sulting from a rising volume of imports, the Bank of England raised its discount rate by $\frac{1}{2}$ per cent on January 27. On February 24 a broader program of credit restraint was introduced. The bank's discount rate was raised by another 1 per cent, reaching $4\frac{1}{2}$ per cent for the first time since the spring of 1932, and restrictions were re-established over instalment credit. In addition, the Exchange Equalization Account was authorized to operate in foreign markets to support transferable sterling.[24] In his introductory statement the Chancellor of the Exchequer noted that the program was designed "to moderate excessive internal demand and so to match the increase in our imports . . . with a corresponding increase in our exports."[25] These measures were taken before any serious fall in foreign-exchange reserves had occurred, and, for the first time in the face of threatening external difficulties, there was no intensification of Britain's import or foreign-exchange restrictions. The decision of the authorities to rely upon financial measures, and not upon direct restrictions over imports or foreign payments, will provide over the coming months a significant test of the effectiveness of the traditional monetary instruments as a means to restore stability in external payments.

[24] The details and certain implications of this further step in the direction of sterling convertibility may be found in "Backdoor Convertibility," *Economist*, March 5, 1955, pp. 827–29.

[25] *House of Commons Debates* (Hansard), February 24, 1955, cols. 1457 ff.

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