THE STERLING AREA AS AN ECONOMIC ENTITY

BY

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A Thesis

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P R E F A C E

The study of the topic of the Sterling Area by this writer resulted from his interest in the subject of 'economic change'. It appeared right from the start of the search for a suitable subject that the Sterling Area provides a field of great heterogeneity as to the degree of the economic development of the member countries and that, therefore, the problems of Equilibrium within the group could be an attractive challenge. It became evident soon after the investigation began that the resultant of the problems in the group (behind the latter's innocuous designation as a 'group') was the Cohesion of the area. Unlike the practice of several authorities on this field, who treat of the cohesion as only one of the problems, this writer saw it as a pivot of every elemental movement. Thus, each relevant factor was tested with a view to its position vis-a-vis the cohesion of the area.

Yet, no *a priori* notions had been entertained. The pivotal character of cohesion as the ultimate target of the study should not be regarded as an *a priori* notion. The study followed the phase of induction first until cohesion became an abstraction and the alternation of 'induction-deduction' was used rather freely afterwards. No doubt, some *a priori* known facts were used in the process, but as long as facts are not confused with value judgements their use is logically permissible.

After the investigation of definitional and kindred questions the study continued with an analysis of the internal factors of the area. Soon it became evident that the internal factors establish contact with external forces and that no proper evaluation of their effects could be made unless they were seen in their dynamic relationships to the external factors. However for the most of the study the logical segregation of the internal factors was given greater weight. When the mass of external factors came for consideration it was established that they had been adequately covered as to the description of physical characteristics in the main body of the study. It was found later that their role as a group could be abstracted into one concept, namely Convertibility. Thus a small chapter was devoted to the latter concept; and a defence of this choice is attempted therein.

The relationship of 'objective-subjective' factors has been regarded as another theme which should be considered in connection with methodological questions. No attempt was made to elaborate on this relationship as a general proposition, for such an attempt would be beyond the scope of this study. However, some reference to it, establishing its relevance to the material of the thesis was made in chapter IV.

Some remarks on the technical difficulties encountered in the process of collecting the material may be of interest to the reader in evaluating the paper. Data have not always been easily obtainable, or in the desired form. Since these shortcomings forced, on occasions, the introduction of changes in the original design, they were pointed out whenever this was deemed necessary. However, this did not affect the whole picture seriously. Although statistics were used quite extensively, the decision of projecting discernible trends appearing in past data was always weighted by other background considerations to such an extent that sometimes the data were shown,only to be rejected later by the introduction of the 'other' considerations. Statistical data were used just as any other element of information.

Another problem encountered throughout the study was that of sementics. However,the writer took confort in the idea that such is the problem in the investigation of any transitional period and must be regarded, therefore, as part of the analytical game. Thus some reclassifications of countries were made which are at variance with accepted practices. Members of the area, such as, e.g. Ghana and Malaya etc though administratively independent, have been treated with the Dependent Territories.

Collection and presentation of information for its own sake has not been envisaged as the purpose of this paper. Therefore, the factual material presented here has been limited to those quantities that were relevant to the conceptual framework of the thesis.

The principal pieces of literature are listed in an Appendix. Their contribution varies in degree. Background knowledge, not included in this literature played also a considerable role. With due appreciation of all sources the writer is particularly indebted to the following references : ref (1) A. R. Connan, The Sterling Area, ref (2) E.C.A. The Sterling Area, An American Analysis, ref (4) P. Bell, The Sterling Area in the Posrtwar World ref (7) J. Polk, Sterling, Its Meaning in World Finance, ref (8) A. R. Connan, The Changing Pattern of Intern'l Investment, and last but not least, to ref (10) League of Nations, International Currency Experience, 1944. For purposes of typing convenience, the writer took the liberty of identifying the references by number rather than by title. The reference numbers are shown in the Appendix of Bibliography.

Thanks must be given to Prof. D. B. Marsh who made several valuable suggestions as to sources of information and the general framework of the thesis.

Finally the writer wishes to ask the reader of the paper to b ear with him certain difficulties in expression which stem from the fact that English is not his original language.

I N T R O D U C T I O N

The Sterling Area can be tentatively defined as the monetary union existing mainly between the United Kingdom and the overseas Commonwealth, with the important exception of Canada. Membership has been extended from time to time, formally or only de facto, to countries outside the political framework of the Commonwealth as well. In its technical aspects this monetary union can be described as an 'association of the United Kingdom with certain countries whose trade is financed mainly in sterling and whose reserves are mainly held in sterling(underlined by the writer, ref (1) p. VIII).

Some basic characteristics such as trade financing mainly in sterling and holding of members'reserves in sterling have been substantially present throughout the life of the old British Empire. The lack of discussion on the topic of " Sterling Area" per se before the thirties may be attributed to the prominence of London as the worlds'trade and financial centre, a situation which obscured any subordinate financial arrangement. The basis of differentiation was the result of a/ the emergence of the U. S. A. as the major creditor nation of the world following World War I, and, b/ the breakdown of the international trade intercourse, (manifested, i.a. in the breakdown of the gold standard and its "rules of the game". While the technical apparatus that evolved from this differentiation is an elaborate and scientifically interesting one, it is the underlying forces that led to present developments that will form the core of this study.

The material has been arranged in four chapters. Chapter One deals mainly with definitional aspects of the area and the description of the monetary mechanism. The presentation is rather static, but the problems which beset the area start emerging from the discussion. The problem of Cohesion is identified. Chapter Two tests the hypothesis of Complementarity' in physical production as the nexus of the area. Chapter Three is considered as the core of the thesis. By necessity, it occupies the largest portion of the paper. The analysis attempts to cover the dynamic aspects of the components of the area. Chapter Four deals with the influence of the external forces as such (cf preface) on the structure of the Sterling Area.

Please, N. B. The term Sterling Area may be found in the text in any of the following abbreviations: S.A. (Sterling Area), R. S. A. (Rest of Sterling Area) for countries other than the United Kingdom, and O. S. A. (Overseas Sterling Area) for the same designation.

B I B L I O G R A P H Y

N.B. The numbers in parenthesis ( ), corresponding to each source of reference have been used in the footnotes in place of the title of the reference for purposes of typing convenience.

(1)	A.R. Connan	The Sterling Area
(2)	E. C. A.	The Sterling Area, An American Analysis
(3)	F. V. Meyer	Great Britain, The Sterling Area & Europe
(4)	P. Bell	The Sterling Area in the Postwar World
(5))	R. S. Sayers (Editor)	Banking in the British Commonwealth
(6)	R. F. Mikesell	Postwar Exchange in the Postwar World
(7)	J. Polk	Sterling, Its Meaning in World Finance
(8)	A. R. Connan	The changing Pattern of International Investment in Selected Sterling Area Countries
(9)	A.E.R.-Sept.54 by K. M. Wright	Dollar Pooling in the Sterling Area 1939-52
(10)	Q.J.E.-Febr.55 by E. Zupnick	The Sterling Area's Central Pooling System Re-examined

(11) League of Nations,Inernational Currency Experience, 1944

(12) Leaugue of Nations, World Economic Survey, 1939/41

(13)	A.E.R. March 54 by S. I. Katz	Exchange Flexibility and the Stability of Sterling

(14) Lloyds Bank Review Australia as a Factor in the Sterling Area July 55

(15) W. M. Dacey British Banking Mechanism

(16) D. MacDougall(Sir) The World Dollar Problem

(17) D. H. Robertson Britain in the World Economy

(18) Intrn'l Affairs, Apr.52, The Sterling Area by H. Gaitskell

(19) Intrn'l Affairs, July52,The Sterling Area Crisis by F. W. Paish

(20) R. N. Gardner Sterling-Dollar Diplomacy

(21) Buchanan&Lutz Rebuildign the World Economy

CHAPTER I

THE STERLING AREA AS A MONETARY MECHANISM

Section A: Pre-World War II Arrangements

1. Structure

As a formal group, the Sterling Area came into being at the beginning of the Second World War. It is mainly a grouping of British Commonwealth countries, with the exception of Canada (whose historical position vis-à-vis the Sterling Area classifies its economy in the orbit of Dollar). The term "Sterling Area" was first officially applied to the grouping in July 1940, in the Statutory Rules and Orders issued under the Defence (Finance) Regulations of the United Kingdom. While the core of Commonwealth members from which the Sterling Area derives its basic characteristics and strength has remained unchanged since its inception, several of the original members have dropped out and new ones have joined the group. The latter, marginal cases, reflect mainly changes in the political alignment of these countries vis-à-vis the United Kingdom[1] or political expediency in taking position in the struggle between the major belligerents. In many cases, countries have used sterling as a medium of payment in their foreign trade. This practice, in itself, would not "qualify" these countries as members of the Sterling Area under the generally accepted definitions.

As already observed in the introduction, it was the existence of the pre-war ties among the members of the Commonwealth of Nations that made possible in 1940 the creation of the Sterling Area, strictly defined. The nature of these ties will be the subject of the discussion that follows.

The developments relevant to this topic have passed through two phases: the period preceding the international economic collapse of the 1930's which, so far as the Commonwealth of Nations is concerned, culminated i.a. in the Ottawa agreements in 1932; and the period following these agreements to the time of the formal grouping of the Sterling Area.

The period before 1932, characterized mainly by the operation of the gold standard, witnessed the forging of international trade and financial relationships centring around London, and the members of the Commonwealth, of course, participated in these arrangements as much as anyone else. It is not considered necessary, therefore, to elaborate on the mechanism of these arrangements, since, governed by the rules of the gold standard, they did not pertain to the sterling countries alone and, consequently, only limited affinity could be established with later developments.

The breakdown of the gold standard--itself signifying i.a. the breakdown of the British economic supremacy--at the time when new forces were emerging on the international horizon, resulted in the polarization of regional interests which, broadly speaking, may be summarized under the following headings: "Sterling Bloc"; "Gold Bloc"; "Dollar Area"; and "Reichsmark Area" (as it was sometimes called). The abandonment of the fixed parity of sterling and gold by the United Kingdom in 1931 and one of its natural corollaries, the Ottawa Imperial Preference Arrangements, narrowed and strengthened the bonds among the countries which subsequently formed the Sterling Area.[2] The signing of the Imperial Preference Agreements in itself did not signify the establishment of an exclusive financial apparatus; in fact, countries outside the Commonwealth agreements could and did participate in the overall arrangements. "While all signatories of the Ottawa Imperial Preference arrangements, except Canada (and Newfoundland) were members of the Sterling Area, there was no direct connection between the informal, purely financial network and commercial agreements. Any country could freely join the Sterling Bloc and many non-Commonwealth countries availed themselves of the opportunity, including Portugal, the Scandinavian countries, Latvia, Iran and a number of others, as well as Japan and Argentina, which kept their exchange rates pegged to Sterling but were not generally considered part of the group."[3]

However, the solid core of the Sterling Bloc (subsequently known as Sterling Area) has always been made up of the Commonwealth countries and countries whose "natural" position--geographical or otherwise--dictated trade ties with the United Kingdom. Indeed, it appears that "history" and "natural affinity" (to use the favourite expressions of a good many--mostly Anglo-Saxon--students of the subject, and which do not seem to be semantically satisfactory terms incidentally) rather than free choice, have formed the material basis of monetary co-operation which followed already-operating trade relationships. As the forces that forged the links among those countries in the past remain largely operative, it will be one of the tasks of this paper to deal with their substance. Quite frequently, however, since the form that monetary arrangements assume is merely a reflection of underlying forces, failure to recognize the resulting overlapping of form and substance leads to the inadvertent substitution of speculation for diagnosis. This is the type of problem that presents the real challenge. (After all, has not the perennial intellectual struggle of Method been largely confined to the distinction between "phenomenon" and "ding an sich"?)

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As indicated earlier, the boundaries of the Sterling Bloc were never formally defined[4], but the members could be identified by two main characteristics. Firstly, the member countries maintained their respective currencies in a fixed relationship with the pound sterling. Secondly, the old practice of keeping their foreign exchange reserves in London continued; only now the reserves were kept mainly in the form of sterling balances, although many countries, nominally on gold, had followed this practice even earlier.[5]

At the outbreak of the War in the autumn of 1939, after most of the non-British members severed their link with the pound, the Sterling Area's membership was confined practically to British Commonwealth nations (with the exception of Canada), and with the application of stricter wartime controls, the Area assumed the cohesion which characterized it in later years.

In summary, this relationship may be called one of an exchange standard which, in its workings, is not unlike the gold exchange standard. It is an open question[6] as to whether or not the absence of gold renders the comparison absurd.

2. Management and Relations to U.K. Money Markets

The problem of management of these reserves had been simplified through arrangements that the Bank of England had made with Sterling Area central banks by which the latter entrusted it with the administration of a large portion of their London funds.[7] The reserve balances of the members of Sterling Area (other than the United Kingdom) were acquired from two sources: (a) in transactions with the centre of the Sterling Area; and (b) in transactions with countries outside the Sterling Area. This dualism is significant in that it portrays the Sterling Area as both a closed and open system.[8] The origin and size of reserve balances were of the utmost importance inasmuch as they determined the situations that arose inside the centre, and the type of action that the Bank of England had to take in each instance.

To the extent that the reserve balances were acquired from without the Sterling Area, they formed part of the general inflow of capital and were treated in the same way as any foreign funds seeking short-term placement in the United Kingdom ("hot money"). It was the function of the Exchange Equalization Fund to offset the usually erratic effects of these movements.[9] This was done through the purchase of gold with money obtained from the domestic market through the issue of Treasury bills on the part of the Exchange Equalization Fund. The significant element here was an increase in the supply of bills offered by the E.E.F. To the extent, however, that these balances were acquired in transactions with the U.K., no such increase in the supply of bills was necessary. They were invested in Treasury bills obtained through competitive bidding on the London market. This competition forced the discount rate of bills down and, accordingly, "it also had a somewhat restrictive effect on the system as a whole".[10] R. Nurkse, elaborating on the procedure, presents the following picture of the mechanism during that period:

> "In addition to a minimum cash ratio of 10% the London clearing banks maintained a tradition of covering at least 30% of their aggregate deposits by liquid assets--namely cash, call loans and bills. The call loans were made largely to the discount market and represented to that extent an indirect holding of bills. In view of the decline in the volume of commercial bills, the banks were greatly dependent on Treasury bills for their supply of 'quick assets'. When a greater portion of the available supply of Treasury bills in London was taken up by S.A. central banks, less was left over for the clearing banks. The shortage of bills, if not actually deflationary, acted at any rate as a check on the expansion of credit. The effect was somewhat analogous to what would have happened under the orthodox gold standard, though obviously much weaker."

One conclusion emerging clearly from the foregoing discussion is that the domestic credit structure in the United Kingdom could have been safe from the erratic effects of the fluctuations of the Sterling Area member reserves--even the ones originating with deals with the United Kingdom--to the extent to which the general operations of the E.E.F. could be effective. Furthermore, it should be kept in mind that the E.E.F. has never been regarded as the panacea of the ills arising out of foreign transaction disequilibria. Its limited role has always been recognized. ".... The Exchange Fund was not supposed, in its operations in the exchange markets, to resist any decided trend in the value of the pound one way or the other, but merely to prevent sharp fortuitous fluctuations in the exchange rate from day to day."[11] (Underlined by the writer.)

While short, periodical fluctuations may normally be regarded as "part of the game" in arrangements such as the one under discussion, a persistent accumulation of reserves of member countries, in this case probably a result of artificially undervalued member-countries' currencies, could definitely meet with objections on the part of the centre. A persistent deficit in the balance of payments of the member countries, on the other hand, which could be a possible result of the overvaluation of their currencies vis-à-vis the centre (a very relative, little understood concept) would meet with reaction on the part of these countries. Either case tends to give rise to solutions not unlike in character to procrustean measures, so familiar to students of international trade. These solutions usually amount to fixing rates of exchange between different currencies at new "equilibrium" levels.

The new ratio, however, does reflect new relationships, whose monetary substance is but a small part of the new arrangement. Whatever the difficulties within the Sterling Area as a closed system might have been, short-term solutions could usually be devised as will be seen in later chapters. However, the difficulties could have become really onerous had the area as a whole run a persistent deficit with the rest of the non-sterling world. Obviously, the process of reducing fluctuations in the balance of payments for the Sterling Area as a group was a much more difficult task for the centre than if the centre had had to perform that duty for itself alone, operating independently. Reactions to such situations have not always constituted solutions and the resulting strains upon the system were both frequent and serious. Part of the problem of the relationship of the member countries has been their relative degree of participation in the allocation of foreign exchange originating with transactions without the Sterling Area. Technically the arrangement was simple. As already indicated, it was the practice of the members to hold the largest portion of their reserves in the form of sterling. Earnings were reconverted into non-Sterling-Area foreign exchange as needed in making payment in non-sterling countries. It is apparent that the problem is not the technical arrangement but the allocation itself. The statement of the problem simply reveals the difficulties with which the system was faced. The interpretation of the phrase "as needed" is not to be found in the existence of any automatically operating standards. At times it was determined in a semi-casuistic manner, and usually, in the case of the colonies in particular, the whole system of relationships to the centre was designed *a priori* in a manner pre-empting all rights on the reserves in favour of the centre. This can hardly be regarded as an "automatic" standard. It would be proper perhaps to regard it as, what was referred to above (cf P.4) an underlying force disguised in the form of monetary arrangement, and for that reason its examination will be reserved for later chapters[12] where "substantial" relationships are discussed.

At the risk of speaking prematurely, it may be remarked at this point that the closed system of the Sterling Area was not so closed after all, and that it was exposed to cyclical disturbances originating within and without, suffering like everyone else, from the same effects that foreign trade disequilibria may bring about. It may not be out of place also to remark here that the outbreak of World War II imposed several Gordian solutions upon the accumulated problems of relationships of centre and R.S.A., not the least of which being the adoption of strict exchange controls throughout the whole Sterling Area. New situations arose and new forces came into play. The relative positions of centre and R.S.A. were altered, "but so were the conditions in which and the purposes for which the whole system was called upon to function".[13]

Section B: World War II Measures and Their Effects on Sterling Area Formation

The outbreak of war in 1939 is the milestone in the formation of what is regarded nowadays as Sterling Area. As observed above, the Sterling Area had lost all the neutral non-Commonwealth members at the outbreak of the war. Sterling had been under pressure for several months prior to the outbreak of hostilities and had depreciated from $4.68 to $4.05 within less than three months. The formal imposition of exchange control on the Sterling Area as a whole for the first time in its history (although domestically imposed controls had been operating during the Thirties in individual countries) is regarded by students of the subject as the outstanding feature of unity of the group that became known thereafter as the Sterling Area. While this may be true in its legalistic implications, the assumption that the imposition of exchange control is but another phase in a long process of evolution, is more valid substantively. However, this question is discussed elsewhere and therefore may be disregarded safely forpurposes of this section, which is devoted mainly to discussion of measures and techniques initiated during the war.

Since the control would operate on the Area as a whole and because of the state of relative flux in which the Sterling Area found itself at its (economic) periphery on various occasions, it became necessary to define the Area. This definition was given in Statutory Rules and Orders issued under the Defence (Finance) Regulations in

July 1940. This defined the Sterling Area as including the United Kingdom and the Isle of Man, all the Dominions, Colonies, Dependencies, and Mandated territories (except Canada, Newfoundland, and Hong Kong) together with Egypt, the Anglo-Egyptian Sudan and Iraq. It became necessary to amend this list in subsequent years, but the "Sterling Area" (renamed since the Exchange Control Act of 1947 to the "Scheduled Territories") had been established as a clearly defined grouping of countries instead of the tentative, and often conflicting, descriptions used prior to the Statute.

It is characteristic of the new arrangement that several Sterling Area countries, which had developed the habit of maintaining their separate gold reserves in the past, abandoned this practice and merely carried <u>all</u> their reserves in London. This change in overall attitude persisted in the post-war years, with some qualifications that will be discussed later. It is also characteristic of the new formal arrangements that the administration of the exchange controls and licensing of imports were left to each member of the group individually with the exception of the colonial territories whose policies were dictated by the United Kingdom government.

These arrangements eventually became the vehicle by which enormous debts were built up within the Sterling Area membership during the war. It appears that it was intended that way, and technically speaking, they proved very efficient in serving the war effort. Thus the new arrangements and the events that followed strengthened tremendously the general cohesion of the Area, and many relationships that emerged in that period played a significant role in preserving, or sometimes forcing, the unit in the post-war years.[14]

Generally speaking, the exchange regulations of the United Kingdom vis-à-vis the other Sterling Area countries were designed in a way that freed transactions within the Area to an extent compatible with the war requirements. One observes in these arrangements the *de jure* and *de facto* operations of, what was for all practical purposes, one monetary unit embracing a geographical area more widely scattered than any other. Within this Area, the United Kingdom could pay for all its purchases with pound sterling. This, of course, was not a new feature of the system, for, being technically related to the habit of the member countries of holding their reserves in sterling, it was *de facto* an established practice even prior to the formal arrangements. The significant aspect is that the United Kingdom was able to buy things and pay for them in a quasi-funded sterling. This proved perhaps more crucial than any statutory arrangements between the United Kingdom and member countries in the strengthening of the bond within the Area. The meaning of this relationship--a truly new one by virtue of the size of the indebtedness of the United Kingdom to the member countries--will be evaluated in later chapters.[15]

The discussion of other techniques in operation during that period strikes a familiar note, for they are mostly a continuation of pre-war practice. Member-countries' sterling exchange surplus obtained through their transactions with the United Kingdom and a dollar or gold surplus derived from transactions with the non-sterling world, tended to increase their (the member countries) sterling reserves as a result of the arrangements discussed above. These balances were invested in British government obligations, principally Treasury bills. Despite this great and plain similarity, however, the comparison is substantially a superficial one. During the pre-war years, the maintenance of balances in the form of sterling could be regarded, ceteris paribus, a normal (and perhaps efficient) method of financing the members' foreign trade. Such, however, was not the case during the years of war. Now, it simply meant that these surpluses were devoted to the financing of the war effort to the degree to which each member maintained its surplus sterling with the United Kingdom government.

As a sequel to wartime trade relations, the position of several of the members vis-à-vis the United Kingdom changed from debtors to creditors. This was carried out by means of "repurchase" of long-term outstanding, mostly government, securities. In its initial stages, the procedure involved the floating by the debtor country of domestic government loans, the proceeds of which were delivered to the British government in exchange for the previously outstanding security.[16] This constituted a definite achievement on the part of the members, considering the lack of domestic money markets (since London had been the market until then), and in turn helped create a machine which proved very helpful in post-war domestic financing. With the nature of the above-mentioned securities (foreign, long-term, etc.) being what it was, this repatriation heralded a new relationship altogether--important enough to merit a separate discussion.[17]

In summary, and quite apart from any considerations of substance, the practice of domestic financing for the purpose of repatriation of United Kingdom-held securities may be regarded as the only additional "technique" employed in the Sterling Area during the war.

Section C: Post-War Status: The Centre and The Periphery

The integration of the group into what constitutes the Sterling Area of today took place during the war. Post-war developments, in particular the requirements of rehabilitation and maintenance of position on the part of the United Kingdom amidst new alignments of the world powers, necessitated a tightening of transactions of the group rather than a liberalization (convertibility) within and without, which could only be carried out with an elaborate, albeit awkward, network of controls throughout the field of international finance. In the discussion that follows, those techniques will be stressed that will assist in our analysis of the operative forces within the system. As in the pre-war period, the two basic characteristics of the system are: (a) The exchange rate between the domestic currencies of member countries and sterling is maintained at a fixed parity (although several adjustments of parities of some members have taken place in the post-war period; and (b) The bulk or all of exchange reserves (gold or currencies other than sterling) of member countries are held in London. The resemblance of the system in all of its functional characteristics to the gold exchange standard, as in pre-war, has convinced some writers that a title such as "Sterling Exchange Standard" would be descriptive of its operations. However, as suggested earlier, it would appear to be an oversimplifying classification merely to distinguish between the United Kingdom and the Rest of Sterling Area, the latter being regarded as a homogeneous monetary unit relying upon the centre for the main functions described above. As in the past, the rigidity of application of the chief features may be regarded as a "function" of the constantly shifting political and economic balance of power. Generally speaking, the relationships between the member countries and the centre may be classified under two categories with respect to rigidity of application.

1. Centre and Dependent Territories

The currencies of Dependent Territories are based entirely upon sterling reserves held by the central monetary authority. By and large, a one-hundred-percent sterling reserve is maintained for local currency. The first feature, i.e. exchange rate, is maintained rather rigidly and is established in London. This classification includes most of the British colonies, protectorates and mandated territories (all known as Dependent Territories), as well as Ireland.

Members of this group are inside the boundary of the Sterling Area Exchange Control. This is an additional characteristic of the overall dependency of the group on policies designed and carried out by the centre, which, ironically, won the title of "inner circle of the Sterling Area"[18] for the Dependent Territories. The instruments through which the relations between the members of this group and the centre are maintained, are the currency boards, of which there are five (i.e. Central Africa, East Africa, West Africa, the West Indies and Malaya and Singapore). Although the boards are, par excellence, the central monetary authorities of the colonies[19], there is hardly any connection between their function and that of a central bank in the sense that the latter's role as a policy-maker is usually understood in the Western World. With the parity being fixed a priori and the one-hundred-percent sterling reserve of local currency being a statutory "habit", policy questions are "solved" for the countries in question even before they have arisen.

The boards represent the central authority which resides in the United Kingdom. They act merely as administrative agents, although the exchanging of opinions with the centre is not uncommon. The boards deal only with banks. Apart from the lack of high policy-making powers, however, the technical aspects of their work strongly resembles one type or another of central bank activity. While, for example, they can never take the initiative to change the volume of domestic currency (normally regarded as a major-policy decision), they are always prepared to exchange domestic currency and sterling. Considering the relatively primitive type of economic structure existing among most members of this group, it appears that the whole mechanism does not operate beyond the specie-currency stage. Since the reserve (a one-hundred-percent one, it should be remembered) depends exclusively on the balance of payments (which in turn is largely determined by the policies of the centre)[20], the term "Sterling Exchange Standard" is appropriate not only as a paraphrase of the term "Gold Exchange Standard" in its technical implications, but also in its effects upon the economy of a given member country resulting from the vagaries of the business cycle in the centre.

The monetary control of the centre over the colonies is further tightened by the existence of legislation providing for the investment of sterling receipts which are in excess of the amounts that banks choose to hold in reserve. The currency authorities are usually permitted to invest surplus only in British securities, Commonwealth securities, or securities specifically approved by the Secretary of State For The Colonies, although the prevailing practice has been to invest only in British and Commonwealth securities. (Southern Rhodesia has been an exception. There, the authorities have been permitted to invest in the securities of their own government.) It is the British government again that determines the amount of sterling assets to be held in liquid form, the quantities usually being based on anticipated demand for sterling. It becomes clear from the foregoing that the basis for the development of a purely domestic credit structure is lacking in the Dependent Territories. In discussing more "real" aspects of the relationships, the monetary mechanism occupies a very strategic position as an instrument of control of the colonial economies. An integrated approach to the problem would include such things as trade and investment relationships of colonies and metropolis, colonies and "dollar pool"; and, by necessity, the basis of the formulation of the problem would have to be broadened sufficiently to encompass political and elements of Weltanschauung, as well.[21]

2. Centre and Independent Members

Under the second category are classified those of the countries, also operating under Sterling Exchange Standard, whose ties to the centre are not as strictly defined or regulated as those of the Dependent Territories. As already established in the preceding section, the dependence of the domestic currencies on sterling is being assured through the exchange rate parity; the reserve requirements for domestic currency; and the participation of the central authority (the British Treasury) in the foreign exchange control.

For countries other than the colonies and Ireland, i.e. Australia, New Zealand, India, the Union of South Africa and Iceland, with Ceylon, Burma and Pakistan following closely on the steps of the former, the technical forms of arrangements discussed above shape up in a way which parallels the political balance between these countries and the United Kingdom.

The rate of exchange of their currencies with sterling rests with the government of these countries (operating either through central banks, which sprang up mostly during the Thirties; or as in Iceland, where *ad hoc* authorization must be given by parliament). Studying legislation that regulates the territory of action for the central banks, wherever control of the exchange rate is invested in them, one concludes that the methods employed are very similar to those of other countries where central bank action is accepted as one of the bank's functions in stabilizing foreign exchange rates. However, the degree of freedom of exchange market operations does not seem to be uniform among banks. Generally speaking, stability, although desirable, is not necessarily, or always, the ultimate goal. This was the case even before the war, as with the rest of the world, for reasons too well known to require any further discussion here; and it seems that the trend continues stronger than ever, restricted only to the extent to which "marginal utilities" of stability and domestic welfare are equalized. The trend is manifested in statutes pertaining to the operation of the central banks of the countries in question or reports of the various royal commissions set up *ad hoc* from time to time during the Thirties and whose recommendations--more often than not--became official guides of action.

An adjunct to the relative independence that the central banks enjoy is their freedom in dealing in other currencies, unlike the currency boards of the Dependent Territories.

Returning to the question of exchange rates with sterling, it appears that nowhere have there been established statutory limits of buying and selling rates in the bank's operations. In practice, however, there is a relative automaticity in the operations, not unlike the policies of the currency boards of the colonies, which is manifested in the custom of the banks to offer to buy and sell sterling at fixed exchange rates which are established for relatively long periods of time. Is there no difference, therefore, between the banks and the currency boards as to the degree of rigidity at which they operate? This similarity is only a mechanical one and the question is answered by the other major consideration, i.e. the percentage of sterling reserves held against domestic currency. Not being obliged to hold 100-percent sterling reserves against domestic currency, the banks are able to expand the basis of credit in the country through open-market operations (a practice which presupposes the existence of some form of a money market and rediscounting of short-term notes). The domestic money supply is, in turn, the controlling factor of demand and supply of sterling. Thus the limits customarily established by the banks rather than operating as "straight jackets" in their operations, they reflect points of equilibrium of supply and demand of sterling, the relevant quantities being regulated in the indirect manner described above. The operations have been further facilitated by several measures of foreign exchange control which were imposed by all Sterling Area countries in the post-war period.

Certain peculiarities among the "independent" countries deserve mentioning. They are found in the status of three countries, Ceylon, Burma and Pakistan, which technically speaking, have been under dual exchange standard, i.e. their currencies are tied not only to sterling but to the Indian rupee as well. This situation, which varies in degree from country to country, resulted from the close commercial ties between these countries and India in the past; and the ties between India and the United Kingdom, in a way that involved triangular arrangements with India playing the role of the equilibrating country. However, the basic technical relationships discussed above operate in a similar manner in these three countries as well.

In summary, the maintenance of a fixed exchange parity, as one of the characteristics that associate one country with membership in the Sterling Area, does not appear to be powerful enough to create a definitional _differentia_. Furthermore, in view of post-war developments in the field of international monetary agreements whereby a _de facto_ stabilization of exchange rates on a wide basis has been achieved on one hand, and the lack of homogeneity in the underlying conditions of maintaining exchange parities between the two groups of countries discussed above, vis-à-vis the sterling, the logic of the definition of Sterling Area in accordance with this characteristic, may be challenged.

The second major characteristic, i.e. the holding of the foreign exchange reserves in London, will be assessed presently.

3. Dollar Pool

The holding of the Sterling Area's foreign exchange reserves in London is usually referred to as the "dollar pool", although the term is a misnomer technically speaking, since the pool holds other foreign currencies as well.[22] Furthermore, the substance of the problem which ultimately helped develop the structure of the Sterling Area in its present form, has been the relationship of the group to the dollar area and the dollar pool has been devised as one of the solutions of the problem. It may be stated, parenthetically, that the solution of the problem of convertibility of sterling, if it ever comes, will require the co-operative effort and loyalty on the part of the whole Sterling Area. Conversely, the cohesion of the Sterling Area depends partly on the progress towards convertibility. No attempt will be made at this point to arrive at any obliging conclusions, although some reference to relatively recent history of relations between the two "areas" (i.e. sterling and dollar) will help illustrate the problem. At Torquay, England in 1950, it was suggested by deputies of the International Monetary Fund, which has always enjoyed the unhindered support of the U.S. government, that several trade controls against the "dollar area" could be relaxed by Australia, Ceylon, New Zealand, and the United Kingdom because of the relatively high earnings of hard currency on the part of these countries at that time.[23]

Great Britain argued, in turn, that sterling balances of the other member countries of the area represented claims on the "dollar pool" and had, therefore, to be subtracted as liabilities from the dollar assets. The other three countries did not adhere to this view, however.[24]

Despite its great importance, the "dollar pool" is not an organization of the type that the post-war Europe has experienced, such as, e.g., the O.E.E.C. It would be erroneous even to compare tentatively the "dollar pool", or for that matter, the whole of Sterling Area to similar formal structures as some people do.[25] The difference lies in that the Sterling Area is basically a structure in which the deterministic element prevails, whereas the O.E.E.C. or kindred types are characterized by their teleology.

Generally speaking, the "dollar pool" arrangements are a micrographic, but extremely accurate, reflection of the substantive relationships of the forces underlying the Sterling Area grouping, as the following analysis will attempt to show. First, here are a few words on the technical structure of the "pool". The foreign exchange holdings of the Area are administered by the Exchange Equalization Account in London. Two bodies associated with some centralized aspects of organization within the group are: (1) the Sterling Area Statistical Committee established in 1957, which is composed of technical experts from member countries and whose function is to collect and dispatch information on the gold and dollar reserves of the pool and the respective balances of the members; and (2) a higher-level Commonwealth Liaison Committee, which operates as a forum for the exchange of ideas as to desirable policies. Neither of these bodies performs a policy-making function, however. Policy-making by a permanent-type body would normally presuppose the adherence to general, but concretely expressed, principles, which under the circumstances would constitute an incongruous or self-defeating mechanism. What is usually regarded as principles of operations in the Sterling Area are nothing but conditions--a different, logical category altogether. What may be regarded as the policy-making body of the group, in the relative meaning of the term, of course, is the Conference of the Commonwealth ministers which takes place from time to time and where current problems are given ad hoc solutions. The first of this kind of conference was held in July 1949 in London and, while it is regarded by some[26] as the beginning of a new phase of Sterling Area co-operation on dollar expenditures, it simply reflected the new period of strains that threatened the very foundations of the Sterling Area co-operation, as the problems discussed in the conferences reveal. The first of these conferences, for example, was held to limit dollar expenditures in view of the mounting deficits of the Area with the dollar countries. A decision to reduce dollar expenditures to 75 percent of the 1948 level was adopted after considerable debating. A second conference, held in January 1952 and necessitated by the dwindling dollar reserves of the Sterling Area (a result of the slow-down in U.S. stock-piling of Sterling Area raw materials), dealt with the perennial topic of "balancing" Sterling Area accounts with the outside world, building-up of dollar surpluses, and the desire for eventually creating conditions of convertibility of sterling. It is characteristic of most of these conferences that their resolutions are coated in vague linguistic generalities, hardly providing a basis for differentiating the one from the other. It is also an equally significant characteristic that they have been held mainly during periods of deficits, real or apprehended, which threaten to break down whatever arrangements have been reached through the years.

More often than not, the "group" of the independent members does not behave as a group, and the conference is held as a device that brings back to line the dissenting members with the weaker argument or position. On other occasions, the offender is the very centre of the Area. Whenever such an offensive behaviour took place, the offence was grave enough not to be considered as among the typical occurrences or just another violation of the "rules of the game". In the field of monetary arrangements, strictly speaking, such was the case, quite frequently mentioned by writers and politicians, when the decision to devalue the sterling in 1949 was taken unilaterally by the United Kingdom, without prior consultation with the governments of other countries who were told of the change shortly before it became effective. The following is a typical criticism frequently advanced in essence by "independent" members of the group outside the United Kingdom:

> "I cannot help thinking that in a matter which so vitally affects the whole economy of every country in the Sterling Area, steps should have been taken to arrange for a secret meeting of the finance ministers of the Commonwealth before a decision was reached regarding these matters: the need for devaluation, the extent of devaluation and the time of devaluation."[27]

In strictly technical terms, however, the flow of benefits and disadvantages between Great Britain and the Rest of Sterling Area seems to be operating both ways. At times Britain has had to reduce her own imports to meet deficits of the Rest of Sterling Area, and on other occasions, member countries have had to apply restrictions to their dollar imports to strengthen the "pool" of the Area. The situation differs from the pre-war conditions in that the latter was then regarded as subjected to a kind of "rules of the game", containing elements of automaticity, whereas the present manifests intentional behaviour designed to preserve an otherwise very delicate equilibrium of forces. The preservation of this equilibrium has been further assisted by a complicated mechanism of "accounts", which is discussed below. Sometimes, people confuse the mechanism with the Area *per se*. The mechanism in its complex form was developed to accommodate the new relationship that grew out of the conditions of war mainly, and it bears logically the same relation to the Area as the war itself.

4. Mechanism of the Accounts of the Area

The first chronologically interesting type of Account has been the "Blocked". Britain negotiated agreements with a number of Sterling Area (and non-Sterling Area) countries to block a portion of their sterling balances which these countries accumulated during the war. These agreements were based on the premise that only future acquisitions of sterling plus periodical releases from blocked accounts could be used for current payments.[28] Balances of Accounts No. 2 have been restricted to certain investments in British securities, agreed upon by the interested parties. The principal holders of blocked balances were India, Pakistan and Ceylon, and among the non-Commonwealth countries, Egypt, Iraq and Argentina. The above arrangements may be regarded as a stop-gap between the end of the war and the expected recovery of the economy of Great Britain, and indeed, they played a significant role in speeding up the recovery. On the other hand, by necessity, they strengthened the cohesion of the Sterling Area in its character as a trading partnership of nations.

The volume of No. 2 Accounts has been declining rapidly since their inception. A systematic policy of reduction has been persued by Great Britain and several ad hoc agreements have been signed from time to time as to the time and conditions of repayment.[29] Alternatively, it may have been just a coincidence that, on occasion, Great Britain has used blocked balances as a weapon of diplomacy.[30]

In examining the character of the No. 2 Accounts, we only begin touching upon the subject of the convertibility of sterling. The effects of the "blocking", which in essence constitute quantitative limitations of exports to Sterling Area countries, would be to help Britain conserve dollars (i.e. increase the size of the pool) or other hard currencies which would otherwise be required for the payment of raw materials and manufactured commodities imported from the hard-currency areas; or alternatively, to acquire hard-currency by selling to those countries, what normally should go to Sterling Area members as holders of sterling balances. The role of control through Accounts No. 2 can be better elucidated by the examination of the No. 1 Accounts. As stated above, current payments can only be made from these accounts.

Parallel to the decline of the balances in No. 2 Accounts, there has been an increase in the No. 1 Accounts, especially those of Australia, Ireland, New Zealand and the colonial territories, and dependencies (whose holdings had never been blocked). Thus sterling liabilities to other countries in December 1952 were only £181 million lower than they were in December of 1947.[31] Most of the £3,400 million in sterling balances as of the middle of 1952 were in No. 1 Accounts. The real meaning of this designation is that sterling balances of this type are available for current payments to any countries <u>except those in the dollar area</u>. Holders of No. 1 Accounts are free to use their balances anywhere in the Area and for payments to all the countries with which Britain has payments arrangements such as the EPU countries, and though there are no formal restrictions by the British Treasury as to purchases in the dollar area, the limitations imposed by the exchange control authorities of the individual sterling countries constitute a <u>de facto</u> restriction of transactions with the dollar area. It can be seen, therefore, that the main elements of the mechanism of intra-Sterling Area payments simply reflect the conditions from which the Sterling Area emerged. Other elements of the mechanism are presented below.[32] The elements to be discussed pertain largely to regulations on non-resident accounts.[33] Generally these accounts are classified according to the country or monetary "bloc" of the residence of the person registered with the bank as the owner of the sterling balance.

(1) American Accounts

Payments between residents of the Sterling Area and the United States, or countries belonging to the dollar area (with the exception of Canada) can be made either in U.S. dollars (from the pool held in London) or in sterling held in an American account. In this case, the distinction between "dollar" and "sterling" as media of payment is inconsequential since the price of sterling, bought and sold on the New York market is "pegged" by the Bank of England within the narrow limits of parity as established by the U.K. government in co-operation with the International Monetary Fund. The American account may be regarded as the "window" from which the Sterling Area looks at the dollar area. The size of the American account is determined, in the final analysis, by the behaviour of the Sterling Area's balance of payments with the dollar area, though for reasons of general policy, a certain degree of manipulation by the central authority deprives the account of the automatic effects of the balance of payments mechanism. Usually the British Treasury acts quickly to prevent any violent swings of the parity. The relationship of the pound to the U.S. dollar is so significant that any swings of undesirable dimensions may affect the soundness of the pound in other parts of the world, by undermining the confidence in the pound even though no other relationships have been disturbed, must be watched carefully.

(2) Canadian Accounts

Transactions with Canada are being financed in several ways, i.e. through: (a) Canadian sterling accounts, (b) Canadian dollar accounts in Canadian banks, (c) American sterling accounts, and (d) U.S. dollar accounts. With the balance of trade between the Sterling Area and Canada being one of the phases of the problem of the Sterling Area and dollar area relations, the regulations on transactions between Sterling Area and Canada are basically the same as those pertaining to American Accounts. The financing, despite the multitude of methods, does not present any more difficulties than financing required on trade transactions with the U.S.A., especially since the Canadian dollar-U.S. dollar rate was permitted to fluctuate in September 1950.[34]

(3) Transferable Accounts

Sterling held by residents of certain countries outside the Sterling Area is known as transferable account sterling. Bilaterial agreements signed with such transferable-account countries, permit them to make and receive payments through these accounts on current transactions with the Sterling Area and with other members classified as Transferable-account countries. The transferability is restricted only in that transfers of pounds must be made by and through authorized British banks, which handle these accounts--a regulation apparently designed to effect a control over the movement of funds, lest the accounts be used as a vehicle for transactions with hard-currency countries, which may have indirect effects on the rate of sterling generally. The agreements usually set forth the condition that the account be used for direct current transactions with the Sterling Area and other transferable-account countries only (cf above) and be kept with banks whose transactions are under the supervision of the exchange control of their country. Experience has been disappointing, however, as many violations of these regulations have taken place,[35] making ineffective the regulation which requires the approval of the British Exchange Control for transfers from such accounts to non-resident accounts.

Non-transferable accounts of residents of transferable-account countries, on the other hand, are subject to the additional regulation that they may be transferred to a transferable account of a resident of the same country.

(4) Bilateral Accounts

Bilateral accounts are also non-resident accounts, non-transferable to non-resident accounts of other countries, requiring specific permission of the British Exchange Control for any crediting of sterling from non-resident accounts of other countries (except the United States and Canada). Otherwise they are subject to the same regulations as transferable accounts. Transfers between residents of the same country are permitted. The foregoing are subject to some variations in certain countries, but because of no serious consequences in the overall picture, they will not be dealt with here.

(5) Accounts of Unclassified Countries

Any country not a member of the Sterling Area, dollar area or the transferable or the bilateral group, which is permitted to maintain and use sterling balances to finance transactions with the Sterling Area and with certain other soft-currency nations, is considered as a member of the group known as "Unclassified Countries". The regulations pertaining to this group are not uniform for all countries, but some general characteristics allow a technical homogeneity to the group. Payments can be made to the Sterling Area or to another "unclassified country". Credits from the Sterling Area, American and transferable accounts, as well as from other members of the group, can be transferred automatically.[36]

(6) Blocked Non-resident Account

Any non-resident of the Sterling Area may hold a blocked sterling account. The name indicates that the accounts cannot be used for payments arising out of current trade with the Sterling Area. Funds from these accounts may be invested in sterling securities of more than ten years. The origin of the accounts originates in the sale of securities or other capital assets by non-residents or similar transactions. Transfers of blocked balances have been liberalized since the end of the war and, as in other similar cases, the general condition of payments of the Sterling Area will determine the character of the regulations that are passed from time to time.

Although the above classes of accounts do not constitute a part of the formal arrangements of the dollar pool of the Sterling Area, they nevertheless, form the very foundation which made possible the operation of the dollar pool. Nor should they be regarded as sacrosanct an arrangement, as were the "rules of the game" under the old gold standard conditions. They are intended as temporary measures, forced upon the participants of the pool, but in reality regarded as most unpleasant in the long run, the ultimate purpose of the planners being the absolute convertibility of sterling. They will be performing their present functions as long as the conditions conducive to the pool arrangements persist.

5. Conclusions

In the foregoing discussion, an attempt has been made to describe the characteristics of what is regarded as the body of "Sterling Area". This attempt has been confined to the examination of the monetary mechanism which usually provides the basis for the logical classification of the participating countries as an "organization".

The existence, or past operation of forces, that helped in the shaping of this mechanism has been assumed throughout the discussion and no attempt has been made to investigate the substance of these forces--a major task reserved for later sections of this paper. The point that was stressed was that the similarity of arrangements between the post- and pre-war mechanisms is a superficial one, for while the pre-war mechanism enjoyed an air of automaticity which resulted from the historical association (which eventually developed into a more concrete organic affinity) between the United Kingdom and the Rest of Sterling Area, the post-war mechanism emerged from the conditions of war which witnessed the strange phenomenon of Great Britain becoming a debtor country not only to major powers outside the orbit of the former empire but to formerly perennial debtor countries always economically and politically subordinated to the Metropolis. This reversal, along with the spectacular developments in the national emancipation movement created new conditions of equilibrium and any attempt by Great Britain towards stabilization, to be effective, had to take into complete account the interests of these countries. In turn, the accumulated debts of Britain, constituting the main bulk of foreign assets of the R.S.A., formed a link that could not easily be broken even if the people bound by it so desired, because of the difficulty of these countries to seek new alignments while old ones were still effective. Thus a situation where "together we stand" emerged, which gives the appearance of unity among the participants, although the occasional outbursts of members betray the depth of the problems threatening the cohesion of the group. The lack of central administration is not an act of omission nor a sign of automatic operation but rather a result of the problems inherent in the group. The instruments of control so far employed, such as the Conference of Commonwealth ministers, or the various committees, are constantly busy in repairing cracks in the mechanism rather than guiding a smoothly functioning organization.

Is there at least such a thing as a unifying ideal? Some people do consider the absolute convertibility of sterling as one. Assuming that this is the case, would convertibility of sterling strengthen the cohesion of the group or threaten its very foundation? The sections that follow will assist in further attempts to formulate the problems in terms of the operation of "real" forces within and without the group.

APPENDIX I to CHAPTER I

Sterling Area and European Payments Union

The relationships between the Sterling Area and the European Payments Union are presented in an appendix rather than in the main part of the text, because strictly speaking they do not form part of the Sterling Area arrangements. If they are presented at all, it is because of the importance that has been attached by the participants (and the U.S.A., the godfather of the E.P.U.) to the E.P.U. as a stabilizing factor of the European affairs and, perhaps more significant for our purposes, because of the problems, both political and economic, that its inception created to the United Kingdom (and through it to the R.S.A.) before and after the British government's decision to enter the E.P.U. arrangements.

The E.P.U. was established in order to facilitate multilateral settlements among its members through the medium of transfer of credits from surplus to deficit countries, while enabling surplus countries to convert partially their earnings to gold. The principles, though applied on a wider plateau of activity if not geography, are not unlike those of the I.M.F.--the aim of the originators being to liberalize trade and start the member countries on their way to convertibility (a localized one, to begin with).[37] It is a limited arrangement, therefore, not only because of geography but also because of the exchange and trade controls that are recognized as indispensable in the early stages of its development. However, the aim of convertibility is promoted with a relatively simple scheme that permits any E.P.U. country to use the surplus that it earns in its current transactions with another E.P.U. country for payment to a third E.P.U. country with which the first country runs a deficit in its balance of payments. As in the rules of the International Monetary Fund, mutatis mutandis, the members' currencies are accepted within strictly defined limits. (The danger of something more than "temporary" disequilibrium is always there.) The U.S.A., through its Marshall scheme, primed the operations of the organization by setting aside dollars that formed part of the central dollar and gold pool from which demands of surplus members would be satisfied on the basis of quotas established in the agreement. Deficits of member countries are settled by a combination of credits from the Union to the debtor country and/or gold payments by the deficit country to the Union.

The position of the U.K. government was a difficult one because of the "Uniscan" (United Kingdom and Scandinavia) arrangements, whereby all but particularly heavy capital movements between the United Kingdom and Scandinavia were freed, and provisions were made for freer capital movements between Scandinavia and the R.S.A.[38] In their final analysis, this monetary alliance meant that the Scandinavians were a very important factor in the U.K. efforts to restore sterling to its old position as an international currency. If the U.K. decided to enter the E.P.U. arrangements, where E.P.U. units of account had been used as a means of transfer of credits, the Scandinavian sterling balances, of which Sweden in particular was a substantial holder, would have become convertible to E.P.U. units, thus making the United Kingdom a debtor to

E.P.U.--an undesirable situation because of its possible repercussions on the price of sterling, considering that the U.K. trade channels would not necessarily follow the pattern established with Scandinavia, nor would they be amenable to the same degree as they were with Scandinavia.

However, the U.K. government managed to negotiate an agreement with E.P.U. whereby the special position of sterling as a world currency is recognized and net debtors to E.P.U. were allowed, i.a., to settle their debts to the Union in sterling from their holdings. At the same time, the United Kingdom negotiated special agreements with members of the E.P.U. in which the amounts of sterling they would hold were established. These two arrangements would normally be regarded as reasonable safeguards for the protection of the external value of sterling. Thus it appears that the link between Sterling Area and the E.P.U. is a relationship that affects the whole Area through its effects on the external value of sterling rather than by creating the real foundations with which the intrinsic value could be intertwined. True--such foundations exist through the trading association of Great Britain and the E.P.U. but Great Britain is only part of the whole Sterling Area, whose external behaviour does not necessarily affect the Rest of Sterling Area in proportion. However, under future conditions, it may very well be the case that the association of one part, with Great Britain being the most consequential one, with economic units outside the Sterling Area, may prove a lever that would upset the delicate equilibrium that permits the designation of "entity" to the group forming the Sterling

Area at present. As to whether this may be the case in the association described earlier, it will not be discussed here, since the analysis would rest on examination of "substantive" relationships.[39] Without prejudice to the discussion, it may be said that the consequences of the association of Great Britain and E.P.U. are not exhausted with the former's diplomatic triumph just described, nor is the E.P.U. the last word in unity among European competitors, in a way that allows a comparison between E.P.U. and Sterling Area. Therefore, only a tentative reference to the problems that may be created may be considered appropriate here.

APPENDIX II to CHAPTER I

Sterling Area and the International Monetary Fund

It is indeed an intellectually interesting exercise to try to place the monetary arrangements of the Sterling Area within the perspective created by the International Monetary Fund Agreements. The exercise consists in evaluating arrangements whereby a member country in the Sterling Area preserves its sovereignty in its dealings with the International Monetary Fund and still is consistent in carrying out its obligations with both bodies. Furthermore, it would be quite interesting to compare the nations of "fundamental disequilibrium" under both arrangements. Luckily the substance of the I.M.F. arrangements is so broad in its implications that the latter (I.M.F.) is dissipated as an entity if any attempt is made to compare it with any existing group.

As to the formal arrangements between Sterling Area and I.M.F., all independent Sterling Area countries except New Zealand are members of the I.M.F. and are thus bound by the provisions of the agreement--the main one being the obligation of maintaining their parities within the limits agreed upon by the founders of the Fund. In the case of New Zealand, the failure to join the I.M.F. is due to the government's desire to preserve its freedom in setting the rates of exchange because of "the great dependence (of New Zealand) on international trade".[40] In view of the behaviour of other countries, e.g. Australia, which participate in the I.M.F. arrangements despite their great dependence on international trade, the explanation given by New Zealand seems to reflect conditions and necessities peculiar to the country and the times, not unlike, <u>mutatis</u>

mutandis, those that forced Canada to follow substantially similar policies by "freeing" the dollar. As such, the explanation may be accepted but not as a general principle of behaviour. It would be incongruous in the spirit of international co-operation. However, the almost-general participation of the "Independent" countries in the I.M.F. does not necessarily add to the strength of the bonds among the Sterling Area members. The latent conflicts have manifested themselves at times through the mechanism established by the I.M.F. Such was the case of the failure of Pakistan to devalue its currency along with the Rest of Sterling Area, which remained a source of friction with India for quite some time because of the latter's disadvantages in obtaining certain raw materials at the new unfavourable rates.

The Dependent territories "participate" in the Fund through the membership of Great Britain. Generally, the effects of the association of Sterling Area and I.M.F. are felt by the former through the influence that the lending operations of the Fund may exercise upon the external value of sterling. This may occur either through direct loans to Great Britain or to any of the independent member countries, although lending to Great Britain is likely to bear a greater influence because of the strategically greater role being played by that country.

CHAPTER II

THE EXCHANGE OF COMMODITIES AS A FACTOR OF COHESION

> "The highly specialized industrial economy of the United Kingdom could not maintain itself successfully in isolation from the complementary economies of other countries. The concentration of industry depends on the exchange of manufactured goods for food supplies and raw materials."[1]

Whichever the historical circumstances may have been, under which the formation of the group of countries constituting the Sterling Area in its physical aspects took place, the type of commodities that each region was originally able to produce formed the material basis on which the structure, manifested in the operation of the monetary mechanism described earlier, was built. This is far from saying that that complementarity of production means a guarantee of harmony among participants to the effect that changes in the type of production among regions would be detrimental to the economy of the members of the group. Such an idea would go very far in meeting the spirit of liberalism of past centuries, especially that aspect of the liberal thought which identifies _status quo_ with natural order of things. (If this isn't so, how could we reconcile ourselves with the memory of England as once major exporter of wheat and raw wool?) As a matter of fact, and as a general principle, not necessarily having an affinity with developments in the Sterling Area, it may be said that a _status quo_ comprising several economies complementary to each other may eventually become an obstacle to new "natural" developments set in motion by forces originating outside the (physical) complementarity of production. As to whether such has been the case in the history of Sterling Area, it will be possible to say later, after the meaning of "complementarity" has been properly examined. As a matter of method, the opening part of this chapter will be description in general terms. Later on, the discussion will concentrate on identifying and assessing the trends within the group.

Indeed, change in patterns of trade within the Area is not a novelty. The advance of technology following the industrial revolution did not leave any of the members untouched and the original advantages enjoyed by Britain began disappearing soon thereafter; and the process still continues.

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The membership of the Sterling Area stretches through most of the climatic zones in the globe, with the members scattered through a wide range of geographical points on the map. Geography and climate have been the factors mainly responsible for the type of commodities produced in the Area. The general type of commodities produced in the Area has not changed appreciably since its inception. What has changed is the relative quantities, either because of shifts in the relative demand or because of the increase in the rate of industrialization with its effects on the patterns of trade generally.[2]

Practically any commodity used in the daily life of people is produced in the Sterling Area. This is far from saying that the Area is a self-contained, self-sufficient unit, as it is in its monetary arrangements. A great discrepancy is evident in production of certain commodities and demand within the Area--a situation which makes both desirable and possible, commercial intercourse with other economic zones (although this type of discrepancy should not be regarded as the only factor necessitating exchange with other zones). On the other hand, other historical factors such as the post-war industrialization of previously economically dependent countries with the insatiably high demands wrought upon the technical apparatus of Great Britain--traditionally the main exporter of capital goods to the other members of the group--forced exchange in an unprecedented scale with other economic zones--primarily the dollar and lately the Soviet areas with effects that may put the whole subject in an entirely new perspective. It is this lack of self-sufficiency, both physical and "historical" (in the sense used above), that provides the basis for an endless sequence of problems that beset the managers who are entrusted with the fate of about six hundred million people--the population of the Area.

Some general examples of "physical" discrepancies follow: The Area produces practically the entire world-supply of mica and jute, while it has to import the better portion of its newsprint and woodpulp from soft-wood forests. It mines 75 percent of the world's diamonds (industrial and ornamental) and produces 60 percent of the world's rubber and tea, and although it is a major producer of raw petroleum, it has to import large quantities of the refined product. Also, the Area is a net importer of cotton[3] and tobacco. Grain, meat and vegetable oils have usually topped the list of imports of the Area despite efforts undertaken on occasions to alleviate the problems within its limits.[4] The Area supplies half of the world's gold (mainly from South Africa), half of the wool and cocoa, and a major portion of tin. The export staples of the Sterling Area traditionally regarded as the major source of strength of the Area (and in years past--of the empire) constitute nowadays a major source of weakness as well, because of the sensitivity of their prices to the fluctuations of world demand as compared with fluctuations in demand and effects on prices thereof of manufactured commodities. This phenomenon, whose description, if not explanation, is associated with elasticity analysis, too well known to be repeated here, appears then to be another source of "discrepancy". Should it be regarded, then, as a third type, in addition to the two already mentioned? It is, indeed, a tantalizing problem, since value-price conceptual relationships are involved here, and the final examination of it rests with that sector of economic theory bordering the field of economic metaphysics, rather than with a paper dealing with more "pragmatic" subjects. Whatever its conceptual positioning, however, no difficulties of any consequence are likely to arise, so long as its existence is recognized and adequately considered.

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A bird's-eye view on the overall relationships within and without the Area is obtained by observing a crude classification of traded commodities.[5] It provides a convenient and logical introduction to the analysis which is beset by all kinds of contradictions. Generally speaking, the outstanding features of this observation, which comprise the Sterling Area broken down to the economics of U.K. and O.S.A. on the one hand and the U.S.A. and Canada[6] on the other, may be summarized as follows: (1) The Sterling Area is not a homogeneous-producing unit. On the contrary, two poles are easily distinguishable, i.e., the pole of the U.K. as contrasted with the pole of the R.S.A. The U.K. appears to be (a) a net importer of what may be regarded as agricultural commodities and raw materials--a situation which is largely matched by the R.S.A. being a net exporter, and (b) the U.K. is a *par excellence* net exporter of manufactured commodities with the R.S.A. being a net importer. The first conclusion then is that what appears to constitute the cohesion of the group so frequently repeated in Chapter I is to be found in "complementarity" rather than homogeneity.

(2) In comparing the economies of U.K. and U.S.A. (dollar area), the latter displays a striking similarity to the former in also being a net exporter of manufactured commodities with the possible exception of certain "specialties" where workmanship and tradition still count, e.g. wool and linen products and spirits. However, the two economies part company when compared as to the character of imports; for, while they both are net importers of raw materials and agricultural commodities, the volume of the relatively few items in which the U.S.A. is a net exporter while the U.K. remains a deficit economy, is so important as to constitute a major *differentia* between them. Such items are wheat and flour, rice, coarse grains, milk and petroleum products, etc., in which the U.S.A. is a surplus country *par excellence*, and

where in turn the peculiar problems associated with raw material surpluses affect not only the economy of the U.S.A. but of other areas as well--the Sterling Area not being spared from their complication. In the sections that follow, the form of trade exchange between the Sterling Area and its principal outside partners will be discussed in greater detail.

(a) U.K. and Rest of Sterling Area

It seems that the present form of relationship of U.K. and Rest of Sterling Area in the exchange of commodities, was sealed with the signatures on the act repealing the Corn Laws in 1846. Much as the repeal itself was a result of the victory of the upcoming force of the industrial classes of the period, it symbolizes the beginning of an unfettered relationship that has lasted for well over one hundred years and which appears to create more and more problems with each passing decade than it solved during a whole century. Britain's relationship with the Empire (eventually Sterling Area) came to be one of complete interdependence, with Britain "specializing" in manufactures and the trading partners in products of nature or, at best, primary manufactures. Generally speaking, "specialization" on either side constitutes a combination of history and nature, although the rules of each alternate as to weight. In some instances, nature has been the only factor, as e.g., in the production of minerals; whereas in the production of--say--wheat, the theory of comparative advantage--a historical rather than a natural phenomenon--offers an adequate explanation.

From the table in the Appendix, it can be deduced further that, of the forty-three commodities listed as net imports of the United Kingdom, thirty-six are net exports of the Rest of Sterling Area; while of the forty-three commodities listed as net exports of the U.K., forty-one are net imports of the R.S.A. Although the correspondence of figures should not give the impression that every single export of the U.K. is necessarily an import to the R.S.A., this holds true for the major part of the traded commodities with some variations. While the percentage of wheat and flour, e.g., imported into the U.K. from the R.S.A. is relatively small, all but a small percentage of rubber and wool imports come from Sterling Area countries. A similar situation is found in Britain's exports. These range from relatively low (both percentage-wise and in absolute terms) exports of spirits to extremely high percentages of machinery, vehicles, iron and steel manufactures, and cotton yarns.[7] Nor should it be deduced that the R.S.A. countries are affected uniformly vis-à-vis the U.K. or among themselves. The classification of all these countries as Rest of Sterling Area is a conventional (and convenient) one, serving some purposes, _ceteris paribus_, but it may defeat its usefulness if applied indiscriminately in every case. Thus the proportion of trade with other members varies from approximately one-third in the case of Iceland, Malaya and Hong Kong to more than three-quarters for Burma, New Zealand and the Rhodesias as well as many of the smaller colonies.[8] Consequently, the individual proportions of trade may be the basis for decisions by these members to remain with the Sterling Area. It is conceivable that, *ceteris paribus*, decisions by individual members may be more crucial for the future of the Area, than aggregate figures for that Area. An examination of the most outstanding relationships within the Area would, therefore, be in order in non-aggregate terms, if the bargaining power of the individual members is to be assessed properly.[9] For purposes of convenience, the countries will be discussed in terms of the commodities they produce rather than vice versa. However, no integrated answer, if any, can be given to the question until an examination of the relationships of Sterling Area, and dollar and other areas, has been completed.

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The major producers of food in the Overseas Sterling Area are Australia, New Zealand, and Ireland. They all depend mainly on the United Kingdom to different degrees for markets. Several of the foodstuffs produced by these countries, e.g. dairy products from New Zealand, are excluded from the U.S.A. market by quota restrictions, and though they have largely replaced wholly or partially other former suppliers to the U.K., the possibilities of competition are always present. Denmark, e.g. with low transportation costs, is a perennial threat as supplier of dairy products (although as a supplier of some processed meats is more so to Canada than to anyone else). Argentina presents another source of competition, but for several reasons which will not be discussed here, Britain would not be too willing to depend on it for all its supplies. Furthermore, as producers of meats, New Zealand

and Australia appear to be as low (or better) cost producers as Argentina, and transportation costs to the U.K. do not differ materially. Ireland, on the other hand, no longer a member of the Commonwealth, depends more heavily on the U.K. market. Cattle is shipped unprocessed to Britain, and alternative markets most likely would not be able to develop because of the high transportation costs involved in shipping unprocessed cattle. The alternative in such or similar cases would be the costly road to industrialization, but this is a point which cannot be discussed here in connection with individual countries.

Regarding wheat (about 15% of Australia's exports),[10] the latter major export of Australia, the situation is very confusing at present in view of the feared developments as a result of accumulated surpluses and the policies of the U.S.A. on this problem. The argument that alternative markets exist in Western Europe whereas the U.K. must turn to the U.S.A. and Canada for supplies,[11] is not strong enough to support the contention that Australia enjoys an independent position vis-à-vis the United Kingdom. The wool position of Australia (50% of its total exports),[12] although no markets other than the Sterling Area mainly the U.K. are certain to exports,[13] is considered as relatively secure (subject, of course, as anything else, to the vagaries of the business cycle), since Uruguay and Argentina, the two principal exporters (and competitors) of wool outside the Sterling Area, would not be able to offer any advantages to the U.K. beyond those offered by Australia and New Zealand. In turn, New Zealand's position is very similar to Australia's. Although wool exports constitute slightly over 30% of the total, the difference is more than made up by the significant quantities of butter and meat, which to New Zealand are as important as wheat to Australia. Tentatively, it may be concluded at this point that exports of the three countries do not provide a leverage sufficiently powerful to make them independent of the U.K. (and through it, of the R.S.A.) ties. As an additional note to the foregoing, it should be mentioned that Australia and New Zealand are two countries whose percentage of national income (25% and 29% respectively for 1949) derived from foreign trade is among the highest in the world, and consequently, any move away from established patterns of trade must be placed in longer term perspective than the perspective required for countries more self-contained as to the sources of their national income. India's and Pakistan's position may also be examined together vis-à-vis the U.K. despite the occasional clashes between these two countries resulting from the antagonistic attitude of the two from time to time. They both enjoy a monopoly of production of jute and jute products, with Pakistan being the main supplier of the raw material and India, the provider of the equipment for the manufacture of jute products, though India is reported to be expanding its raw jute production as well.[14] In a sense, they also enjoy a great deal of self-sufficiency--they produce all but 7 percent of what they consume[15]--and a considerable part of their external trade is carried on with each other. These two countries are important as suppliers of most of the world's mica and shellac. However, these commodities are as foreign exchange earners--behind five other leading commodities, i.e., tea, jute, cotton and products of the two fibres. The tea trade depends heavily upon the London market and, in this respect, it may be said that the ties to the U.K. are compelling. The United Kingdom took about 60 percent of India's, and 93 percent of Pakistan's, exports in 1949-50. In view of Ceylon's piling up surpluses, any market for the Sub-Continent's tea is well accepted. The demand for jute and its products seems to be well under control, because of the monopolistic position of these countries as suppliers and the large U.S. market, which have already grown larger than the British. As a matter of fact, the benefit to London is just as substantial through the acquisition of dollars from exports to the U.S.A. for the pool, as the satisfaction of the U.K. domestic demands for the raw jute. It is worth noting that substitutes for jute started appearing in the U.S. market in increasingly larger quantities following the spectacular rise in raw jute prices after the Korean conflict--a development which certainly creates second thoughts in the minds of the Indian planners.

Summarizing the foregoing, the examination of the export position of the Sub-Continent is not conducive to any conclusions as to the "balance of powers" between these countries and the United Kingdom. As in the case of Australia and New Zealand, additional factors will have to be introduced to put the question in perspective.

The most independent of the London market among Sterling Area countries is the Union of South Africa.[16] Only for the marketing of wool (about 15% of South African exports) is the country dependent upon the U.K. whereas parts of these and other exports, as furs, hides and skins, find their way to the U.S. market.[17] Fresh fruit and by-products also enjoy a good market in the U.K., although in total they are not very significant (about 2.2% of principal exports in 1949 including gold).[18] Otherwise the Union enjoys equally strongly the benefits afforded by the dollar market, because i.a. of the very nature of its exports and their importance to the U.S. economy, such as industrial diamonds, non-ferrous metals (chiefly manganese and chrome). Continental Europe, on the other hand, consumes about as much of its exports as the United Kingdom. About half of South Africa's exports consists of gold which, of course, is never after markets. The Union, by providing the dollar pool with much-needed gold, assists in balancing the perennially deficit position of the Sterling Area. Gold is the asset of the Union <u>par excellence</u> in its relations not only with the United Kingdom but also with the whole of Sterling Area; and, not unnaturally, the country tends away from the group. In fact ever since the Nineteen-Thirties, the position of the Union began showing peculiarities. Special arrangements had been reached. Even during the war, the Union through gold, conducted a policy not very consistent with what is usually regarded as the spirit of Sterling Area; namely, it did not pool its gold in the central reserve, if this meant increasing its sterling balances--a policy diametrically opposed to the behaviour of dependent or independent members of the group. More recently, in the post-war years, this policy has been somewhat reversed--the Government having allowed the accumulation of substantial sterling balances. However, there is no evidence that this accumulation is allowed in order to assist the finances of the Area. Nor is any accumulation of this type significant, in principle, of assistance to the country whose currency is accumulated. The next five years will be crucial in the Union's position.

Lastly, because of their common product, i.e. oil, three countries, namely Iraq, Bahrein and Kuwait, may be grouped together. The story of oil is too well known to be repeated here and therefore any discussion on "bargaining power" possessed by these countries may be redundant. However, the position of these countries as members of the Area merits the special attention of any student of the latter's affairs, for their contribution to the Area in general and to the U.K. in particular is out of proportion to their size or demands. Furthermore, the agreements providing for exploitation of oil resources signed between these countries and the U.K. present several peculiarities, and their effects cannot be assessed easily from statistical tables of royalties or physical exports. An attempt, therefore, will be made to present the case of this group in more concise terms in the next chapter.

In conclusion, it seems redundant to examine the "Dependent" territories, mainly colonies, as to their relative position in their relationships to the Area and to the U.K.[19] Considerations of economic relations disappear before the onerous burden of political dependency, and despite their substantial stake in the economic activity of the group, it is their contribution that is a likely subject of discussion rather than their "bargaining power". Furthermore, the view may be repeated here (and without claims of sound analysis at this point) until an opportunity for its substantiation is afforded in later sections, "that what the colonies contribute to Britain and Britain to the colonies cannot be inferred from trends in their balances of payments and in their holdings of sterling".[20] A conclusion whereby "the principal advantage which the colonies derive from membership of Sterling Area is that they thereby become part of a large area in which multilateral trade is freely transacted in sterling and this area is one in which a very high proportion of their trade naturally takes place",[21] may be accepted only within a very limited framework. It is a conclusion based on a rather static analysis and it could not possibly claim general validity under all considerations of alternative possibilities. True--the colonies under the impact of nationalistic forces gain greater prominence as world powers and their "bargaining power" grows along with their political fortunes. However, this type "bargaining power" is conceptually different from the type that we set out to assess in this section.

(b) The United Kingdom as Exporter <u>to the O.S.A. and Associated Problems</u>

Despite the intention in this section of developing and analysing data related to the physical form of exports of the U.K. to the O.S.A., an apparent deviation from this rather mechanical approach may be necessary, at least as an introduction to the whole question, so that the relationship between the "metropolis" and the rest of the group may be seen in its entirety rather than one of exchange between an industrialized economy and a group of relatively underdeveloped countries. The war developments in the creditor-debtor relationships have already been adequately discussed in the first chapter, so that now it may be mentioned without elaboration that practically the whole of the O.S.A. emerged as a creditor to the U.K., mainly through the medium of the accumulation of credits of sterling which arise out of purchases of the U.K. Government from these countries. These developments turned out to be of great significance for the economic position of the U.K. and are largely responsible, as already indicated elsewhere in the paper, for the new character attributable to a group that had existed <u>de facto</u> as a political and economic quasi-entity long before. "Until 1939 Britain, the banker for the system, had also been the ultimate creditor, and this fact put into the hands of the British authorities weapons of control and the unquestioned leadership attuned to the position of the banker. By the end of the war this position had been reversed and on balance Britain had become a substantial net debtor to the Rest of Sterling Area..... At the same time an entirely new relationship was created between Britain and the other members of the Sterling Area. In particular the problem of..... competitive bidding for British exports <u>in the repayment of claims on London</u> called into being entirely novel problems...."[22] History may discover some day that the Sterling Area of the period following the second world war justified an old logical game "post hoc ergo propter hoc". It has been an unique case of a historical monopoly, and monopsony for the U.K. and the R.S.A. respectively; the former because of its instinctive desire to survive as an economic and political entity into the future by meeting obligations accumulated in moments of dire need; the latter because of its eagerness to collect rewards for sacrifices incurred voluntarily in the past. The problem is being put in its correct perspective, when through an analysis of the exports of the U.K. and the examination of markets--actual and alternative--the relationship that resulted from a force majeure of the war can be shown as having passed successfully the test of the conditions that created it.

It has already been established that the U.K. is mainly an exporter of industrial goods to the R.S.A. countries.[23] The questions posed to the U.K. in this capacity are typical for any seller of industrial commodities in domestic or foreign trade. In summary, does the U.K. possess the ability of supplying its S.A. customers with products and under conditions as good as any alternative supplier could offer?[24] While it is difficult to quantify quality, especially in such general terms employed in international trade, it is hard to believe that Britain offers goods of a quality inferior to an overall average among the industrialized nations. This statement does not require any further support, in view, i.a., of the great success that U.K. exports have achieved in countries in which it entered on a strictly competitive basis.

A tentative approach to this question would be to discuss the major categories of items whose exports to the O.S.A. are regarded as typical of the post-war period.[25] The main items, especially important because in addition to the great volume in which they are exported, they are the most exposed to foreign competition, are: machinery, vehicles, iron and steel manufactures and chemicals with the total of the remainder forming a substantial sum of the exports.[26] A straight statistical analysis of trends of exports to O.S.A. would not seem too consistent with the dynamics of foreign trade in the troubled world of the post-war period even if a "perfect fit" of a trend line could be applied.

The next stage in the approach would be to consider Britain's position in conjunction with the forces that present the most in competitive possibility. It would be partly defeating one's purpose if only competitive forces which operated in the past, were taken into consideration. However, this seems the most pragmatic datum that one possesses where discussion of forces other than the known ones will constitute theorizing rather than expression of experience. Thus the major competitor of the U.K. in the O.S.A. as supplier of industrial commodities has been the U.S.A. These two countries compete in the production of at least six of the eight principal industrial commodities.[27] It appears that the U.K. has been a larger supplier for the O.S.A. than the U.S.A. However, this is not necessarily an indication of strength, since the post-war restrictions of pound convertibility have more often than not forced the use of procrustean tactics.[28] It has been contended that demand by major O.S.A. importers has shifted away from textiles toward vehicles and machinery and that this shift in the type of goods favours the United States. It is difficult to substantiate such an argument despite the generally prevalent nebulous opinion that the U.S.A. is the most efficient producer. It appears that the ability of the U.S.A. to supply war-devastated or capital-hungry countries following the war with heavy equipment and vehicles, has been confused (or interpreted) with structural inability of other nations (and U.K. in particular) to compete in the same field. However, serveral cases in the years following the (technical) reconstruction seem to defy such an interpretation. The British, e.g., have displayed a comparative advantage in producing some types of machinery such as turbines by underselling even American manufacturers in the American market.[29] The British automobiles with their advantages of economy and efficiency began creating marketing problems for U.S. manufacturers in their own U.S. market. The ability of the British industrialists to supply the Chinese market (where their tractors, e.g., are rated very highly according to newspaper reports), is another indication that the shift of demand to this type of import is not necessarily per se favourable to the U.S.A.

The lately announced plans by the British in the field of atomic reactors construction, which because of the "round-aboutness" will constitute a very costly (and profitable) export to a power-hungry world, being ushered at rapid pace to a new phase of industrialization, also indicate that the producers can excel their American competitors as to both technical performance and price. What then? It is difficult to answer in strictly technical terms. Going by past tendencies, it appears that in an absolutely growing market the U.S. position gains relatively at the expense of the British, in spite of restrictions on dollar imports imposed by the Sterling Area countries in the years following the war. Thus the U.S. share of the O.S.A. market grew between 1934-8 and 1948 in four of the six major groups of exports.[30] On the other hand, it may be useful to watch trends in other parts of the world, say in countries which have not discriminated against dollar exports, in order to establish a more neutral source of comparison. Thus in Canada, major imports of iron and steel and chemicals as well as lighter manufactures, have gained impressively during the last several years at the expense of the British again, despite the anticipated difficulties usually associated with lopsided foreign trade relations. (It remains to be seen if the conscious efforts of a Conservative government can attentuate the established trend.) Generally speaking, U.S. salesmanship has penetrated areas inside and outside the Sterling Area which for many years had been the exclusive preserve of the British manufacturer. This penetration was assisted by the conditions created by the war which allowed the American manufacturer entry to places where under normal conditions it would be denied to him, and because of a general factor: namely, the change in the relative position of forces among the competitors which would not permit the application by the British of measures intended to exclude newcomers from competing in previously British dominated markets.

The examination of reasons conducive to the improvement of the U.S. position cannot be confined to the Area alone. It transcends its limits and becomes part of the discussion on the evolution of capitalism in the Western World. Without prejudicing further discussion, it may be suggested here even as an *a priori* proposition that the penetration of Americans as investors (mainly private) has much to do with the gains of the American economy in the field of industrial exports. Capital export, sometimes looking innocuously neutral in its material effects, is very closely intertwined with industrial exports from the capital-exporting country. This, of course, is not a novel phenomenon and needs no further elaboration here. However, the error is usually committed in failing to see the resulting connection between capital movements and movements of merchandise in its consequences, although a lip-service thereto is usually paid without obligation.

The latter part of this discussion is based on only recent and scantier evidence. However, *a priori* theorizing on the role of factors to be introduced here can be supported adequately on the basis of past experience (limited but impressive) as well as on logical grounds. The factors to be introduced are two: the U.S.S.R. and Germany. While the latter has had some experience in years past with what constitutes the Sterling Area today, the former is a newcomer not only to the Sterling Area markets but to the world's industrial markets in general. They are mentioned here together, not because of any intrinsic relationship between themselves but because they both (each in its own way) are potential competitors in the S.A. market, similar to the U.S. exporter but with their own peculiarities which complicate their role. In introducing the discussion on the U.S.S.R.'s role, it will not be necessary to present it in its political context, already adequately covered for the last four decades; taking it for granted may be permissible as long as it remains in the Subconscious of the student. The role of the U.S.S.R. as major exporter of industrial commodities had been planned long ago,[31] i.a., as a consequence of the growing industrial might of the U.S.S.R. and countries in its politico-economic orbit, but it did not take effect until after J.V. Stalin's death (and not as a result of it, as many naively tend to think) through pompous announcements of economic "assistance" by the successors to power of the late dictator. By design or chance (because probably, if the latter is true, of the geographic proximity or the relatively unstable political and social conditions), the efforts of the U.S.S.R. exporters were concentrated on the soft "underbelly" of the Sterling Area, i.e. India, Burma, and later, Ceylon and Pakistan with offers of trade and assistance exceeding the boundaries of S.A. In a sense, the type of competition that the new competitors is forcing in the old established markets is, in its technical aspects, very similar to the type in which the U.S.A. participates, i.e. heavy equipment (electric power plants, steel furnaces and chemical factories) and vehicles, mainly earth-moving equipment, as well as oil-drilling machinery, et cetera. Obviously the United Kingdom is not the only country that may be affected by such competition; the U.S.A. may be equally concerned. To assess the real reasons for the Soviet possibilities of success in those areas, it will be necessary to abandon any consideration of qualitative comparison,[32] in favour of examining the role of other forces which appear on the world's scene with such an impressive impetus that not sufficient analysis has yet been carried out. The major advantage enjoyed by the Soviet (and associate) exporter is his ability to compete price-wise through manipulation of prices of individual items by compensating with others. Although in total, the Soviet economy is subject to the same forces as any other economy (despite the notion entertained by journalists that the all-powerful Soviet state can indulge in a continuous subsidization of exports at no penalty), the "juggling" of prices for individual commodities to exploit individual competitive gaps is naturally easier in an economy where the profit and loss will affect one owner than for private merchandisers who are inhibited in their action by their inability to "pool" or "tie" their exports with each other.

Equally serious to this characteristic, however, is the combination into one unit of the function of the banker and exporter. The unique conditions of credit (2 to 2½ percent interest on as many as 20-year maturity loans) offer a hard-to-resist temptation to capital-short countries which try their wings for the first time in the flight towards industrialization. However, even this latter characteristic would not be irresistible, at least in the long run, if it were not for another element that, so far, has constituted a perennial disturbance in the relations among the countries under discussion and their industrial partners. This is the element of the surpluses of agricultural and, in general, all types of raw materials, which from time to time regularly, though not rythmically (to use an impressive phrase coined by the late Prof. Pigon in describing the nature of the business cycle) have plagued the economies of these countries. The U.S.S.R. has turned this handicap of the world of private enterprise to its advantage by offering barter agreements to virtually all capital-needy countries inside and outside the S.A. in exchange for exports of industrial commodities.[33] As to whether such arrangements are temporary moves intended to widen the rifts in the economic fabric of the world of private enterprise in order to gain more permanent political advantage for the U.S.S.R. later, or such an intercourse can be sustained and bring about mutually beneficial benefits to both parties involved is a question whose answer cannot be given separately from the analysis of the overall texture of socialized economies. Therefore, for the purpose of this study, it still remains an open question.[34]

The latter major challenger, just beginning its moves into the Area with more active participation to come, is Germany. The following incident may summarize a latent situation in the German thinking on the subject: The editor of a German financial journal, having been told that some people in Britain were questioning the benefits of the Sterling Area, commented, "Very good. Now perhaps those Empire countries will be freed from central control and world payments will become more free".[35] If one substitutes more real terms in the hoped-for situation for the financial terms used in the above quotation, the desire of the German industrial exporter can be easily seen. Moves by West German private concerns have been reported lately in India, Egypt and some neighbouring countries in the fields of heavy construction (e.g., bridges and steel mill construction by the Krupp companies in these areas and exports of locomotives through a number of kindred economies) and although it is still early for collecting data that might serve as basis for assessment of trend, an _a priori_ thought that the efforts towards expanded exports will continue unabated is consistent with both past behaviour of the German exporter and the efficiently aggressive nature of any private trader. To this, it may be added that the German state, despite the persuasive arguments of Prof. Erhard towards a _laissez-faire_ policy at home, has not abandoned altogether the old notions, promulgated in the form of principles by Friedrich List and engineered by Dr. Schacht in the field of international, mainly export, trade. Cartelization of one form or another, official state export subsidies coupled with an efficient organization of commercial attachés, and all in turn supported by a powerful diplomacy which takes advantage of the precariously delicate equilibrium of political forces in a very skilful way, render the most ideal support to the relentless efforts of the private trader. The German export machinery ultimately may not differ very substantially from the Soviet competitors in so far as the latter's economic and organizational advantages are concerned.

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Attempts towards measuring elasticity of substitution of manufacture in the past indicate that the average rate is about the same for the major industrial powers of the world.[36] Despite the difficulty of statistically measuring substitution, analysis of the nature of modern technology is quite convincing as to the high degree of substitution of industrial output among manufacturers. Experience with technology, but mainly consequences of economic competition in the field of politics, renders a judgment of that kind axiomatic. It may not be altogether out of place to recall with F. Nietzsche that "All mountains above a certain altitude are covered with snow".

Conclusions

In this chapter, an attempt was made to present the comparative advantages that hold the members of the Sterling Area together. It was not for purposes of convenience that the distinction between the United Kingdom and the Overseas Sterling Area was made. The distinction has been the objective result of a long historical process and the whole *raison d'être* of the group has hinged precisely on the contrast between the two types of economies represented by the U.K. and the Overseas Sterling Area (with due considerations of differences within the latter) respectively. Under this assumption, calling this relationship "complementary" may be preposterous and defeating the purpose of analysis if used as an *a priori* notion; for the purpose of any analysis of this type is really the examination of whether the "complementary" character is an attribute of history or of technological factors. Otherwise the dynamics of history are completely missed and the designed pertinent policies may follow unrealistic paths.

The answer to this question, i.e. the nature of the "complementary" character, although just beginning to take shape, is still far from supported by sufficient arguments to a final conclusion. Additional material in later sections will be required before any integration is attempted. However, it would be not inconsistent with this line of thinking to disregard the question in the first stage of the argument and confine the problem to what was set out for examination in this chapter; namely, if the United Kingdom and the Rest of Sterling Area really need each other and can afford each other as trading partners. The discussion was based on devaluation of (a) the United Kingdom as market for the agricultural products and other raw materials offered by the Overseas Sterling Area with consideration of alternative possibilities of marketing the same products, and (b) the Overseas Sterling Area as a market for the industrial production of the United Kingdom, by considering alternative suppliers of industrial commodities to an existing market.

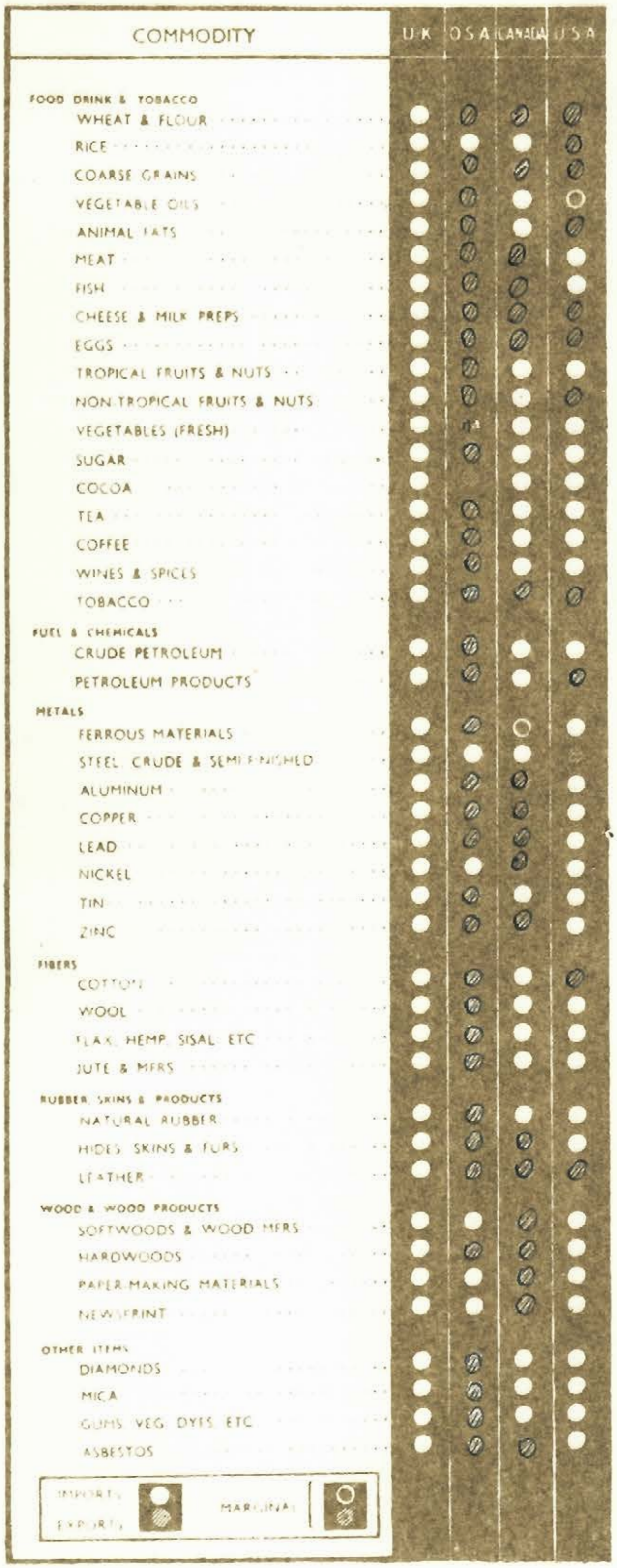
The discussion had to depart from its technical framework, strictly speaking, for the operation of general economic conditions outside the group (such as world surpluses of farm commodities) renders absurd a discussion strictly defined in technical terms. Thus, after examination of what by past experience have been regarded as the main export items of the O.S.A., it was established that while alternative markets (i.e. other than the U.K.) may exist for these commodities, so exist most frequently (with some exceptions) competing sources of similar commodities outside the orbit of the Sterling Area.

Regarding Item (b), it was established in empirical terms, for reasons already explained, that no technical superiority of the U.K. as the main supplier of industrial commodities over actual or potential competitors is evidenced, and that inroads made by the American exporter at the expense of his British counterpart in the post-war period may be of more than temporary significance. The role of new forces coming onto the scene, namely the U.S.S.R. and Germany, was introduced in the discussion. Finally, the implicit conclusion was reached that on technical grounds alone, the relationship between the two poles of the group could not be justified.

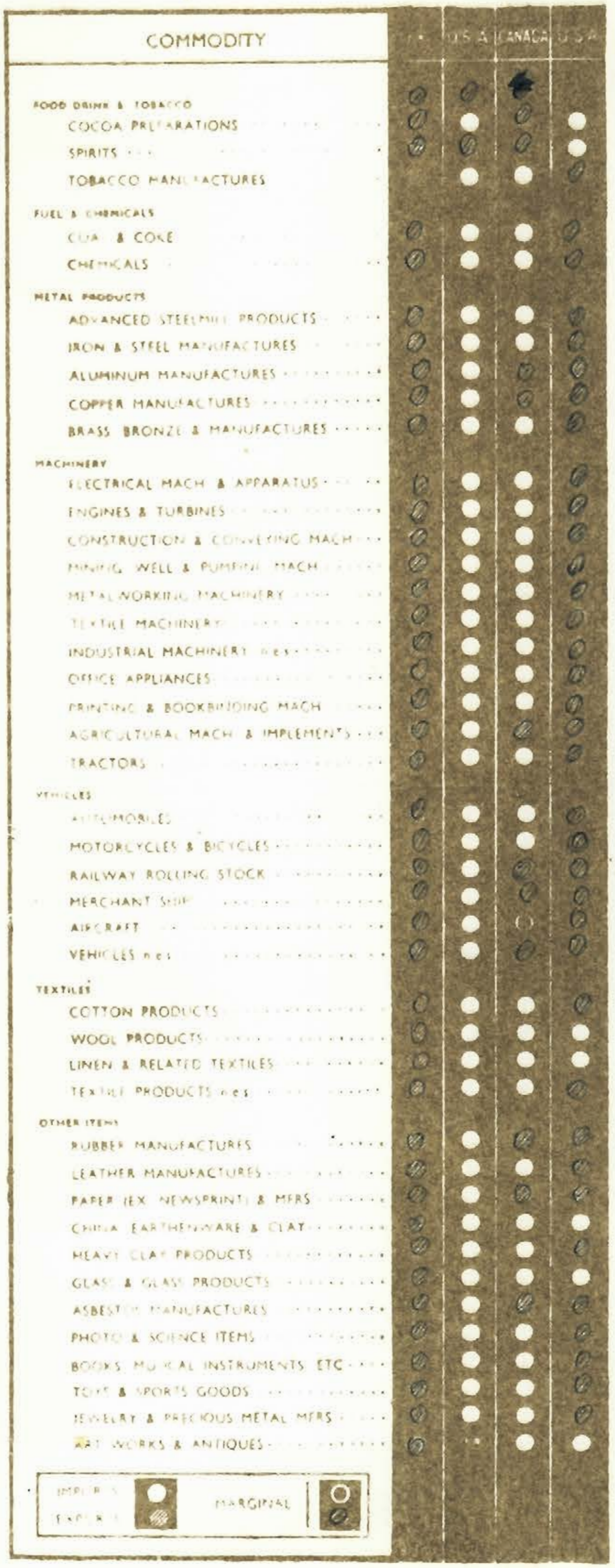
Thus, in the opinion of this writer, the elements of this chapter added to the knowledge of the subject can only serve to strengthen the notion that, although present arrangements strongly evidence a mutually satisfactory complement in the economies of exchange between the two poles, the position of relative equilibrium is an unstable one, and that the subject begs of further research for the development of the proper perspective. Analysis of questions related to the balance of payments and re-examination of the classification of grouping within the Area may shed some light on the problem.

1. Net Imports and Exports of United Kingdom, Overseas Sterling Area, Canada, and United States, 1948

A. UK Net Imports



B. UK Net Exports



APPENDIX II to CHAPTER II

Principal United Kingdom Exports to the Overseas Sterling Area

Commodity	1949:50 £ Million	Exports to O.S.A. as percent of total value of U.K. exports of commodities in 1949:50
Machinery	206.8	52
Vehicles	161.5	49
Iron and Steel Manufactures	92.8	55
Cotton yarns & piece goods	80.9	68
Chemicals	45.1	46
Wool products	45.1	34
Synthetic yarns & piece goods	27.9	79
Selected non-ferrous metals & products	20.0	47
Paper & manufactures (incl. newsprint)	16.3	70
Refined sugar	10.4	43
Leather & manufactures	5.0	28
Books	4.5	63
Spirits	3.1	13
Total of above	719.4	56

SOURCE: Based on Table 3, Ref (2).

CHAPTER III

GENERAL

Hitherto, the analysis has been a static one. Despite occasional discussion of trends, which sometimes is regarded as dynamic analysis, for it involves change-over times (which by some is understood as the meaning of economic dynamics),[1] it was the static element that prevailed throughout, the main effort having been concentrated on (a) the description of the components of the structure of the Sterling Area (monetary and "real"), and (b) the discussion of the cohesion of the Area, i.e., the raison d'être of the Area. The description of the components served the dual purpose of, firstly, defining the Sterling Area in its economic, political and geographic terms and, secondly, of providing the material basis for search of an answer to the second item, namely the cohesion of the Area. Although conceptually, these two are related, so much so that quite frequently students of the subject interchange freely between the terms "structure" and "cohesion", the identity is not a necessary one. This has become evident through the preceding chapters. Quite frequently, the discussion was forced to reductio ad absurdum and consequently, the discrepancy between structure and cohesion was affirmed. The a priori notion that monetary arrangements usually reflect other basic relationships was found as justified in the case of the Area also, and the much-celebrated "complementary character" of the economies of the members was established as an ex post historical meaning rather than of technological significance. As such, it adds more questions to the problem than it answers.

However, the Area is a fact and not an intellectual creation. Since neither monetary nor "real" components were found adequate in giving an explanation of its substance, the further approach to the problem should be developed along the lines of (a) analysing any elements in the economic process other than the monetary and the considered "real" components as they may be found in the "balance of payments" of the countries concerned, and/or (b) questioning the very meaning of the classification of the Area as one group. As far as the latter is concerned, assistance was given by the a priori knowledge of significant historical differentials of economic development existing among the members which usually have a bearing on the established balance of powers.[2] A study of the available material seems to justify the approach. The heterogeneity of what has been regarded hitherto as one group is reflected in the Balance of Payments figures of the various units. Not only the relative heterogeneity of the group is evident, but also the relationships among the members of the group, as seen through the balance of payments mechanism, provide an integrated basis for the explanation of the "cohesion". Through further induction within the dynamic process, such questions as behaviour of foreign investment and domestic capital formation will be taken up. As a consequence to the questioning of the meaning of the "group" mentioned above, the analysis will assume a more detailed form than previously and the "groupings" of units which may be required from time to time will serve as a convenient abstraction, and will not necessarily reflect conventional nomenclature. It may, therefore, become necessary on occasions to have a fresh look at definitions which have already served other purposes.

It has been found convenient to direct the discussion from the Colonial Territories--a major part of the "inner circle" of the Area--to the outlying or "independent" members. A certain degree of overlapping in the presentation of the information will prove helpful in the intended differentiation. This reconstructed approach is expected to serve additionally the ultimate purpose of the analysis; namely, the meaning of the cohesion of the Sterling Area and its logical sequel, the Prospects for the Sterling Area.

A. The Colonial Territories

Tentatively defined, these territories are those for which the Secretary of State for the Colonies is responsible to parliament, together with the self-governing colony of Southern Rhodesia. Despite the deficiencies of this legalistic description (rather than economic definition), it may be agreed that these territories do represent the economically most dependent areas of the S.A. group in the sense of being the par excellence producers of raw materials of the farm or mine, and relying on outside producers for most of their needs of items of manufacture. There is no reason to depart from the description of this relationship from the time-honoured pictures of Metropolis and Colonies. These territories cover an area of over two million square miles and have a population of over 75 million. They are widely dispersed geographically, probably offering a representative sample of the geographic dispersion of the whole of Sterling Area and, in general, they display extreme diversity in every important characteristic. Their political status varies from a lower level of absolute tutelage to complete autonomy with still more interesting, intermediate gradations. A characteristic of the post-war years is not so much the status itself as the preparations of change in status towards independence for a number of these territories which follow the kaleidoscopic course of history at an accelerated pace which offers a striking contrast to the desultory steps of pre-war years.

A similar picture, sometimes but not necessarily related to their political status, is presented in their economic development, which differs from the pastoral Somaliland to the highly organized trading and financial centre of Hong Kong and the efficient structure of rubber-producing Malaya. Their resources, although not completely inventoried, are as a rule rich, and the inhabitants become more and more aware of it. In general, they offer a _par excellence_ picture of what has come to be known in post-war years as "the underdeveloped countries" and as such, they pose a number of questions ultimately begging for solution in the political field along with other countries of a similar status but of different Commonwealth alignments. These questions are bound to affect the future of the world. However, a proper assessment of the future will have to be made through the present relationships within the economic systems of which they are members, since their present status may be in a functional relationship with the rest of the system and it would definitely be affected by it.

The emphasis in the introduction may appear out of perspective, if the size of the colonies were seen in comparative terms with the Rest of the Sterling Area system. Indeed, their population constitutes only one-eighth of the number of the Commonwealth of Nations' inhabitants and slightly over 25 percent of the area of the Overseas Sterling Area. However, comparisons of this type do not render justice to the magnitude of the problem. Firstly, the colonies present, in a somewhat more dramatic way, problems shared by major (quantitatively) countries whose political set-up may differentiate them from the colonies, but which, however, is not a true reflection of the status of their economic development. Secondly, the relationship of some of the colonies or dependencies is one of highly qualitative nature forming a link in a chain of economic relationships which, if broken, might bring about repercussions on the whole Area far out of proportion of the colony's size to any general value. An example, not a typical one but befitting the argument and frequently quoted, is the case of Bahrein and Kuwait, both small sheikdoms located in the area of the Persian Gulf. Kuwait is the largest producer of petroleum in the Sterling Area, with 13 percent of the world's proved reserves (as of the end of 1950).[3] Bahrein and Kuwait together contribute nearly 40 percent to the total oil imports of the United Kingdom;[4] namely, a pool of oil equal in importance or even basic to the existence of a pool of dollars. As an adjunct to this, it may be added that owing mainly to the climatic conditions, colonial products are in many cases such as cannot be readily or economically produced elsewhere, and that the market for these products is exceptionally wide, since it includes not only agricultural and industrial countries but both sterling and dollar areas.[5] Finally but not least, the nationalist torrent of the post-war period seems to have repercussions on the political and strategic alignments of the world far out of proportion to the size of the moving colonial units. Malaya and Cyprus offer impressive examples.

Notwithstanding remarks on the character and availability of statistical data in the introduction, some notes on the same subject in the case of the colonial territories may be pertinent here. The difficulties in obtaining data on foreign trade in desirable groupings is not necessarily caused by technical deficiencies in the statistical organization of the colonial office. The meaning of foreign trade as applied to the colonies is indeed a conceptually controversial one. The old classical view that it is more like domestic trade because, apparently, of the monopolistic and monopsonistic positions enjoyed by the "mother country" in the colony's economy, seems to have permeated the thinking of the persons charged with the statistical description of the colonial trade relations. The raging controversy as to the relative contribution of colonies and metropolis to each other's welfare does not help matters. Value judgments are helplessly intertwined with expediency of maintaining statistics altogether.

Generally speaking, the statistics for the colonies, despite the frequent (and sizable) revisions in which the U.K. authorities indulge from time to time, have no reason not to be reliable for what they are intended to portray. The difficulty arises, as in most subjects involving statistical analysis, only here more so, in the things that are conceptually susceptible to manipulation, and which may defeat the purpose of statistical presentation if the latter is taken at face value. The relation, e.g., between sterling and colonial currencies, is so direct and mechanical a one[6] that it "creates some ambiguity as to how far colonial currencies can or should be distinguished from sterling".[7]

Notwithstanding the foregoing difficulties, there are still some substantive guides of analysis. Data on the type and the direction of movement of commodities, e.g., could be evaluated confidently, and certain reconstruction or reclassification of aggregates in a manner that would eliminate the ethical aspects of metropolis-colony relationships, could be arrived at by co-ordination of more than one source of information. The rest is interpretation which, of course, is a subject not related to the nature of the data, but to the Weltanschauung of the student.

Colonial Balances of Payments

The main difficulty with statistics on the Colonial Balances lies in the lack of figures indicating total investment in the colonies, although figures on public investment become available from time to time. Also the degree of information is not uniform for all colonies but as the raw data shall deal with aggregates mainly, the significance of the latter statistical discrepancy is minimized. Transactions of British-owned oil companies are not included in the exports but this item is evaluated elsewhere separately.[8] Inter-colonial trade is excluded since the colonies are being examined as a group in its relationships to other groups of economies.

Frequent reference will be made to the following material which is tabulated together for the purposes of reading convenience:

TABLE III. 1.

External Accounts of the British Dependencies

With Dollar Area ($ million)	1946	1947	1948	1949	1950	1951	1952	1953
Imports	n.a.	n.a.	310	220	130	210	190	170
Exports & Re-exports	n.a.	n.a.	495	390	505	645	515	425
Trade Surplus	n.a.	n.a.	(185)	(170)	(375)	(435)	(325)	(255)
Other (net)	n.a.	n.a.	21	32	33	26	54	52
Gold sales to the U.K.	24	22	27	27	28	25	7	1
Dollar Surplus	158	62	233	229	436	486	386	308
Transactions with O.E.E.C. countries ($ million)				(-30)	(143)	(20)	(48)	(-3)
Sterling Balances (£ million)								
At end of Yr.	504	510	556	582	754	968	1,076	1,161
Change	50	6	46	26	172	214	108	85

SOURCE: Table No.24 Ref (7) based on Cmd. 8976 and 9119.

TABLE III. 1.A.

Changes in Colonial Dollar Position

	Change in Dollar Earnings Compared with Previous Year ($ million)	Change in Dollar Imports Compared with Previous Year ($ million)
1949	-105	-90
1950	115	-90
1951	140	80
1952	-130	-20
1953	- 90	-20
Total	-70	-140

SOURCE: Table 24 Ref (7) p.195, corrected for errors in the Earnings Column.

TABLE III. 2.

Dependencies' Balances of Payments on Current Accounts by Areas

(£ Million)

	1950	1951	1952	1953	Total
West Africa					
With Sterling Area	13	19	5	10	47
With other areas	34	31	25	26	116
Total	47	50	30	36	163
East & Central Africa (incl. Aden)					
With Sterling Area	-8	-6	-33	-72	-119
With other areas	14	19	29	31	93
Total	6	13	-4	-41	-26
West Indies (incl. Bermuda & Bahamas)					
With Sterling Area	-9	-13	-10	2	-30
With other areas	7	0	-5	1	3
Total	-2	-13	-15	3	-27
Malayan Area (incl. Borneo, Brunei & Sarawak)					
With Sterling Area	-59	-29	-55	-55	-198
With other areas	150	151	80	30	411
Total	91	122	25	-25	213
Other Territories					
With Sterling Area	-2	2	5	6	11
With other areas	0	-4	-2	-6	-12
Total	-2	-2	3	0	-1
Total (Excl. Hong Kong)					
With Sterling Area	-65	-27	-88	-109	-289
With other areas	205	197	127	82	611
Total	140	170	39	-27	322

SOURCE: Table No. 25 Ref (7) based on Cmd. 8856 and 9169.

TABLE III. 2.A.

The Direction of Colonial Trade

(Percent of Total Trade of U.K. Dependencies)

	Exports To				Imports From			
	U.K.	R.S.A.	$ Area	W. Europe	U.K.	R.S.A.	$ Area	W. Europe
1937	20	12	30	19	27	12	8	9
1950	23	16	21	13	27	20	9	8
1951	27	17	17	14	24	18	7	14
1952	31	15	14	14	29	17	7	12
1953	32	16	14	30	30	18	7	18

SOURCE: Table 28 Ref (7) based on International Financial Statistics, July 1954, p.29.

TABLE III. 3.

Dependencies' Balances of Payments on Current Account by Transactions

(£ Million)

	1950	1951	1952	1953
West Africa				
Imports (f.o.b.)	-103	-138	-160	-160
Exports (f.o.b.)	169	222	223	223
U.K. grants to colonies	4	2	5	3
Other invisibles (net)	-28	-36	-38	-30
Balance	42	50	30	36
East & Central Africa (Incl. Aden)				
Imports (f.o.b.)	-112	-150	-178	-176
Exports (f.o.b.)	146	211	236	200
U.K. grants to colonies	5	6	6	4
Other invisibles (net)	-39	-54	-68	-69
Balance	0	13	-4	-41
West Indies (Incl. Bermuda & Bahamas)				
Imports (f.o.b.)	-74	-94	-106	-101
Exports (f.o.b.)	51	59	65	80
U.K. grants to colonies	4	3	5	4
Other invisibles (net)	16	19	21	20
Balance	-3	-13	-15	3
Malayan Area (incl. North Borneo, Brunei & Sarawak)				
Imports (f.o.b.)	-253	-423	-340	-281
Exports (f.o.b.)	406	635	401	274
U.K. grants to colonies	4	5	10	9
Other invisibles (net)	-70	-95	-46	-27
Balance	87	122	25	-25
Other Territories				
Imports (f.o.b.)	-48	-61	-67	-67
Exports (f.o.b.)	32	44	51	47
U.K. grants to colonies	1	1	2	2
Other invisibles (net)	12	14	17	18
Balance	-3	-2	3	0
Total (excluding Hong Kong)				
Imports (f.o.b.)	-590	-866	-842	-778
Exports (f.o.b.)	804	1,171	967	817
U.K. grants to colonies	18	17	28	22
Other invisibles (net)	109	-152	-114	-88
Balance	123	170	39	-27

SOURCE: Table 26 Ref (7) based on Cmd. 8856 & 9169, Colonial 298.

TABLE III. 3.A.

The Sterling Assets of the Dependencies

(£ Million)

	1945	1949	1950	1951	1952	1953	Change During Period
West Africa	100	200	256	333	362	400	300
East & Central Africa	100	138	172	217	259	288	188
Malayan Area	115	107	164	252	283	282	167
Hong Kong		68	94	116	120	132)	
West Indies	(210	67	78	81	91	107)	144
Others	(	90	88	91	107	115)	
Total	525	670	852	1,090	1,222	1,324	799
Of which:							
Securities of Dominions & Colonies	71	88	98	122	146	163	92
Obligations of the U.K.	454	582	754	968	1,076	1,161	707

SOURCE: Table 29 Ref (7) based on Col.298, Cmd. 8976, 9169.

Note: The area breakdowns are from Col.298 in which a somewhat different approach was used from that of the other cited command paper. There is, therefore, a slight discrepancy between these figures and previous tables.

Some conclusions may be readily drawn from the foregoing figures. Although any attempt to fit a smooth trend curve in order to obtain a future value would be futile, the existence of a situation through the persistence of a certain performance cannot easily be denied. The following summarize some aspects of the colonial trade movements.

Firstly: (From Table III. 1, it becomes evident that the dollar surplus is a persistent phenomenon in the colonial trade balances. The years 1950 and later reflect largely the impact that Allied stockpiling, necessitated by the Korean War, had had upon the dollar-earning position of the colonies. However, the relative dollar-earning capacity of the colonies (i.e. high ratio of dollar exports to dollar imports) could, and most likely would, persist because of the greater susceptibility of the colonies to import controls than the independent units of the system. This behaviour, quite common even among politically independent countries as a solution of first resort during the 1930's, is most likely to continue. It seems that the Bretton Woods agreements are far from materializing the dreams of their creators, and at any rate, there is no reason why the dreams should materialize through the colonies first, if ever. An indication of such, typically procrustean, policies is offered in Table III. 1.A. where for a period of five, mostly buoyant, years a net change of $70 million in dollar earnings through trade runs parallel to a net decline in dollar imports twice that amount. The suggestion is made [9] that "the colonial contribution to the Sterling Area has been maintained by tightening colonial quotas on imports from the dollar area". The machine of control is indeed an effective one.

It has already become obvious that the "economizing" of dollars transcends in significance the boundaries of the colonies, reaching the life-blood of the whole Sterling Area, namely the Dollar Pool already described in previous chapters.

However, by observing Table III. 1, a <u>second</u> tendency becomes evident; namely, that the contribution of the dependent territories to the "dollar pool" is not only one of dollars; but that their earnings have been converted to sterling credits rather than to imports from the Sterling Area, as one, thinking in terms of normal trade-balancing, would expect as a compromise within the framework of the Sterling Area. Naturally, short-run increases of credit balances, usually playing the role of foreign exchange reserves, constitute normal behaviour, or even intentional tactics on the part of trading nations. However, in the case of dependent territories, the size of sterling balances has increased by about 130 percent within eight years. Accumulating credit balances of another trading partner's currencies (although usually objectionable on general grounds if persisting[10] to the point of creating dangers of disequilibrium), is regarded as a sign of economic strength on the part of the creditor. This could not be the case with the colonies, however, because of the lack of freedom in pursuing economic policies of any type.

Equally significant in judging the accumulation of credits may be regarded the fact that these occurred during a period which, despite the difficulties faced by the Sterling Area as a whole, represents a highly prosperous phase of the business cycle of the Western World taken as a whole.

As an adjunct to these observations, it may be remarked that the credits, which are generally invested in short-term securities, are mainly placed with the U.K. authorities, although as already mentioned earlier, the dependencies can invest in other Commonwealth securities as well. For purposes of general analysis, it may be significant to present a tentative picture of the situation on vis-à-vis the members of the Sterling Area other than the United Kingdom. From Table III. 3.A, it may be deduced that colonial holdings of the securities of the members in question more than doubled at the end of the time series, although the rate of increase was slightly below that for total sterling assets. Still, the investment of the colonies in this type of security amounted on an average to 13 percent of the total, with the main bulk held by the United Kingdom.

From the standpoint of geographic distribution, three areas, namely West Africa, East and Central Africa, and Malaya, held about two-thirds of the total of colonial balances. British West Indies, on the other hand, presents some peculiarities (especially since the discovery of oil there) and may play a more significant role in the future of the U.K., despite the announced Federation. It may be pertinent here to elaborate upon the type of trade of these areas, for it is precisely the type of trade there--in particular their exports--to both sterling and non-sterling markets that made possible such an impressive accumulation of credits. Furthermore, it appears that they are exporters of par excellence special commodities--a feature which may be of some significance in the cohesion of the area because of the relatively low degree of substitution, which is not the case with other exports, as already indicated in Chapter II above. The slight risk of duplicating part of the information already supplied previously will be offset by the advantages of analysis afforded by the better perspective in which the colonial and Sterling Area questions will be placed.

Thus, West Africa is a major producer of cocoa which is its major crop and its largest single export (about 35 percent of total exports as of 1949[11]) and constitutes one of the most valuable dollar earners of the Sterling Area, mainly because of the high demand of this commodity in the United States and Canada. (The size of production and export is not uniform for all territories comprising West Africa but, for purposes of this discussion, it is not deemed necessary to supply more detailed information by areas.) The exports of the commodity from this area represent about 50 percent of the world's total trade.

Next in importance come ground nuts and palm kernels, exports of which together about equal the cocoa trade. However, other items in other categories of commodities have some peculiarities as elements of cohesion despite the relatively low position they occupy as percentages of aggregate trade. The area has extensive mineral deposits, i.e. gold, manganese, and bauxite, diamonds and iron ore and tin (in which the B.W.A. is the second largest producer in the Commonwealth exceeded only by Malaya).

As to the export pattern in general, the United Kingdom took around 66 percent of the total in 1949, with the United States occupying second place with 16 percent, and the European countries--third with 10 percent. This is different from pre-war experience when Europe occupied second place with an average 33 percent of exports of the B.W.A.

The developments in the political relationships of the area to the United Kingdom, with the most significant countries changing status from dependencies to dominions, though not of immediate consequence at present, may eventually add to the intensity of the "creaks and groans" of the Sterling Area as a whole.

East Africa is a major producer and exporter of cotton, sisal and coffee, with cotton constituting about 40 percent of the area's exports. It is also a major producer of diamonds in post-war years (chiefly through the discovery of diamond deposits in Tanganyika) which have been marketed, mainly through the South African concern of De Beers Consolidated Limited. Ironically, although not out of line with the general colonial pattern, B.E.A.'s main imports consist of cotton yarns and piece goods, as to counteract its chief export of cotton to the metropolis.

The general distribution of exports differs from B.W.A.'s in that India is one of the major buyers of goods from this area (mainly cotton whose exports to India reached as much as 65 percent of total exports), ranking only second to the United Kingdom, with Europe and the United States interchanging the next place.

Central Africa is characterized by the unsuitability of soil and climate for raising foodstuffs and the farming carried on by the natives is of the subsistence type. The main exports are tea and tobacco, but copper from Northern Rhodesia is regarded as a very valuable commodity. (It constitutes over 85 percent of the exports of N. Rhodesia and its mining employs about a third of the gainfully occupied population.) Because of its importance as raw material in modern industry, it is regarded highly because of the contribution it makes as a dollar saver to the balancing of dollar accounts of the whole Sterling Area. The pattern of export trade is not different from that of the other colonial areas already discussed, with the United Kingdom occupying first position, and the United States and Europe following. However, about a tenth of the export trade is conducted with the Union of South Africa.

The Eastern Group of Colonies, i.e. Colony of Singapore and the Federation of Malaya, is well known for its exports of rubber which constitutes over 40 percent of the colony's exports, and tin--about 15 percent. Unlike the other colonies, the colony's exports are directed mainly to the United States with Europe and the United Kingdom following. The percentage going to the United States (about 26 percent in 1949), however, was considerably lower than before the war, and shows a downward trend in the post-war years with corresponding increases of the percentages for the Overseas Sterling Area and non-sterling O.E.E.C. The proximity of this area to the Chinese People's Republic, coupled with internal rebellion which started immediately following the end of war and the perennial rice deficit, the staple diet of the population--all these factors considered together point out to the precariousness of the British position in this fringe of the Sterling Area.

The British West Indies (presented here for comparison), which constitutes the Atlantic fringe of the Sterling Area, has been traditionally one of the major sugar exporters in the world, though production and export of petroleum has increased in importance since before the war, with Trinidad being considered by 1949 as the fourth largest oil producer in the Sterling Area. The region's other mineral resources are chiefly in British Guiana, the world's second largest producer of bauxite, exceeded only by the neighbouring Dutch territory of Surinam. Between 1947 and 1949, British Guiana produced nearly a quarter of the world's total in bauxite. Like most of the other colonial territories, B.W.I. has its principal export market in the United Kingdom, which through a series of purchase agreements, is taking between 40 and 50 percent of the colony's total exports. In addition, B.W.I. is a direct dollar earner through exports of sugar and bauxite to the Canadian market, and the development of a prosperous tourist trade strongly supported by North American visitors.

It is probably deserving of mention that changes in the field of the political relationships with the United Kingdom are bound to affect the economic alignments of the area in view of: (a) the proximity to the North American continent--a very important market and source of industrial supplies--and (b) the strategic position occupied by the colony in relation to the South American countries, which are usually associated with the sphere of U.S. economic interests. With this technical but necessary parenthesis on some detailed aspects of particular colonies completed, the discussion can be returned to the consideration of the colonies as a group.

Since trade of the colonies is subject to direction by the administrators of the "pool" who operate, i.a., through the various Marketing Boards of the Colonies, the normative element in the behaviour of the trade and items affecting the general balance of payments (and not simply the dollar imports), should be expected to prevail. This becomes quite evident from Table III. 2.A. describing the direction of total trade. Thus, the <u>third</u> observation depicts the sharp decline of the dollar area as market for the colonial exports. Despite their increase in absolute amounts, exports from colonies show a tendency, if not away from the dollar area, at least towards Sterling Area (either directly or through the medium of W. Europe)--

a tendency which is having something to do with the general cohesion of the Area, regardless of its normative or positive origin. This phenomenon will be better evaluated when contrasted later with tendencies of the Independent Members of the Sterling Area. It is, moreover, rather dramatically emphasized by the almost stationary (slightly declining in fact) percentage of imports from the dollar area which in itself is a matter of great controversy among the parties concerned.

Colonial Investment

The term "investment" has so far contributed more to the general confusion of the economic semantics than to the clarification of the relation "consumption-investment" and through it, possibly to the discovery of any clues toward the general economic process. It is, for instance, common knowledge to the majority of students of economics that the major element of controversy in the interpretation of the Keynesian theory centres around the discussion on the meaning of the "savings-investment" relationship, on which, as appears to be the case, the cornerstone of the whole theory has been built. In turn, the length and promiscuity of the controversy indicates that it is not so much the implicit functional relationship between the two values in question that is the cause of the difficulty as it is the superficiality with which the term "investment" has been so far regarded. It appears that even after several years of bitter disappointment, the bookkeeping-flavour of the term is assiduously chasing the concept; whereas any attempt towards its clarification to the point of practical consequency, founders prematurely. It is not within the competence of this study to follow the subject any further. However, this introduction was deemed necessary, for the indiscriminate use of the term in an analysis involving countries in transition may be conducted on barren ground, despite the ever-present subconscious belief (or intuition) that investment is such a pivotal factor in any economic structure. It will be necessary, therefore, to specify occasionally the meaning under which the term is used for lack of any <u>ad hoc</u> terms. It will be necessary, e.g., to specify occasionally the meaning of the term "capital inflow" (or "outflow"), for it is not as homogeneous a term as some writers imply through its indiscriminate use.

Generally speaking, the term "investment", or its equivalent, "capital", will be used in the two senses of (a) use of funds (originating either with borrowing, outright grants or equity placement) on a long-term basis, and (b) as a medium of creating productive facilities--an activity which adds a special meaning to the term because of the well-known traditional dearth of capital in the colonies. Although the latter sense is consequential to the former, there is not always an absolute affinity between the two, especially as the former sense is usually applied to foreign-trade accounting.

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It is generally accepted that, with some exceptions, the pre-war investment in the colonial territories had been relatively small. This stems directly from the type of the economy traditionally encouraged there which does not share the "round-aboutness" of process common to highly industrialized countries.

The post-war economic position of the Sterling Area in general, with the accentuation of the dollar shortage on one hand and the social upheavals, real or apprehended throughout the colonial territories on the other, necessitated a process of intensification of use of resources in the colonies in order either to save or to earn more dollars, or to initiate programmes of social development for welfare purposes respectively.

Although a complete survey of the material form of investment is lacking, the available information indicates that the investment has concentrated on (a) development and expansion of basic raw material resources, including efforts towards reclamation of land for cultivation, and (b) expansion of social services. There is no indication that any serious attempt towards--what may be called--planned industrialization has been undertaken--a situation which appears to be in contrast to developments in "independent" members of the Sterling Area. However, the fact remains, for the reasons mentioned above, that the pace of capital inflow into the colonial territories has accelerated. The various plans of the colonial governments and some grandiose schemes originating in the metropolis, are indicative of this acceleration. Thus in 1954, the estimated cost of the approved 10-year development plans (which of course refer to public expenditure only) amounted to no less than £450 million. The plans provide for about one-third of the required sum to be formed by public borrowing.[12] The financing is mainly done by the United Kingdom government and/or through borrowing in the London market which remains the main source of private capital, although as it will be seen later, the United States either directly or through the World Bank, enters the scene as of late.

The public investment of the United Kingdom government is handled by such agencies as the Overseas Food Corporation, which spent £40 million in Tanganyika (in the ill-fated ground-nut scheme, whose failure is usually associated with failure of socialism in the British political scene), and the Colonial Development Corporation which, i.a., is credited (or debited) with the gigantic effort to create a poultry farm in Gambia, with the unfortunate events that followed.[13] Generally speaking, while the public type of investment is associated with schemes necessitated directly by the "dollar shortage" or the social development mentioned above, the private inflow appears mainly in the form of equities in productive facilities (within the realm of raw or semi-finished material). Thus private capital, estimated officially at approximately £300 million as of May 1956,[14] most of which can be attributed to either individual colonies or major projects within colonies, includes the cost of a refinery at Aden (nearly £50 million) to accommodate shipments from the neighbouring oil fields; investment on mine development in British West Africa (about £25 million); and substantial investment (probably £100 million) for East Africa, which went primarily into production for export and associated enterprises.

In the British West Indies, the relatively new oil discoveries and the expansion of facilities of bauxite mining have accounted for nearly £50 million. It is worth noting, however, that in Malaya, which operates its rubber trade in a highly efficient manner, only reinvestment of profits took place with very little additional inflow from outside sources.

Based again on incomplete data, some evaluation of the capital development is made possible by comparing pre-war total estimates with post-war inflow. Thus capital imports since the war have been about 150[15] percent of the total volume of investment effected in pre-war years. It is quite an impressive development for the colonies to absorb within ten years more external capital than had previously been invested over a period of fifty years.[16]

Another measure of evaluation, again with the statistical limitations applicable to the foregoing comparison, may be considered the comparison of capital inflow and the domestic capital formation. This comparison may be logically permissible despite the implicit functional relationship that usually exists between the two terms of comparison. Thus the capital formation for the colonies is estimated at £2,800, or 75 percent of the total capital invested,[17] although it is conceded that the margin of error may be too great for any firm conclusion.

Finally, it may be of interest to examine the pattern of origin of capital and to characteristics of national origin--a criterion of major importance for the Sterling Area as a whole. Though this item will receive attention again in connection with the "independent" members of the Area, it may be mentioned here that the character of the origin of foreign capital for the colonial territories has changed very little compared with the "independents". Thus while the United States originating capital inflow (including World Bank) in Australia amounted to around 30 percent of the total compared with almost 60 percent of United Kingdom origin, in the Union of South Africa 21 percent and 70 percent, and India 60 percent, and 40 percent for the U.S.A. and the U.K. respectively; in the colonies, the corresponding figures have been approximately 11 percent and 87 percent respectively.[18] Despite the doubts raised as to the accuracy of these figures,[19] it is rather consistent with past experience and considerations of general expediency to think that the United Kingdom would try to preserve its *par excellence* privileged position as a source of capital supply on a high relative scale. All in all, it appears that the main source of capital remains the domestic formation. However, no forecasts of future situations should be made on the basis of projecting present trends, for, undoubtedly, the source of capital will be largely determined by developments in the political *status quo* of the colonies, many of which are at present in a state of flux. These developments in turn may be regarded as functions of the relative balance of powers, economic, lately tempered by political considerations, between the United Kingdom and the United States, where the colonial question should be taken as a part of the total position of the Overseas Sterling Area, with proper allowance for its historically established peculiarities.

As to the technical character of the investment, it must be repeated in conclusion that it really matters from the viewpoint of long-run socio-economic development as to whether money, regardless of origin, will be "invested" in improvement of health services or irrigation projects on the one hand, and manufacturing facilities on the other. The lesson of the Industrial Revolution with its effects on the evolution of the Western World, cannot be brushed aside with a remark that investment is a neutral concept. However, colonies present only one of the many points where the problem manifests itself, and the subject is, therefore, associated with, and will consequently be reserved for, wider areas of discussion.

The petroleum industry and its role in the Area present a particular economic value, and its discussion will be taken up at the end of the section on Dependent Territories.

A Synthesis on Colonies

The main characteristics to which the analysis of the position of the dependent territories can be reduced are then (not necessarily in order of importance, for this would be somewhat self-defeating to establish): (a) their contribution to the Dollar Pool of the Sterling Area; (b) the accumulation of sterling balances, invested mainly in securities of the United Kingdom government; (c) the direct control of the United Kingdom government over the foreign trade (both importing and exporting) of the territories; and (d) the equally "mercantilistic" character of investment in the colonies. Parallel or supplementary to these, a powerful control of intangibles is exercised through the banking mechanism described in previous chapters. Around these four major posts and a few subsidiary ones, a whole legend is being written, sometimes with such passionate undertones that the economist sheds his scientific dress to assume the role of the poet of virtue or despair, and the poet of virtue or despair dons scientific clothes to conceal his passion in either direction. Unavoidably, the discussion ends usually in sharp statements involving value judgment, sometimes confused in the course of passion with objective interpretation of history.

However, despite its dramatic undertones, the controversy may be a substantive one. Political slogans are built on economic arguments, and economic settlements of long-term repercussions are reached on appeals to ethical ramifications of historical relationships. As such then, what has been referred to as "dramatic undertones" becomes an objectively operating value and, therefore, its treatment in an economic essay becomes justifiable. Since the ramifications associated with the characteristics described above are overlapping, the discussion cannot be conducted strictly in the sequence in which the characteristics have been arranged. The question could be asked: Is the dollar contribution to the "pool" of the same character as other members' transactions? The answer is definitely in the negative. The basic precept of any "pooling" arrangement (An illustration as to purposes, if not <u>de facto</u>, may be considered the International Monetary Fund.) is the alternating of the roles of debtor and creditor for the participating units. Through the medium of the pool, the accumulated reserve helps countries to carry themselves over periods of gaps in their balance of payments, thus preventing the occurrence of disequilibria otherwise inevitable in the absence of the adjusting mechanism. Another element of the operational principles of the pool, ultimately related functionally to the question of equilibrium, is the achievement of trading efficiency by making use of the optimum resources of commodities production which can be realized only through multilateral arrangements. If there is agreement as to the above precepts, there seems to be a violation of this principle in the case of colonies. The situation as to both may be summarized as follows: ".... For the colonies.... dollar pooling has had serious drawbacks. <u>Lacking autonomy in their own import-policies</u>, they have contributed almost \$2 billion to the pool in 1946 - 1952 and have accumulated sterling <u>balances of roughly equal size</u> during the same period. <u>The colonies have thus been exporting capital to</u>

the United Kingdom in the form of dollar exchange." (Underlined by this writer.)[20]

So far as the colonial territories are concerned then, the principles of the "pool" seem to be non-operative, and, on the contrary, as it will be seen later in discussing the participation of the "independent" members, the fact that they operate altogether for the rest of the group may be attributed to their failure for the colonies.

As a sequel to this situation, it seems that the question of investment in the colonies may have to be reassessed in view of the real outflow of "capital" to the metropolis in the form of hard currency. However, the question of introducing the subject in conjunction with investment or otherwise is only a matter of classification, and the conclusions as to the effects of such flow on the overall situation cannot be altered in substance.

The second characteristic, namely the accumulation of sterling balances by the colonies, is as important in the assessment of the position of the dependent territories within the Sterling Area as their dollar contribution. Under certain conditions, the first characteristic may be regarded as subsidiary to the second. The latter may result from direct transactions with the United Kingdom as well, though its significance lies not only in the possible misallocation of resources, but in the non-allocation of resources at all. Theoretically, the dollar pooling by the colonies could amount to only a shift of their sources of supply to the United Kingdom, in which case the question would be reduced to problems of allocation. Accumulating sterling balances, however, on a continuous basis may give rise to discussions as to the potential status of the creditor. It will be necessary, therefore, to familiarize oneself with the particular elements of the accumulation before venturing any assessment on the basis of other a priori criteria.

Indeed, the controversy on the character of the balances has assumed proportions equal to those of the colonial question. Some writers modestly call the problem "the objective of economic growth".[21] Others seem to consider it as the mirror reflecting the basic relationships between Metropolis and Colonies, watched by the whole world, and they try hard (though not always very efficiently) to polish up this mirror.[22] A very realistic approach used by one of the participants in the controversy[23] amounts to reducing the question of balances to three basic issues: (1) Are existing colonial balances actually saving on the part of people in the colonial territories which have been lent to the United Kingdom? (2) Could such a saving, if indeed it is, have been utilized for purposes of the economic development of the colonies rather than loaned to the United Kingdom? (3) Are colonial balances subject to the same hazards of withdrawal as balances of others? As to the first issue, the general assertion that colonies have been traditionally a source of wealth for the metropolis and that, therefore, the question should be answered in the positive, is rather preposterous, if applied as *a priori* reasoning. It may be argued, e.g., that funds held by the currency boards came initially from trading accounts in Great Britain. Furthermore, the determination of the origin of the funds in various classifications of accounts, in addition to statistical difficulties, poses questions of relationship, namely cases such as the following may arise: Would, e.g., an account that can be identified definitely as of domestic origin exist altogether, had not another account, originating--say--with capital imported from the U.K., existed before the former? Well, it appears that the argument can go on indefinitely, with results similar to those of the primary capital-accumulation controversy of the capitalist system as a whole, or something in that order. Would not the question then be one of economic metaphysics (if not of economic nihilism) rather than of economic analysis?

It seems inevitable that the decision must be based on grounds of principles and some experience on consequences, rather than *ad hoc* analysis of origin of accounts, as some writers do.[24] The balances not only are there, but they also increase constantly. This, in turn, signifies that either the colonies are exporting more than they import (for that part of the increase that is due to current account surplus[25]) and/or that the marginal efficiency of capital investment is higher in the colonies (for that part of the increase that is due to U.K. investment in the colonies). These arguments, coupled with the control that the metropolis exercises over the economy of these territories (control over credit expansion through the strict stipulations of 100 percent reserve of sterling against domestic currency which can hold back the development of a local money market indefinitely), are sufficiently convincing that the build-up of sterling balances is not altogether a result of freewill on the part of an (imaginary) authority representing the colonies.

It is sometimes suggested that, even under the assumption that sterling balances constitute saving, they nevertheless receive a fair, commercially-acceptable treatment since they earn interest in the centre. Ever since 1952, following the reversal of the "cheap money" policy of the British government, sterling balances in London have been receiving 2 - 4 percent interest, which is considerably higher than ½ percent that existed prior to that date, and which had been established in England as part of the monetary policies of the 1930's. However, an assumption of fair treatment would not consider the current interest rate alone. It would consider again the whole question of deciding whether to keep the savings <u>in the form of balances altogether</u>, as against utilizing them for local development where the return cannot be measured in current market terms alone. Another remark to the contrary is that the general price level throughout the world seems to keep on rising so that the colonies are exposed to the same risks as any creditor under any circumstances of rising price levels, so that receiving an interest may be regarded as a partial compensation against such an increase rather than an income on one's saving. (The devaluation of the British pound did not help the purchasing power of the colonies vis-à-vis dollar imports. However, this matter does not seem to have attracted attention in view of the low rate of dollar imports by the colonies, and it may be fused into the question of price increases within the Sterling Area, which again leave the creditor scarred to an extent proportional to the price increases.) These remarks help clarify the second issue raised above, i.e., the alternative of investment to the colonies.

What happens when a colony leaves the Area? A limited experience is available on this subject, and it is doubtful that any a priori principles may be established. A casuistic approach is more likely determined by political and other considerations. One thing that is certain is that the general legal principles of debtor-creditor relationships are not applicable without qualifications. This problem poses itself not only in the case of colonies, but of any member of the Sterling Area, of course. (On a higher plane, it seems that it constitutes The Problem of the Sterling Area.) When Egypt and Israel left the Sterling Area, the ownership of the balances in their note-covers was not disputed, though both countries indicated that such sterling would be increasingly "demobilized". When, however, Eritrea was to be federated with Ethiopia, and indications were that the country was planning to spend part of the reserve, the question became a difficult one and ultimately settled by compromise.[26]

As to the last two characteristics of the relation, namely the direct control over foreign trade and investment exercised by the metropolis, no further discussion is regarded as necessary here, for the questions are part of the "colonial problem" *per se* rather than of the Sterling Area. The latter are extrapolated through the media of "Dollar Pool" and "Sterling Balances".

Since the colonies are part of the Area, some additional conclusions on their overall role cannot be properly reached until they are seen in context with the discussion of--what may be called--the independent members of the Area. This reservation is not one occasioned by propriety as to the classifications of the material, but by considerations of structural relationship of colonies and the Rest of Sterling Area (including the United Kingdom), for as the discussion on the "pool" in particular already indicated, this relationship is one of *raison d'être* for the Area as a whole. The last item that remains to be covered in connection with dependent territories is the issue of Petroleum. In substance, the issue of Petroleum constitutes a Colonial item, not so much because of the geography of the producing territories, as because of the conditions of the exploitation of this source of wealth which is largely conducted in an atmosphere of colonial relationships in their economic, political, and social ramifications. On the other hand, in official statistics and general discussions, it is separated from the colonial subject. It usually overflows to more general (and more urgent) channels than the metropolis-colony relationship.

However, it remains an integral part of the Sterling Area and only as such, it will be considered here. It will be presented in the form of an appendix to the present section, so that both its difference from the commonly accepted form of the Colonial issue and its share in the fortunes of the Sterling Area, can be emphasized accordingly.

APPENDIX ON THE PETROLEUM

The question of the relative role played by oil revenues of the companies operating in the Sterling Area in the balance of payments of the United Kingdom in particular, and the overall position of the Sterling Area in general, is an extremely complicated one to answer in precise terms. Looked at in a negative way, they are known to have been responsible for a larger part of the hard-currency drain in the post-war period than any other single category of expenditures.[27] The difficulties arise, i.a., because of the complicated structure of ownership and operation of oil properties. American companies, e.g., operating in sterling have filling stations in the United States, while in the United Kingdom 30 percent of the petroleum is marketed by American-owned companies.[28] In the Caribbean area, although American companies predominate, one British company has carried on substantial operations ever since these began to be developed.

The difficulties become formidable indeed, when the analysis is further stressed to cover the case in which the assessment, not of the present gain but of the potential loss of the oil revenues to the Sterling Area, is attempted. In addition to the infinite number of possible combinations of factors which must be considered, conceptual questions as to the character of present cost elements complicate the matter further. (E.g., royalty payments to Kuwait which are being converted to sterling reserves, largely immobilized in

London now; should they be considered as cost of operations which will disappear in case of a loss of the oil fields, or as a source of revenue that the Sterling Area will have to forego along with the oil from the dependency?)

On the strictly technical side of the problem, it would be difficult also to develop averages of performance in the post-war era, mainly because of the revolutionary increase in use and production of oil in the post-war period, and a series of oil crises such as the Iran and Suez, which do not contribute to the smoothness of any statistical curve.

Furthermore, the subject of oil is one that overlaps with the dollar problem more than any other commodity because, by coincidence of geography and history, the two main groupings of dollar and sterling meet as partners and rivals at the same time. (Witness conflicts of Western Allies over Suez operation and co-operation in Middle East crisis in July 1958--two most incongruous phases which, if nothing else, indicate that a "point of contact"--to use a military term--on the subject of oil has been reached between them.) The situation in its long-run implications is not getting any clearer by the lately announced entry of Italian and Japanese interests in the oil competition, under sharply revised-upwards royalty payments to the governments of Iran and Saudi Arabia respectively.

The question of oil, therefore, is one of global significance, and a reasonably complete coverage would require a vertical approach, i.e., an *ad hoc* approach to the problem rather than a horizontal one in which only a part of it would be considered within a major economic concept such as the Sterling Area. Thus the discussion that follows is a tentative one, having no claims on statistical accuracy, for the mentioned reasons, but in its controversial character, is sufficiently capable of portraying the magnitude of the problem.

The principle of alternative cost, a time-honoured principle of theoretical economics, is adopted here, namely: What would be the loss to the Sterling Area should the oil concessions of the British companies be taken away from them to the effect that the sterling customers of British-owned companies will have to pay currency other than sterling for their purchases?

The question centres around the oil of Kuwait and Bahrein, on which some figures have already been given above, and Iraq, the second largest producer in the Middle East, ranking behind the two protectorates. Iran is not included in the discussion because of the changes that were already brought about earlier and which, even for purposes of Sterling Area analysis, altered its character as an outside participant in the Area's arrangements.[29]

A recent controversy[30] on Bahrein helps elucidate the problem. Taking this as a basis, the rest of the Middle East concessions may be assessed proportionately. It has been remarked that "A single individual, the Sheikh of Kuwait, contributes very nearly 10 percent of the new capital annually available in the Sterling Area." The

Sheikh's income is estimated at roughly between £35 and £40 million a year. The percentage calculated above seems excessive considering that the new gross capital formation in the Sterling Area amounts to some £4,500 million annually. It is conceded, however, that "the sum is large only in relation to the total funds generated within the Sterling Area that are not used in the countries where they are generated" (underlined by this writer).

The question would be poorly approached, however, if only the book profit of an economic unit were included as the potential loss. Another part of the loss would be the cost of production of oil which at present is paid for in sterling, and the loss of a ready market for the commodities that are bought with the receipts of sterling at present. Thus the role of sterling balances of the oil countries, similar in their implications to those of the colonies (with some possible exceptions as to the flexibility of handling by the owners), is not the only element that should be considered, although very substantial in itself.

It has been contended that "sterling has always been a hard currency in the Sterling Area in the sense of being convertible into dollars, and since February 1955 it has been hard outside also, in the sense of being convertible into dollars at a discount of no more than one percent--and recently at no discount on the lower official rate."[32]

It is rather startling to use an argument of this type--an argument which is part of the legal set-up of the framework of the Sterling Area according to which there is no limit as to the ability of the members to convert their sterling, though in reality this limit is the rule rather than the exception to the effect that the issue of convertibility has become the issue of the existence of the Sterling Area. It is more startling because the author is completely aware of the official policy in case of a run on the central bank on the part of the sterling-balances holders derived from oil revenues. "We have a sanction against the refusal of sterling in payment for oil. It is inconceivable that, if certain countries refused to accept payment by us in sterling, we should continue to give them the privilege of dollar convertibility for their existing (large) holdings. That should make them pause" (underlined by this writer).

The possible consequences of a loss are considered very stoically by the same writer. It is the significant past contribution of the man to economic science that compels one to take these passages seriously. Thus as to the possible consequences of a loss on Great Britain, "Our difficulties would at worst be temporary. In the long run we are in a very strong position on our balance of trade, because the rest of the world will increase in population and, we hope, in buying power per head, while our population will remain stationary". It would be interesting to know how A. Hansen would take to that last ray of hope. Would he still regard the factor of population as one of the pillars of his stagnation thesis?

In general monetary terms, without regard to the loss of the ready market for British commodities, the loss for whatever may be regarded as Middle Eastern oil is estimated at one billion dollars per year. This constitutes about 50 percent of the total net annual capital formation in the Sterling Area.[33] It appears that there is no dispute as to the size of the loss. Reaction to recent moves in the Area confirm the concern of the official authorities, and any further discussion would be redundant. The Economist dismisses the whole question through a *reductio ad absurdum*: "Anything like this figure could be arrived at only by assuming (a) that the entire Middle East oil sources are lost, not only to Britain, but also to the rest of the world, and (b) that sufficient dollar oil could be made available to make good the loss of the Middle East oil fields, which is impossible.... This loss.... concerns the whole of the West--and could hardly occur in circumstances other than those leading to a third world war."

B. The Independent Members of the Sterling Area (I.S.A.)

The latter major grouping of countries in the Sterling Area consists of the politically independent members. The adverb "administratively" would, perhaps, picture the relationship more faithfully than the term "politically" in several cases because of the misgivings contained in the latter term under certain conditions. It would not be pedantic then if the description were modified to the effect that the grouping consists of the politically or administratively independent members.

Generally speaking, the distinction is accepted because of an implicit assumption that political or administrative independence presupposes freedom of economic behaviour, as the latter may be defined in contra-distinction to that of the dependent territories. Although this may not necessarily be so, the distinction still holds, for ultimately it is not the actual that is important but the potential. The member countries of the group in question do possess these potentialities, and only under this qualification the grouping may be accepted.

The majority of the countries in this group are Commonwealth members. The remainder have either severed their relations with the Commonwealth or have never had any with it. Some of the latter, such as Bahrein and Kuwait, are classified officially as I.S.A. countries. However, the substance of their relationships to the whole of Sterling Area is similar to that of dependent territories (for reasons already explained) and they are not considered in this section. Generally speaking, the degree of permissible generalization here is much lower than that in the dependent territories, and the need for continuous qualifications is greater.

From the standpoint of the economic relationship to the whole of the Sterling Area, the same remarks made for the group as a whole, as distinguished from the dependent territories, can be made for some individual countries of the group as opposed to others. Accounting-wise, some of them draw resources; some of them contribute. However, it is the substance of their position that is of importance, and it is not always described best by accounting tables. The problems of the latter may bear some similarity to these of the dependent territories, complicated by the fact of political independence.

Despite all these points of heterogeneity, the reasons for treating these countries together are weighty. "..... the common fact of independence has economic significance since it bears on the degree of policy co-ordination in the system. It also bears on the promptness, nature and severity of measures taken to correct difficulties in the Area's balance of payments. It bears on the degree of willingness to pool reserves. It affects local credit structures, which, although based heavily on sterling reserves, have their own flexibility and can produce important variations from time to time in the rate of use of sterling.[34]

Thus the treatment of the subject must be designed in a way that emphasis on grouping or on individual characteristics may interchange according to the nature of the question to be answered at a time. Although this approach is exposed to the risk of procrustean treatment, it strengthens nevertheless the analysis, for quite frequently, as it will be shown later, it is through the analysis of the individual characteristics that a proper assessment of the cohesion of the Area can be made, whereas it may be that group treatment could lead one to forced procrustean solutions.

A few preliminary remarks as to historical background, and special characteristics of the independent members, may be pertinent as introduction to the analysis at this point.

It has become customary to distinguish the Commonwealth members between "British" and "non-British". Thus in the first group, Australia, New Zealand and, to a certain extent, South Africa, are included, whereas the latter's main characteristic is the non-European origin of the bulk of the population. India, Pakistan and Ceylon are the most important of these countries. Generally, the former group achieved political independence relatively soon, whereas the independence of the latter is a post-War II development. While the economies of the former are more advanced than the general average, and the standard of living nearer European and North American standards, the latter are generally emerging from the levels associated with a long colonial status, the consciousness of which seems to add to the impetus towards a rapid industrialization which follows a rather unorthodox, by traditional measurements, path.

The non-Commonwealth members, on the other hand, have in common their semi-colonial economic status with a large share in the desire towards complete independence, with some of which displaying an understanding of emancipation differing from the British concept. This applies particularly to the Arab member nations, as recent events indicate.

It has been a traditional British argument that the independence of the former colonies takes place within an *a priori* conceived historical plan and that the ultimate aim of the metropolis vis-à-vis any of the dependencies, is the promotion of conditions that will enable them to stand on their own feet, as in the case of India and Pakistan. It is in fact suggested by some writers that the status of Commonwealth members must be regarded as experimental and that ".... the experience of the present Asian members of the Commonwealth may have a strong bearing on the ultimate status of the African dependencies as they achieve their planned independence".[35]

Whichever the generic origin of "the plan", it seems that a striking characteristic of the post-war *status quo* is that the countries in question chose a path dictated, not by benevolent foreign planners but by the socio-historical forces of independence as the latter are manifested, i.a., in the seemingly incongruous foreign policies of the so-called neutralist powers.[36]

This is one of the considerations, whose role in the future of the cohesion of the Sterling Area cannot be overestimated--not that similar considerations do not enter the picture in the behaviour of the so-called British countries. Cultural and other similar ties with the U.K. have helped attenuate their demands, and their relatively high position vis-à-vis the rest of the members, renders an air of conservatism in their policies.

The question of the character of the hitherto-British economic influence on the independent members of the Area involves value judgments, and its inclusion would not be required in the present discussion. However, a proper assessment of the future of the Sterling Area would require a clarification of the nature of some of the major problems with which the countries in question are besieged.

The problem of population and its sequel, its menacing rate of growth, is usually regarded as an autonomous factor which should be attacked accordingly. This applies particularly to the case of the Indian sub-continent; although on a higher scale, it is a problem common to all of Asia.

The second problem is the scarcity of arable land resulting in a menacing food deficit which is regarded by some as the most urgent economic problem in the Sterling Area, though the frequent food supluses of Australia and New Zealand add a taint of incongruousness in the "grouping" together of "independent" members.

The question arises as to whether these two factors, usually regarded as the causes to which all troubles of the non-British group may be ultimately attributed, are physically independent variables, or do depend for solution on other basic relationships which must be tackled first (if not temporally, for the urgency of both factors is too great to be delegated to later decisions, at least in terms of weight of action).

Unfortunately the answer cannot rely greatly on statistics (scanty in any case). However, the contribution that can be made at this point is the introduction of the hypothesis that the two factors in question may be depending on more basic causes--causes of social relationships which are not prima facie recognizable and which have obscured many a mind in the past as to their influence.[37]

Much as the foregoing may be regarded as long-run considerations, their effects are being felt throughout the system continuously at present. It seems that the theoretical notion of Equilibrium is truer than life. The effort of these countries to reach the comfortable standard of living of their advanced counterparts by teleological means rather than relying on old-fashioned laissez-faire, is manifested in their foreign trade transactions, i.a., and the accumulative action of these manifestations could prove very concise for the cohesion of the Area.

The general modus operandi of the Independent members will be studied in the subsequent parts of this section. The sequence of topics will be similar to that followed in the discussion on Dependent Territories, and, as in the previous section, the required statistical material will be tabulated together for purposes of reading convenience.

TABLE III. 4.

I.S.A. Balance of Payments on Current Account

(£ Million)

	1949	1950	1951	1952	1953	Total
Australia	-18	-45	-177	-156	132	-264
Burma	n.a.	7	22	21	6	56
Ceylon	2	15	12	-26	-22est.	-19est.
Iceland	-4	-2	-4	-3	-3	-16
India	-122	42	-54	-20	19	-135
Iraq	-6	9	11	13	22	49
Irish Republic	-26	-45	-77	-26	n.a.	-174 (4 yrs)
New Zealand	-2	18	18	-29	26	31
Pakistan	-34	-8	60	-84	15	-51
South Africa	-114	-2	-105	-59	-59	-339
S. Rhodesia	-30	-20	-51	-41	n.a.	-142 (4 yrs)
Total	-354	-31	-345	-410	136	-1,004

Note: Gold transactions have been included.

SOURCE: Table 15, Ref (7) based mainly on Balance of Payments Year Book, I.M.F.

TABLE III. 4.A.

I.S.A. Regional Current Account

(£ Million)

	1949	1950	1951	1952	1953	Total
With Dollar Area (incl. gold sales)	-52	114	7	-28	46	87
With O.E.E.C. countries	30	111	25	4	27	197
Total Dollar Area & O.E.E.C.	-22	225	32	-24	73	284
Total current account	-354	-31	-345	-410	136	-1,004
Therefore, deficit with areas other than Dollar Area & O.E.E.C.	-332	-256	-377	-386	63	-1,288

SOURCE: Table 16 Ref (7) based on material as preceding table.

TABLE III. 4.B.

Sterling Area Current Balance

(£ Million)

Member Country	1938	1947	1948	1949	1950
United Kingdom	-70	-545	-29	21	221
Ireland	-3	-38	-29	-17	-36
Australia	-15	8	37	-4	-2
New Zealand	-5	-9	-4	-5	17
South Africa	-9	-180	-175	-114	-7
Southern Rhodesia	-	-11	-13	-24	-21
India)			(-75	-136	46
Pakistan)	-12	-91	(-2	-37	-11
Ceylon	-2	-14	2	-2	11
Colonies	-20	-50	-20	-50	140
Other	10	-37	-13	-	-
Total, R.S.A.	-56	-422	-292	-389	137
All Sterling Area	-100	-950	-300	-350	350

SOURCE: Table in Page 65 Ref (1).

TABLE III. 5.

I.S.A. Operations in the Dollar Pool

(£ Million)

(Blank) = Contribution
- = Draught on pool

	1949	1950	1951	1952	Total
Australia	-73	31	29	-50	-63
New Zealand	-53	21	23	1	-8
South Africa	55	190	151	140	536
India	-69	77	-12	-118	-122
Pakistan	-46	-20	-72	-41	-179
Ceylon	18	62	30	1	111
S. Rhodesia	n.a.	14	9	32	55
Irish Republic	11	11	-39	-48	-65
Total	-157	386	119	-83	265

SOURCE: Table 17 Ref (7), based mainly on A. R. Conan, The Sterling Area.

Note: This table should read as a general outline rather than as an accurate accounting of dollar transactions. The figures are limited to known transactions in the dollar pool.

TABLE III. 6.

Comparison of I.S.A. and United Kingdom Transactions on Current Account by Regions

(£ million)

	1949	1950	1951	1952	1953	Total
With all areas						
I.S.A.	-354	-31	-345	-410	147	-993
U.K.	31	300	-385	255	225	426
With dollar area						
I.S.A.	-52	114	7	-28	46	87
U.K.	-296	-88	-431	-172	-4	-991
With O.E.E.C.						
I.S.A.	30	111	25	4	27	197
U.K.	-16	114	-201	-26	104	-25

SOURCE: Table 18 Ref (7) based on same material as preceding tables.

TABLE III. 7.

United Kingdom's Share of I.S.A. Trade

(Percentages)

	1913	1929	1937	1949	1950	1951	1952	1953	1954
Australia									
Exports	44	38	49	42	37	30	38	38	37
Imports	52	40	42	50	51	45	42	47	47
Ceylon									
Exports	45	40	43	33	24	31	29	25	29
Imports	29	21	22	18	20	22	22	22	21
India									
Exports	23	21	34	23	22	25	20	28	32
Imports	64	42	31	25	22	17	19	25	25
Pakistan									
Exports	--with India--			13	17	13	13	19	19
Imports	--with India--			23	26	21	20	16	29
New Zealand									
Exports	79	74	76	73	66	57	65	67	67
Imports	60	49	50	55	60	54	55	57	57
South Africa									
Exports	81	49	36	25	28	26	30	29	32
Imports	57	43	43	42	41	35	34	38	34

SOURCE: Table 19 Ref (7) based on: Memorandum on International Trade and Balance of Payments, 1912-26, V.2; Same, 1930, V.3; Statistical Abstract for the British Empire, 1931 (Cmd.3919); International Financial Statistics, Dec. 1950, July 1954, February 1956; Statistical Abstract for the Commonwealth, Years 1948-51.

TABLE III. 8.

Changes in I.S.A. Imports from the United States and the United Kingdom, 1934-38 to 1949-50

	Imports from U.S.	Imports from U.K.
	(In percentages)	
Australia		
Machinery	50	300
Vehicles	-80	1,100
All commodities	10	100
New Zealand		
Machinery	40	150
Vehicles	-75	150
All commodities	5	60
South Africa		
Machinery	60	10
Vehicles	-50	50
All commodities	45	-8
India & Pakistan		
Machinery	500	200
Vehicles	50	300
Iron & steel	400	No change
All commodities	400	25
Ceylon		
Iron & steel	1,000	50
Machinery	500	300
Vehicles	50	130
All commodities	400	66

SOURCE: Table 20 Ref (7) based on: The Sterling Area, an American Analysis, U.S. Economic Cooperation Administration.

The I.S.A. Balance of Payments

A summing-up of the various operative forces inside the grouping of Independent members is given in the changes of their position as shown in their Balance of Payments on current account (Table III. 4), as derived from the figures of the individual countries. These figures, based mainly on information compiled by the International Monetary Fund, should be considered as representing trends, and values, at least in a proper order or magnitude, and hence adequate for a general assessment, while any attempt towards evaluation of individual situations must by necessity be supported by additions and more minute documentation.

In this group, all countries except New Zealand, Burma and Iraq have been incurring deficits almost throughout the entire period. Since the three countries' surplus over the entire period constitutes only 13 percent of the total deficit, and with indications that even these countries (with the possible exception of Iraq) will turn to deficits following the decline of the raw materials markets, it may be deduced that the group is basically a deficit area as to its Balance of Payments.

Table III. 4.A. presents a breakdown of transactions by trading area. It appears that in trading with the dollar area, the group is in surplus, as the Dependent Territories, although not on such a large scale (cf Table III. 1.). The table also shows that they have been running a considerable surplus with the O.E.E.C. countries and a high deficit with areas "other than dollar and O.E.E.C.". This means mainly other parts of the Sterling Area, and from general experience on patterns of trade, it may be concluded that much of the deficit is with the United Kingdom. It is characteristic of the situation that the United Kingdom's overall deficit has been lower, although the part of transactions with the dollar area runs a considerable deficit--a question of great significance which will be given special consideration later in the paper.

These figures, important as they may be as such, reveal a relatively small portion of the total picture. The real change, that ultimately amounts to shift of trends, is shown by juxtaposition of post-war and pre-war figures. Table III. 4.B., although not covering as many post-war years as the previous one, serves the major purpose of describing the shifts in patterns of payments within the Area. While the United Kingdom was mainly responsible before the war for the deficit, in 1947, the deficit was shared in equal proportions between the U.K. and the Rest of Sterling Area (With the Colonies taking up less than one-eighth of the "blame", their position can be ignored for all practical purposes.), while in subsequent years the deficit was almost entirely in respect of the other countries, with South Africa and India accounting for the largest amounts.

This situation became feasible, mainly because of the accumulation of the large sterling balances in the I.S.A. countries during the war, and again it may be suggested here, it reflects the new relationships, political and/or economic, as they developed after the war. Another part of the deficit on current account is balanced by investment capital from the United Kingdom and the United States. Since foreign investment involves some serious ramifications which affect the Area beyond the balancing of its current account deficit, it will be treated as a separate item as in the case of the colonies. It may also be observed[38] that the investment on the part of the United Kingdom must have been made possible, to a considerable extent, by the dollar surpluses that the dependent territories have accumulated in the past.

To integrate the basis of discussion, some additional observations on the preceding tables will be made. Thus from Table III. 7, it may be deduced that the relative share of the United Kingdom as a market for the I.S.A.'s exports is declining compared with pre-war years. The growth of the economies of these countries over the years intensified the intra-area trade. On the other hand, the I.S.A. countries, following the general pattern of policies of the whole Sterling Area, tried individually and as parts of the group to develop their Dollar market, and their efforts, especially of the raw-material-producing countries, substantially concurred by the Korean War and similar events, were not unsuccessful.

On the side of imports, despite the relative decline of the United Kingdom as supplier, the trend is not as pronounced as in its role as consumer. Here is a case where analysis of trends must be qualified by macro-historical analysis to such a high degree that it is rendered almost meaningless. As already indicated, e.g., in discussing the factors of cohesion of the Sterling Area,[39] the accumulation of sterling balances by these countries during the war created a situation whereby the United Kingdom was provided with a made-to-order market, especially after the often-repeated assertions that it would honour its war-born obligations to all members of the Commonwealth.[40] Hence, although the figures are statistically sound, trend projection, or even comparison with pre-war situations, is of rather limited value. By and large, the remarks made in Chapter II on the probabilities of substitution of non-British heavy industrial commodities, which will play the keynote in all future developments, apply here also. The inconclusiveness of the time-series of imports is not assisted by observations on the physical content of these heavy industrial commodities, as Table III. 8. indicates. The absence of absolute figures does not permit the development of the question in deeper perspective. However, it gives a sample of a tug-of-war game between the two great world partners in their efforts to supply the markets of the I.S.A. It may be worth noting that in countries such as India, South Africa and Ceylon whose post-war policies have been interwoven with teleologic industrialization, the United States is gaining ground percentage-wise. The reference of the table to two years only, limits its value considerably, but there are no indications that the United States suppliers will abandon their efforts to sell in that lucrative market either. Furthermore, with the shrinking of international export markets evidenced recently, it is likely that suppliers other than the two principal ones will intensify their efforts to enter the I.S.A. For the time being, however, the United Kingdom remains in absolute terms the main single supplier of these crucial commodities. The relationship is based on the very factors on which the whole of Sterling Area relies for its cohesion, and it assumes under the circumstances a much greater importance than any other time-series would suggest.

In discussing the role of I.S.A. as a market of U.K. exports, special mention was made of the role played by the Sterling Balances of these countries in London. The topic is not exhausted with a statement as to their role in forming or maintaining trade relationships with the United Kingdom as a result of their accumulation. It will be necessary to assess their overall significance in greater detail. Some comparisons with the Sterling Balances held by the latter major grouping the Sterling Area, namely the Dependent Territories will be made, for it appears that their role on the operations of the Sterling Area constitutes a serious basis of differentiation between I.S.A. and U.K. on the one hand, and Dependent Territories on the other. Subsequently, the behaviour of capital formation will be examined.

Sterling Balances of I.S.A. as a Factor of Cohesion in the Area

There is a dearth of properly classified material on Sterling Balances holdings in either Government publications or Government sources. The U.K. government publishes regularly only the total holdings held by governments and banks in London, but information as to individual holdings by country, which could possibly assist in the study of forces of differentiation within the I.S.A., is either lacking or appears in non-comparable terms. However, there are some outstanding features in the general picture which permit some deductions.

The technical handling of the Sterling Balances accumulated during the war has been done elsewhere in the paper.[41] Perhaps the more interesting aspects of the new relationships would be found in the *ad hoc* agreements signed between the United Kingdom and the holders of balances,[42] which have been dictated by a complex of considerations--world politics not being the least.

The following remarks will pertain to their overall role in these relationships, as may be deduced from the balances' quantitative changes for the I.S.A. as such (with remarks for individual behaviour in outstanding cases) or in comparison with other values. The following summary table will provide the basis:

TABLE III. 9.

The Sterling Balances of the Sterling Area
1938 and 1945-52

(£ sterling million)

	1938	1945	1946	1947	1948	1949	1950	1951	1952
Total Independent S.A.	339	2,007	1,922	1,786	1,809	1,771	1,980	1,825	1,603
Total Dependent Territories		446	495	502	556	582	752	964	1,065

SOURCE: Ref (4) Table I.

The outstanding conclusion from this table is the already-noted-elsewhere increase of Sterling Balances from pre-war for both Independent and Dependent Sterling Area groupings. The total sterling holdings of the I.S.A. in 1945 were slightly over £2 billion, with the colonies possessing slightly over one-fifth that amount. However, considering the political dependency of the colonial territories, some doubts may be raised as to the significance of the figures as representative of the relative contribution of the colonies in the war effort. Be that as it may, a comparative study of trends is more revealing than the absolute figures. While Colonial balances have been increasing since 1945 mainly as a result of the conversion of dollar earnings to sterling pounds, the balances of the I.S.A. members as a group have been declining. Thus total holdings of I.S.A. as of the end of 1952 were about £400 million less than at the beginning of the post-war period (subsequently, in 1953, the decline reduced to £234 million). It is significant, however, that while the decline contrasts itself to the increase of the colonies, it does not display a persistent trend that could be projected through the application of statistical methods. The movement has been erratic, to a certain extent, with up-and-down fluctuations being large at times. Thus, the series taken independently conceals more things than it reveals, and some further background information must be resorted to, if the role of the balances is to be assessed properly.

It is significant that over half the balances of the Sterling Area in 1945 were held by one creditor, British India; with colonies taken as a group, the next largest holder. The concentration of such a large portion in one unit could, under certain conditions, become a very disturbing factor in the stability of the Area. Such a possibility is not reflected clearly in the above table.

Another significant factor is the procrustean manipulations resorted to by the interested parties during the course of post-war developments. From the very beginning, pressures began piling up for limiting the use of the balances in the immediate post-war years. This found expression, i.a., in the American loan agreement (cf Ch.IV) which proposed, as one of the measures leading eventually to convertibility, that part of the balances be cancelled as a contribution to the war effort by the creditor countries. The proposal, carried through to a very limited extent with only Australia and New Zealand declaring as gifts a total of £26 million of sterling balances in 1947, is itself signifying the pressures to which the whole Area has been subjected. Despite its failure, the negotiations on the status of the loans which followed thereafter did in effect influence trade transactions in the limiting way intended originally by the proposal. Apart from considerations given to funding the major part of the debt, but rejected by Great Britain because mainly of the high interest charges involved in the proposal, a series of agreements were concluded between the United Kingdom and I.S.A. members regulating releases of sterling against concessions by the I.S.A. members, e.g., with respect to dollar spending, etc.[43]

In analysing the behaviour of individual countries, it may be observed that India, Pakistan and Ceylon are the heaviest spenders. They spent over £500 million between 1945 and mid-1952 reducing their balances from £1,300 to £800.[44] However, despite agreements signed subsequently with the United Kingdom limiting the rate of spending for some years, the factor of industrialization in which these countries devote their efforts, with India, which is the largest holder of all, more determined to pursue it to its practical conclusions, is likely to upset the artificially established unstable equilibrium of the period under discussion.

The possible situations or solutions are summarized by a student of the subject as follows: "We have already noted that, as a country becomes more developed economically, it is likely to give up its dependence on the promises of a foreign treasury as a basis of the issuance of its own currency. This fact creates a doubt that in the long run, there is any such thing as a hard core of sterling that will be held by independent Sterling Area countries as a reserve for their own currencies. What will be held is the amount needed as working balances in the financing of trade with that part of the world which is willing to accept sterling. On this point, the Reserve Bank of India has noted a significant decline in India's use of sterling to finance its world trade. Egypt, a former Sterling Area member and still a large holder of sterling, is using sterling less and less in its international transactions."[45]

In summary:

The story of the sterling balances may ultimately prove to be the story of the future of the Sterling Area. Through the differentiation of the bookkeeping term "Sterling Balances" into "I.S.A. and Dependent Territories", part of the substance of the nexus of the Sterling Area was revealed. Both I.S.A. and Dependent Territories were shown as creditors to the United Kingdom although the relationship differs in substance and degree between the two. Legalistic arrangements between creditors and the United Kingdom do not provide sufficient force in attempting a solution to the outstanding problems, and the usually resulting procrustean measures accentuate the existing difficulties. Finally the existence of Sterling Balances constitutes the most significant element of cohesion of the Area, and at the same time, it provides the ground on which the seeds of the destruction of the Area may be sown.

Are there, possibly, any real forces other than the ones already mentioned that may mitigate the problems of, or affect adversely, the cohesion of the Area? As in the case of the colonies, the behaviour of Investment will be examined next, although general conclusions will be reserved for later sections.

Investment in I.S.A. Countries

Most general remarks as to the meaning of investment made in Section A of this chapter apply here as well. The term "investment" therefore, will be used with the same qualifications as in the case of the colonies.

As in the previous section, the discussion will be devoted to examination of the main aspects of flow of capital; its character as expressed in changes of the technical composition of investment and/or ownership; and changes in its origin.

The changes in I.S.A. countries present a strongly autonomous picture which can be evaluated in itself, in contrast with the colonies where the assessment had to be chiefly based on comparisons with other values. This does not preclude comparison as a method of analysis. The statement is made to emphasize that the evolution in the countries in question has been more pronounced, for obvious reasons (or, at least, not subjected to examination here), than in the colonies where a certain degree of short-run manipulating is possible in opposition to secular trends.

Recalling previous remarks on the conventional character of the classifications and groupings adopted throughout the paper, it must be re-emphasized that essential differences as to character and degree of change do exist among the countries in the I.S.A. grouping as well. However, several outstanding common features are powerful enough to permit consequential abstractions; individual characteristics are being placed in perspective wherever they are deemed sufficiently important as to affect the general picture. The changes in this group may be regarded as changes in the relationship of the Rest of the Sterling Area and the United Kingdom par excellence. Since in twentieth century developments the focal point of relationships involving countries of uneven economic growth is the investment structure, the need for a careful interpretation of statistics of investment cannot be overemphasized.

As indicated in Chapter I, one of the by-products of the accumulation of export credits by the I.S.A. members during the war was the repurchase of long-term, mostly government, securities held in London by the debtor countries. The technique employed for the transfer of ownership has been discussed in the same chapter. Over a long period of years, all of these countries under colonial, or semi-colonial status resorted to the London market for borrowing on Government account. The incurred public debt (sometimes confused quite absurdly as to its ramifications with modern domestic "public debt"), in addition to the political implications, contributed a serious burden upon the finances of the debtor countries through its service being one of the largest items in the balance of payments. Considering the inelastic character of exports of the commodities usually exported from the debtor countries, the debt often became onerous under conditions of falling export prices. With the years, it came to be regarded as the symbol and instrument of colonial subjugation, sometimes out of proportion to its real influence upon the economy of some countries.

It seems then that the reduction of debt fitted a logical pattern which had been under development for some time. The following table indicates the degree of debt repatriation:

TABLE III. 10.

External Public Debt

Year	Australia (£A million)	New Zealand (£NZ million)	S. Africa (£ million)	India (RS crores)	Colonies (£ million)
1939	644	197	106	397	87
1945	618	200	14	14	-
1946	572	152	14	13	79
1947	567	152	14	12	75
1948	560	138	13	6	78
1949	548	107	33	3	84
1950	549	105	34	3	99
1951	534	104	34	1	125

SOURCE: Table Ref (1) p.123.

It can be seen that while the reduction of indebtedness is general (with the exception of the colonies, for reasons associated mainly with the type and method of investment), the degree varies from country to country quite substantially. Thus the most important debtors, Australia and India, display a great dissimilarity in their policy of reduction, while South Africa and India are closer. In Australia and New Zealand, there was little reduction during the war years but the repayments later were considerable. Despite Australia's larger repayment, New Zealand is ahead percentage-wise.

As an observer of these developments remarks, it should not be concluded that the repayment of public overseas debt necessarily involved an equivalent reduction of individual country's total external indebtedness or was itself sufficient to effect a reversal of debtor-creditor status.[46] Indeed, the repayment taken in isolation would defeat its usefulness as an element of information.

The only meaning that can be attached to it as such, is that it heralds the conclusion of an era which began centuries ago, creating the embryo of its own destruction, while enhancing itself to heights of economic and technological achievements never experienced by mankind before. The Victorian form of economic relationships came to an end. The embryo grew up to become entities standing on their own feet. The next question to answer would then be whether they stand on their own ground.

The above findings remain true despite additional borrowing on public account that took place in later years, not shown in the table. The fact that this type of financing ceased effecting the main form of capital transfers remains unaltered.

This is also one of the points of investigation at which the grouping of the countries begins losing its force. The abstractive process is gradually being forced to narrower and narrower orbit until finally the particular replaces in importance the general.

The I.S.A. countries still rely on the London market for development capital. In fact, many students regard this reliance as a major factor of cohesion of the Area. The evaluation of this argument will be made during the discussion of the particulars of investment. This dependence seems somewhat strange in view of the practically continuous deficits on current account that the United Kingdom has been running for years, averaging some £40 million a year. Yet figures show that the United Kingdom has been investing money abroad, particularly in Australia and the Union of South Africa, from among the I.S.A. countries. It is suggested[47] (and there appears to be general agreement on the subject) that the investment has been made possible by the utilization of the United States and Canadian aid dollars and of the dollar surplus earned by the colonies.[48]

The United Kingdom government has attempted to use planning in investment activities through the Area as an instrument for overcoming deficits of the Area with the dollar countries. In the communiqué of the 1952 conference of Commonwealth finance ministers in London, the decision was taken that "development should be concentrated on projects which directly or indirectly contribute to the improvement of the Area's balance of payments with the rest of the world."

It appears that the corrective measures on the part of the United Kingdom do not operate smoothly. Two conflicting forces have been at work at the same time, i.e., the "pumping" of dollars on the part of the United States for the express purpose of assisting the Sterling Area in achieving convertibility on the one hand, and on the other hand, the official policy of the responsible managers of the units constituting the Sterling Area to become self-sufficient--a situation which by all definitions could not be regarded impossible with the idea of convertibility. Quite apart from the difficulties inherent in the implementation of such a policy by individual units, it is in itself indicative of the circular behaviour to which post-war Britain has been forced. The scheme appears bluntly as follows: Invite United States dollars for the purpose of developing projects which will be owned by Britishers and designed in a way assuring the exclusion of the United States as a source of supply.

The foregoing remarks are not intended as moral judgments on United Kingdom policies. They rather constitute an attempt to qualify the ultimate origin of what will be referred to in later paragraphs as "British" capital on the one hand, and to introduce some elements of dynamics to the comparison of figures, on the other

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In returning the discussion to the scene of the I.S.A. countries as users of capital, the need for further differentiation within the group mentioned above becomes pressing. There is a characteristic common to all of them, namely their desire to expand more and more. But it is through this expansion that differentiation begins, i.e., differentiation as to social purposes, membership in the Area, Weltanschauung.

The difficulties in discussingsuch a situation may be realized a priori. One approach would be to classify the countries into sub-groupings according to common characteristics wherever identifiable, and then proceed towards discussing flow, character and origin by sub-groupings. The alternative would be to discuss individual situations by "attributes" of investment, i.e., flow, character and origin, and reserve the formation of sub-groupings for the end. This seems to be a more practical approach.[49]

Flow of Investment

Australia: The inflow of capital in the post-war period has been quite impressive. It is estimated that a total of £A 1,000 million[50] has been imported over a 10-year period, of which only £A 125 constitutes Government borrowing overseas.[51] The figure, to be sure, includes re-investment from profits.

New Zealand: The experience in that country is somewhat different from Australia's, despite the noted similarity in other aspects of their structure. Aggregate inflow of capital from abroad is put at £75 million since the war. Public overseas borrowing has been limited. However, domestic sources have played a significant role in financing Government capital expenditures. This constitutes a radical departure from pre-war relationships, when as much as 50 percent of the total public debt was held overseas.

South Africa: Only estimates are available for this country, deduced from balance of payments calculations. The inflow of foreign capital is estimated roughly at £700 million. The figure indicates that the Union of South Africa ranks with Australia as a field of investment of foreign capital. A characteristic of the inflow to the Union has been the large scale of borrowing on public account by the Government, which reached £100 million in the post-war period. This figure compares with about an equal sum constituting the total public borrowing held abroad in 1939, which was reduced considerably later. However, it would be erroneous to deduce that the Union has been countering the trend in this respect. This figure constitutes only one-seventh of the total inflow--the remainder representing entirely private capital. The country has been traditionally a user of private capital to a considerably larger scale than other countries of the group. This is explained mainly by the attraction which gold mining provided to foreign investing and which, incidentally, continued operating through the opening-up of Orange Free gold mines.[52]

India: The economy of the country is traditionally classified together with Pakistan's and Ceylon's. It seems that the classification rests on negative common factors, i.e., the underdeveloped status of the countries. However, such a rigid application may conceal more things than it discloses. For purposes of analysis of investment characteristics, the picture is one of complete differentiation; hence the traditional grouping must be abandoned. As was indicated earlier,[53] the government had completely wiped out the foreign-held public debt when the new India came into being in 1948. A characteristic in the domestic policies of the government has been the acquisition of perhaps as much as a quarter of pre-war holdings of non-nationals in business investments.

Post-war policies of the Indian government do not seem to corroborate prima facie the aversion of the Indians to foreign borrowing on public account. The government has not borrowed any money in London but incurred a debt of $300 million within a few years following the war. If one adds some lately incurred obligations vis-à-vis the U.S.S.R. and Germany, mainly associated with steel mills' construction, the amount is becoming sizable and, in view of the declared intentions of the Indian leaders to accept any foreign assistance in the process of implementing their five-year plans, it should be expected that the new foreign-held debt may come close to, if not exceed, the pre-war levels.

Simply to compare figures and arrive at general conclusions without analysing the nature of the capital created through the transfer of money, would be misleading. This task will be completed in a later paragraph of this section which will attempt an evaluation of character and origin of investment. Suffice here to say that these obligations of the Indian government vis-à-vis foreign investors (chiefly governments) do not suffer from the same rigidity usually inherent in pre-war-type foreign lending. World politics and competition between major powers using, i.a., their "investing" ability to attract or swing allegiance of weaker, "underdeveloped" countries should be regarded as factors mitigating the superiority of any "monopsonistic" pre-war-type foreign lender.

In the private sector, the data are insufficient and several estimates only have been attempted. Thus the "Survey of India's Foreign Liabilities and Assets" puts the total of new foreign capital for the years 1948-1953 at approximately £135 million.[54] It is believed that most of it comes from reinvested profits and, if it is to continue at the same rate as it is suggested,[55] it is most likely that reinvested profits will play the main role because of the discouragement with which potential foreign investors see the future of private enterprise in India, and the balance of payments difficulties which force a retention of profit in the country. India is a place where the future of private investment in general is most uncertain.

<u>Pakistan</u>: It seems that the geographic remoteness of Pakistan in the past has determined its role as a poor user of private capital, although it shared in the public investment financed by overseas borrowing in pre-partition times. There has been no considerable inflow of either private or public capital in the post-partition period. It is likely that one of the chief factors in resisting the general trend of development has been the preservation of some old forms of land ownership supported by a powerful religious fanaticism which has been fanned by the nationalistic antagonism with India ever since the partition was completed.

The inflow of capital has been limited to loans from the International Bank totalling 30 million dollars; a £10 million loan from the United Kingdom government; and the loan part of United States aid (20 million dollars). Some assistance has also been provided under Colombo Plan provisions.

<u>Ceylon</u>: The picture of the inflow of foreign capital, either on public or private account, in Ceylon resembles strongly that of Pakistan. However, the structure of the economy seems to be developing differently under the new government, which in its planning seems to be sharing the ideals of the Indian leaders. It is also significant that the connection of the economy of Ceylon to that of India seems to be getting stronger with time. At this point, some of the main characteristic trends in the countries under discussion may be summarized: Australia

and South Africa have been very large importers of capital, both on public and private account with the latter considerably in excess of the former, with New Zealand ranking right behind them.

On the other hand, India, Pakistan and Ceylon used comparatively little foreign capital, which appears rather insignificant if compared with the absorption rate of Australia and South Africa on a per capita basis. Though the reasons for this lag seem to differ from country to country, the economic backwardness of all three as compared with the previous sub-grouping seems to operate as a common factor in one way or another.

Character of Capital

The term "character of capital", nebulous as it may be, provides a flexible classification for factors which are not considered in statistical tabulations, or their relationships are not easily amenable to statistical interpretation. Furthermore, the social developments that followed World War II have brought to the surface several items which had never been regarded before as significant or useful in any analysis.

The foregoing define the discussion as one that will be conducted inductively, more so than the discussion on "flow". It must be borne in mind that the topic of "character" interlocks with that of "flow" on more than one point and a certain overlapping of presentation of the pertinent data may be necessary.

The first item to be discussed is the role played by inflow of foreign capital in the overall capital formation. This role may be defined here in quantitative terms only. Thus the comparison will be made between capital inflow and total capital formation. Considering that the subject of industrialization has formed the core of political programming of any ideological nuance in post-war developments, the "foreign versus domestic" controversy has occupied the attention of a good many people, and of course it would be deserving a more integrated treatment if the controversy had to be followed to its logical conclusions. However, in consideration of the limitations of this study, only the quantitative aspects of the situation will be examined. The following table may be used as a basis for discussion:

TABLE III. 11.

Post-War Capital Inflow in Relation to Capital Formation (a)

	Capital Formation(b)	Capital Inflow	External Capital as percent of total
Australia (£ million)	8,500	750	9
New Zealand (£NZ million)	1,400	75	5
South Africa (£ million)	3,000	700	23

(a) Pakistan and Ceylon are not included in this table because their capital imports were very small; India has been excluded because of inadequate data. However, it may be assumed that, in view of the large size of the country, the planned industrialization and the relatively small amounts of inflow, as discussed earlier, the percentage of capital inflow is very low.

(b) Partly estimated.

SOURCE: Based on information supplied by Table 2, Ref (8).

As in the case of Dependent Territories, the estimates must be considered reliable in the limited role of providing information as to the order of magnitude only. The case of South Africa may be qualified as indicating only a spurt in mining activity which, as is usually the case, necessitated large sums of investment over a relatively short period of time. The percentage of external capital to total is, therefore, artificially inflated and is likely to remain so until the gestation period is over.

The figures for Australia and New Zealand on the other hand, present a statistically better amenable picture. Thus the percentages for these countries are 9 and 5 respectively. In Australia, which benefited from a high rate of capital inflow as measured by pre-war standards, domestic resources were entirely responsible for covering the needs of the country for development expenditure. The new external capital went to sensitive sectors of the economy--primarily in manufacturing where it constitutes about one-third of the new investment. In a later section, some aspects of investment in productive enterprise will be discussed in greater detail. New Zealand, on the whole, has had experiences similar to Australia. Only in New Zealand, special methods were adopted to conserve foreign exchange--a policy which lessened the dependence on foreign capital considerably.

Although figures for India are not available, it may be assumed for reasons already given[56] that the percentage is low. It may be added here that the Indian case is a special one, in that the country follows a deliberate policy of future independence from foreign capital by depriving itself of benefits that it could acquire at present, had it decided to let foreign capital in under laissez-faire assumptions.

Despite the differentiating characteristics of the countries discussed above and the qualifications made on the nature of the data, it may be concluded that the group relies on foreign capital to a relatively low degree. This becomes more striking if compared with a strictly-colonial type of economy where, as already indicated in Section A, the reliance is very great. The general economic maturity of these countries is expressed, i.a., in the growth of a powerful domestic basis which eventually may reduce considerably their significance as markets for foreign investment. This will be defined by the degree of determination of each; it is one of the questions in which they all differ either as to degree (Australia, New Zealand, South Africa) or as to philosophy (all three taken together vis-à-vis India and Ceylon).

It seems, however, that lessening of reliance on foreign capital possesses some qualitative aspects which beyond a certain point of development of the country may affect the very growth of the quantitative basis. These are related to the type of activity in which investment is made. Since the subject is a more general one, no attempt will be undertaken here to express any value judgments on the significance of each type of activity. It is generally conceded though, that the higher the degree of "roundaboutness" of the process the more advanced the economy and, *ceteris paribus*, the more impervious to the vicissitudes of business activity originating abroad the country should be considered.

The lack of comprehensive and comparable data on this subject necessitated the use of indirect information to describe some of the qualitative aspects of the economies. Since this information is largely imbued with opinions and value judgments, it simply serves the purpose of highlighting the problem without attempting to lead to any obliging conclusions.

Beginning with an analysis of Imports and Exports, as discussed in Chapter II, there is no doubt that the countries of the Sterling Area as a whole are importers of manufactured products and exporters of products of the mine and the farm. This applies to the I.S.A. countries as a group within the Sterling Area on a net basis. This could be an indication that the countries are still far from being considered as "industrialized". The question is not whether they still have to import industrial commodities on a net basis, for this is definitely the case; but whether the bases are being laid for the development of local manufacturing of the more advanced type.

The industrial development of these countries is partly connected with the two world wars. Thus Australia's industrial development received a stimulus in the First World War when the basis of the iron and steel industry was established. This facilitated the industrialization of the inter-war years. In the Second World War, production of arms, ammunition, aircraft and tires was expanded to satisfy the war requirements. Considerable advances were made in steel production, alloys and non-ferrous metals. The war affected the textile industry also. Woollen and worsted mills were expanded, absorbing by 1946 about 12 percent of total Australian wool production, compared with 8 percent in 1938.

However, Australia remains predominently an agrarian economy. The fact that a higher proportion of the population is in industry than in agriculture, is due to the predominance of sheep-farming which requires relatively small manpower. The main factor that deserves consideration here is that Australia is consciously taking steps to assure a greater measure of control over economic conditions by decreasing its dependence on external markets and supporting policies of self-sufficiency.

The case with New Zealand is different. The country has developed only light secondary types of industry, mainly food processing, or in general, consumers' goods, and depends for its basic industrial components on imports. The general trend of movement of the labour force from agriculture to industry is evident in New Zealand as well. However, the large size of the country and its small population necessitate the employment of a substantial part of the labour force in service industries such as transportation, shipping and warehousing.

In conclusion, Australia is considerably more advanced than New Zealand from the viewpoint of industrial development, and there are some indications that its further growth may retard New Zealand's relative development, ceteris paribus, by making the latter more dependent on the former's industry which enjoys a head-start.

South Africa presents a peculiar picture as regards industrial development policies. Despite the Government's measures to support mainly light industries which emerged in the First World War, its policy of discrimination and the general problems associated with the social structure of the country have placed obstacles to a consistent line of action on the part of the entrepreneurs.

The country's output is predominantly in raw materials and gold, and only 23 percent of the total is derived from manufacturing. Mining serves mainly the needs of foreign markets, and there is no evidence that any serious efforts are made to boost the industrial sector and benefit from the availability of raw materials. The Union of South Africa is, in conclusion, considerably behind Australia in terms of present industrial strength or prospects, based on projection of present evidence.

India and Pakistan have in common their extensive dependence on agriculture with 70 percent of India's labour population and Pakistan's 80 percent, being employed in the agricultural sector. However, in terms of industrial development, India appears in a stronger position than Pakistan. Traditionally the Indian part of the Sub-Continent has been more developed industrially with the Pakistani areas supplying raw materials, mainly jute, for the mills located in the south. Thus as late as 1948, 100 percent of jute manufactures and wool textiles of the Sub-Continent were produced in India. One hundred percent of iron and steel facilities and 80 percent of cement factories were located there.

Both India and Pakistan have made strides in development of industrial production and, in addition to protective policies, both have put to application comprehensive plans. However, India's appears as the most imaginative, Pakistan's being characterized by conservatism dictated mainly by the social structure of the country. Despite this difference, it may not be said with assurance that India's industrial future is guaranteed. The success of the plans is a function, i.a., of the policies vis-à-vis other structural problems of the Indian society that the Government will be called upon to pursue, and hence no attempt will be made to evaluate the figures of to-date growth in that sector.

Origin of Foreign Capital

The emphasis on "foreign" is necessary because of the strategic significance that the type of industry owned by foreigners bears on the economy of the countries under discussion. Furthermore, the ownership of industry by foreigners seems to assume dimensions of a problem, not merely of domestic but of international character. Here it will be treated as another aspect of the investigation of Investment in the I.S.A. countries.

Before the war, virtually all capital requirements of these countries were satisfied by the United Kingdom. As already pointed out, the most substantial part was on government account and was devoted to development projects. Very substantial changes took place after the war, with investments originating in other sources as well. The following table provides a basis for estimating the changes in order of magnitude. (Part of the material supplied here was used in Section A of this chapter.)

TABLE III. 12.

Estimated Capital Inflow, 1946 - 1955
by Source of Supply

(in millions of pounds sterling)

	Source of Supply				
Destination	U.K.	U.S.A.	World Bank	Other	Total
Australia	350	100	100	50	600
South Africa	500	100	50	50	700
Colonial Territories (a)	450	50	10	10	500
India	100	100	50	-	250

(a) The colonies have been included here to emphasize the relation between political dependence and origin of capital supply.

SOURCE: Based on Table 5 Ref (8).

The United Kingdom is still predominant, but the United States and World Bank count for 35 percent of the total (U.K. + U.S.A. + World Bank) supplied to Australia, South Africa and India combined. However, the United States share of investment seems to behave differently in the colonies. Apparently direct or indirect (e.g., conversion of earnings to dollars or taxation) restrictions associated with colonial policies are the cause for the lower participation.

Despite the fact that the United Kingdom remains the main source of supply, the strength of the United States as a serious alternative should not be underestimated. If one looks at the more substantive points, he will consider that a great portion of the capital invested by the United Kingdom is of United States origin, as already indicated previously. The question of further participation by the United States is not one to be answered unilaterally by the United States alone. It is a question related to the overall balance of payments of the receiving countries (the effects of the surplus disposal programmes of the United States having something to do with it ultimately), and the measures that undoubtedly will be taken by the governments concerned in view of the deteriorating world trade conditions lately. In the case of India, while the overall amounts from the United States may increase, especially as a reaction to the Soviet efforts to become a major capital supplier of the country, it is unlikely that the participation of any foreign capital will entail the same implications as under conditions of freedom of enterprise as in the case of Australia on South Africa.

The substance of the topic is that the British quasi-monopoly of capital export is there no more. Capital export has always been regarded as a basic element of cohesion of any relationship and is still so regarded by many. An endless sequence of economic mishaps plus the expansion of the welfare state in the United Kingdom, all too well known to be repeated here, resulted in a relatively short supply of funds. The United Kingdom has to turn to the United States or to international financial agencies supported by the United States, for assistance on numerous occasions, while the United States suffers from occasional fits of stagnation because of limited investment opportunities at home. There is no doubt that competition in this field will continue. Perhaps this is more important than the outcome of it.

The problem of investment export to the Rest of Sterling Area appears to portray some of the strains in the structure of the group and, so far as the two major participants are concerned, constitutes a very sensitive sector of the overall Dollar-Sterling relationships. The problem is further complicated by the growing nationalism in the countries concerned (usually manifesting itself, i.a., through local development programmes) and the appearance of second-rate but potentially dangerous competitors such as the U.S.S.R., and Germany and Japan. In situations of this type, it may be necessary to consider that the <u>marginal</u> influences are more significant on a given structure than their percent magnitude to the total would indicate.

A Synthesis on I.S.A. Countries

The foregoing analysis of the structure of the I.S.A. countries reasserts the conventional character of their classification as the counterpart of the Dependent Territories. As long as they are viewed as political (or administrative in some cases) entities, the distinction holds. It fails if attempt is made to apply it in the description of their economic behaviour (and accordingly prospects) as members of the Sterling Area.

Political independence, however, does affect the economic operation of the group in a way that distinguishes it from the Dependent Territories.

The sub-groupings within the group are not static, and numerous combinations can be formed depending on the logical categorization intended by the student. Summarizing such categories is not regarded as necessary here.

The common characteristics to all members, in their post-war behaviour (with some reference to the discussion of Chapter II) may be described as follows:

1. Shifting from foreign-held public debt to equity financing.
2. Less dependence on foreign capital in relation to existing investment as compared with pre-war conditions, mainly because of the broadening of the domestic basis.
3. The strengthening of the non-agricultural sector of the economy, though there are no indications of strength in the sector of heavy industry (with the exception of automobiles whose classification as heavy industry for

purposes of evaluating degree of economic integration, may have to be qualified).

4. Despite the continuous need for development capital, the United Kingdom's role as the main supplier does not seem to constitute a centripetal force for these countries which would compel them to stay in the Sterling Area. Despite widely held opinions to the contrary, this factor should be regarded as one whose precarious equilibrium is contingent upon the willingness of the United States to continue their dollar support, and the ability of the Dependent Territories to supply the necessary surplus (usually associated with dollar surpluses) to the metropolis for investment purposes within and without the Sterling Area.

The active forces centrifugal or centripetal (often changing roles under the impact of changes in other variables) within the group vis-à-vis the Area, may be summarized as follows:

The historical discrepancy in the economic development among members of the former empire necessitated the adoption of widely differing economic policies and, on a higher scale, socio-political ideals. While laissez-faire appears to be defunct in all cases, the two poles of private and state-directed initiative are shaping up distinctly. Such a discrepancy could not be regarded as a force conducive to greater co-ordination among members of the present arrangements. The conflict between individual and group interests is likely to increase in degree. The very discrepancy may be interpreted, in macro-historical terms, as an outcome of such a conflict.

The fact of increase of foreign (mainly United States) participation in both foreign trade and capital supply, indicates that forces from without would not be indifferent to the challenge that the resources of the group offer as a place for investment capital. Their rather limited (relative to the U.K.'s) participation is not proof that their post-war enthusiasm has been dampened. On the contrary, considering the various restrictions imposed by the members on numerous occasions, the limitation may have been an artificial one. (This subject--one in a series of items affecting the operations of the Sterling Area from without--will be examined in Chapter IV of the paper in its general implication.)

Finally the discrepancies in contribution among countries create a natural antagonism which raises questions from time to time as to the share that each is entitled to on the pool. Thus South Africa, because of its privileged position as producer of gold (and the latter's characteristic of convertibility), constitutes both a cohesive and disruptive force within the Area, depending on whether it uses gold to strengthen the S.A.'s reserves or as an argument to acquire a greater share of foreign exchange.

On the other hand, the similarity of the farm products of the group, mainly wheat, to those of the dollar area and the competition the latter may offer to the former in traditionally established markets (the surplus disposal programmes of the United States being one of the forms of competition) may act as an incentive towards unity on the part of the producers of the Area (e.g. Australia) as a step toward consolidation of Sterling Area markets, or as a disruptive force for some recipients of United States aid (e.g. India).

As a general conclusion, it may be stated here that so far as the I.S.A. countries are concerned their role as members of a solid group has been determined ex post but is not determinable ex ante.

Having discussed the major parts of the Sterling Area structure in detail, an attempt towards a general synthesis for all its elements in their inter-action, namely United Kingdom, Dependent Territories and Independent Sterling Area countries, will be attempted presently.

Conclusions

The description of the structure of the Sterling Area and the pressures to which it is subjected, present a picture of a live organism creaking and groaning under the strain imposed by forces which more often than not constitute its source of strength as well.

The discussion was concentrated on the inner workings of Area and the introduction of external influences was made only inasmuch as it was required to shed light on the operation of the inner elements.

Some of the outstanding conclusions are discussed below.

The so-called complementarity of the economies of centre and periphery was shown as of insufficient strength to form the nexus of cohesion.[57] From the foregoing analysis, it appears that complementarity corresponds to a certain stage of development beyond which the growth of each economic unit to independence changes the character of relationships from one based on physical complementarity through commodities to one of financial complementarity which may or may not create conditions of stable equilibrium. The forces in either direction were discussed in detail. This should not be interpreted as denying the existence of any physical complementarity, however. The latter exists, but its role is limited to creating minimum conditions for an exchange, such as are found between any trading countries which find an advantage in trading in commodities.

The second conclusion of importance is the necessity for classifying countries according to the degree of political dependence on the centre, even though the group of the Independent Sterling Area is an incongruous one as to most other substantive characteristics. Otherwise the indiscriminate inclusion of all countries into the vague title of Sterling Area conceals more things than it reveals. In reality, the relationship among the Centre, Dependent Territories and Independent countries is a strange one, with the Dependent Territories financing and contributing a substantial share to balance the dollar deficits incurred by the other two. Their participation in the "pool" of dollar reserves in London appears to lead mostly toward the "pool" and not away from it. " .... Naturally the degree of confidence with which it (each member country) exercised or presented claims on the dollar pool depended partly on its political status; the little black children, who were often the best earners, could be smacked on the head if they showed too great a propensity to spend dollars, while the grown up white daughters, who were often pretty extravagant, could only be quietly reasoned with."[58]

It would be a mistake to see the role of the colonies limited to the absolute amount of their dollar contribution. To put it in its proper perspective, the matter should be considered in terms of "alternative cost" which, i.a., should take account of the losses to the United Kingdom that would result from the reaction of the independents to the lack of investment capital from London, the meaning of the loss of the colonial markets, etc. As argued previously, the question of Petroleum relationships forms part of the picture, notwithstanding the classification of the producing countries as "Independents".

The third major conclusion is derived from the analysis of investment in the Sterling Area. The foregoing distinction into "Dependent" and "Independent" proved again crucial in determining both character and role of investment. While Britain's role as supplier of investment has been increasing relatively to its role as supplier of manufactured commodities, the domestic capital formation of the Independent countries appears to be assuming substantial proportions, which is an indication of higher degree of economic maturity, as contrasted to the colonies which await capital from abroad [59] for development.

The character of investment is determined by, or at least is found to be in a functional relationship with the political status of the member countries. While the 'Independent' members possess mainly the equity type, or similar, privately owned investment, concentrated mainly on industries operating at advanced stages of production (relatively high degree of roundaboutness) the ' Dependent ' countries are still characterized by the ' public debt ' type, concentrated mainly on development projects. Notwithstanding the fact of positive growth of the former, indications are that normative policies on the part of the centre tend to perpetuate the character of the latter. It seems that any alternative programs have met with *a priori* rejection. Thus, Professor D. Robertson, though in a different context, expresses this type of policy in an effort to impart the British experience to the Americans as follows: "....It is worth remembering, as Professor Nurkse of Columbia University has recently reminded us, that when British overseas investments were at their zenith in 1914 only a quarter of them in nominal capital value (though admittedly this was the most lucrative section in annual income) consisted of mines, plantations and the like; the remaining three quarters, even in those so-called laissez-faire days, consisted of railways and other public utilities and of loans to governments which were themselves operating schemes of basic development - roads, harbours, irrigation works and so forth. It would seem that somehow or other a balanced policy of overseas investment by the world's greatest creditor nation must, under political conditions admittedly more difficult than those of the nineteenth century, be so fashioned as to include provision for these things, and for the slow process of agricultural improvement, and not be confined to the sucking of petroleum and the tearing of metals out of the bowels of the earth."[60] What a strange, indeed, by North American standards concept of 'balance' of investment.

With the bases established above as background some aspects of the expediency of its preservation may be brought forth, and since ' expediency ' is related to human decision (as contrasted to operation of objective forces,) it should be acceptable to present the case in terms of the arguments advanced by persons with consequential opinion. Thus, H. Gaitskell, while he is ready to examine the expediency of preserving the Area as it stands at present, he arrives at the conclusion through a reductio ad absurdum that if the area were broken up it would have to be re-assembled. [61] He explains it as follows: (if the S.A. were broken up).... it would I think undoubtedly mean that the trade relationships between the members of the Sterling Area would have to be conducted on a dollar standard-that is to say that any surplus or excess on the bilateral account as between any two countries would be settled by dollar payments. I say that, because if the Sterling Area is broken up, the countries concerned would no longer agree to hold sterling in indefinite quantities as they do now....We might have payments agreements under which, when the balances accumulate either way beyond a certain point, there has to be a dollar settlement."

And he concludes: ".. That leads me to the conclusion, that having broken up the Sterling Area we should be forced to reassemble it." It is obvious that Mr Gaitskell, perhaps subconsciously, obtains a view of potential situations from the United Kingdom's standpoint. He attempts to see the results of a change imposed from above but within the same framework of forces which determine the present structure. Does it not sound a bit tautological?

Of similar nature, though more emphatically so, are most statements frequently made in the Economist, which i.a. has made a point to portray in the most vivid colours the benevolent character of the central role played by the United Kingdom, while denying at the same time the existence of any central control : "...its (the S.A's) very discomforts arise largely because the facilities it provides for freedom of payments work so freely....Britain hears most of the brunt of maintaining the free system of international payments and it gets little thanks for it; if it were to lay down the responsibility, there would be a painful moment of truth for today's passive beneficiaries (the rest of the world,note of the writer). The more mercenary question is whether it would be of Britain's economic interest to get out of the sterling business ". Thus, the Economist shifts the weight from the Outer members to the United Kingdom as the party whose interest of association may be questioned. The Economist's attitude seems to be representative of a viewpoint common among British politicians and students of the subject. With some variations as to expression the benevolent character of British leadership is emphasized time and again in a way similar to the old aphorisms on the imperial relationships. The following opinion however, seems to offer a plausible, objective answer to the British common front: " The present structure is built upon the bargaining power, and the future course of the area will depend primarily upon shifts in bargaining strength and upon the utilization of positions of strength by Great Britain and individual OSA members, or OSA members acting in groups." 64

With the introduction of the external factors in chapter Four the perspective for the area will be broadened to new directions.

CHAPTER IV

THE STERLING AREA AND THE PROBLEM OF CONVERTIBILITY

"..Though, eventually, most of the dollars will find their way back to the United States, the way they do so, whether to purchase gold, or invest in our securities, or as deposits in our banks, or the purchase of certain materials rather than others- does make a difference to us. It (pooling) means that many American producers are not getting a fair chance to sell in the sterling area markets." 1

"...If it seems likely that the dollar problem is within sight of a lasting solution, the non-dollar countries can embark with some confidence on full currency convertibility and non-discrimination in trade. And, unless it seems fairly certain that the problem is chronic and serious (underlined by this writer) there will be a very strong case against any suggestions that may once more be made for some kind of permanent non-dollar bloc of countries that would try to become more independent of the United States or of the whole dollar area." 2

The nebulousness in which the subject of 'convertibility is shrouded is indicative of how unstable the foreign trade equilibrium in the relations among countries or blocks of countries is. In a broad sense the term 'convertibility' describes a situation in which trading economic units handle each others currency in payment of exported merchandise without reservations as to quantities of commodities or direction of trade imposed by any of the trading partners. A situation apparently satisfying these conditions is found in the period dominated by the Gold Standard.3

In a more limited sense the term is associated with the problem of balance of payments between the United States and the rest of the world. Since the end of the Second World War, however the term has been almost exclusively identified with the 'Dollar Problem' that besets the United Kingdom in its relations with the United States.

In any attempt to analyze this problem the student will invariably have to consider those of its aspects which pertain to the operations of the Sterling Area, as the latter has been presented in the previous chapters. In this chapter the subject of convertibility will be treated in a similar, though not identical sense, i.e. as a problem of 'Dollar Shortage' in the transactions between the Sterling Area and the United States. The difference between this approach and the one mentioned previously (i.e. United Kingdom vs United States) lies in that the weight of discussion has been shifted to consider the whole area as its focal point rather than one individual country. The shifting is based on the conclusion that the Dollar Problem, even if handled directly by the United Kingdom alone, cannot be separated from the Sterling Area for purposes of real analysis. The policies hitherto adopted by the U.K. have been co-ordinated with, or carried out through practices of members of the area. The operation of centrifugal forces in the area, on the other hand, (as seen in previous chapters) forebodes further moves on the part of the members which may turn out quite influential in the solution of the problem. It will be attempted, therefore, to put the problem in final perspective.

* * *

If the terms 'objective-subjective' may be allowed in economic analysis, the discussion hitherto has been devoted to the 'objective forces, Reference to the 'subjective' factors has been made parenthetically from time to time whenever this helped highlight the operation of the former. The order will be reversed presently. Emphasis will be laid upon the discussion of some outstanding 'subjective' efforts to solve the problem of 'convertibility' for the area.

Two questions may arise out of this statement: Firstly, has 'convertibility' per se been really discussed in 'objective' terms? and, Secondly, assuming that this is the case, what kind of subjective forces will be included in the analysis?

To the first question the answer is, no. Convertibility per se has not been discussed. The focus of discussion throughout all previous chapters was the 'cohesion' of the area rather than 'convertibility'. However, it became evident that the question of cohesion was logically related to the question of convertibility, but no attempt was made to define the degree or direction of this relationship. As to the second question, it follows that those of the 'subjective' forces should be discussed which emanate from the initiative of the United States and the United Kingdom. Though forces other than those of the United States and the United Kingdom may be involved, their examination here is regarded as redundant since their possible effects are ultimately overshadowed in one direction or another by the operation of the two major participants. (It is a different story with 'objective' forces, however.)

A possible approach to the development of such a topic could follow casuistic lines, i.e. tracing the history of individual events and applying an analysis,thereon, beginning with a conventionally established date. This is the approach employed by several students of the subject[4]. However the magnitude of the task is such that it would form a separate topic altogether, and could not possibly be treated as one chapter within this thesis.

The second approach would be the discussion of some major steps taken by the participants in the postwar period (since the Sterling Area has been regarded as a war development, for reasons already explained in previous chapters) to be followed by an attempt towards generalization on this basis, if careful investigation showed that they constitute principal categories within the fabcric of the United States - Sterling Area relationships. The second approach was considered more suitable for purposes of this paper, even though some additional scaling-down of presentation of material had to be made subsequently. The two major landmarks in the postwar relations are, the International Monetary Fund, as a part of Bretton Woods Agreements, and the Financial Agreement between the Governments of the United States and the United Kingdom through which the loan of $3,750 million to the United Kingdom by the United States was made. However, the first landmark is only in its ultimate effects related to the sterling area, while its scope extends much beyond the Area's boundaries. More important perhaps, than the Articles of Agreement(I. M. F.) would be the study of the preliminary plans (Keynes and White) in which it can be seen that the conflict of the two is not one of academic points of view alone.[5] Thus the selection of the Bretton Woods agreements for discussion was not adopted here, because its relationship to the Sterling Area can be established only after considerable logical manipulation. Furthermore, the second landmark affords practically all the advantages contained in a study of the first in a concrete way. Be it as it may, no discussion on any postwar major move can be fertile,unless the subject is seen in context with all major expressions of postwar policies. Thus, free reference to other experiences may be required in the course of discussion that follows.

The Financial Agreement Between the Governments of the United States and the United Kingdom.

The two quotations at the head of this chapter present in a succinct form the main issues in the relations between the United States (dollar area) and the Sterling Area. The first is a brief but almost violent, in its desultory sequence, expression of the desire of the American businessman to enter the sacrosanct preserve of the sterling area. The second is the conditional acceptance, under the circumstances, on the part of his British counterpart, expressed in a cloud of hypothesis, which if carried to finality, may constitute an outright rejection; for such is the meaning of convertibility. It is not a sine qua non for free trade. It is free trade in itself. However these two concepts appear as two different issues , pivotal ones, in the agreement[6], granting the loan to the United Kingdom in December 1945. A discussion of the bhief articles provides, a/ an insight into the more subtle aspects of problems between the two areas,and, b/ information as to the attitudes (subjective force) of the participants vis-avis these problems. Furthermore, the experience on the results of the loan (or, at any rate, whatever is regarded as results of the loan) may provide a test for the power of subjective behaviour against the touchstone of reality.

The basic elements of the agreement are well known. The United States Government agreed to extend to the United Kingdom credit of $3,750 million which could be drawn upon at any time between the effective date of the agreement and the 31st December 1951, i.e. six years from the signing of the agreement. The time provision of the agreement is an important element, for it represented the honest forecasts of the planners on both sides,on which, incidentally, other policies were developed, and in a sense it was normative (from the American viewpoint). As purpose of the credit was stated the desire of the United States to " assist the United Kingdom to meet transitional postwar deficits in the current balance of payments', a desire not unlike the deliberations contained in the Bretton Woods agreements and related to the concept of disequilibrium on a larger scale. It appears that it has been the candid opinion of all planners that the disequilibrium in the payments among trading countries was due to frictional factors not unlike those operating on a world wide scale which were considered in Bretton Woods.

> " Anglo-american opinion on the Financial Agreement displayed the same kind of premature optimism that it had displayed with respect to Bretton Woods".[7]

One wonders, however, whether they had an alternative, even if they recognized the secular discrepancies in international trade relations, as the latter were subsequently re-asserted by events.

In the same section of the agreement the often expressed ideal of multilateral trade is re-introduced. It appears that the Americans attached such an effort to the attainment of this ideal as to link the writing-off of war-time Lend-Lease with the British adherence to the multilateral principles in the Lend-Lease settlement, which was concluded at the same time. This innocuous attitude of the Americans should not be regarded as much different from the British commercial liberalism of the nineteenth century. It seems, however, that the British knew from experience quite well that an ideal is acceptable only so long as it conforms with a favorable material basis; otherwise it ceases being an ideal.

> "...The linking of the commercial policy 'Proposals' with the Lend-Lease (and Loan) agreements was seriously to prejudice their reception in the United Kingdom".[8]

Thus, it seems that the unanimity of opinion between the participants as to the high moral value of the ideal of multilateralism was only the diplomatic sheathing, within which real moves, resulting from or foreboding a conflict of interests were tried, as further analysis of the terms indicates.[9] The main issue in these moves was the future of relations between the U. S. A. and the U.K. as they were affected by the position of each vis-a-vis third parties the most important of which being the Rest of Sterling Area.

> "The multilateral obligations included in the Financial Agreement concerned four major subjects- the current transactions of the sterling area countries, the current transactions of the United States, the current transactions of third countries and treatment of accumulated sterling balances".[10]

The first and fourth subjects are inseparable, of course, and attempts to regulate both simultaneously were logical. However, the degree of regulation varied as to precision of expression. Thus, the provision concerning the first subject was drafted as follows:

> " The Government of the United Kingdom will complete arrangements as early as practicable, and in any case not later than one year after the effective date of this agreement, unless in exceptional cases a later date is agreed upon....under which....the sterling receipts from current transactions of all sterling area countries....will be freely available for current transactions in any currency area without discimination with the result that any discrimination arising from the so-called sterling area dollar pool will be entirely removed and that each member of the sterling area will have its current sterling and dollar receipts at its free disposition for current transactions anywhere ".[11]

On the other hand, the subject of sterling balances was not susceptible to an equally precise drafting. The agreement simply classified the intentions of the British Government as to future handling of the balances, without stipulating any proportions according to which the settlement would be graded, thus rendering the whole arrangement void in effect. The arrangement provided for the division of the balances into the following categories:

"a/ balances to be released at once and convertible into any currency for current transactions, b/ balances to be similarly released by instalments over a period of years beginning in 1951, and c/ balances to be adjusted as a contribution to the settlement of war and postwar indebtedness and in recognition of the benefits which the countries concerned might be expected to gain from such a settlement."

It appears that the first subject which amounted to abolition of the dollar pool, was regarded as of paramount importance by the Americans, as the debates which took place during that period in the United States indicate.[13] The negotiators tried to put across to the public the idea that the Financial Agreement would work a major change in the operation of the sterling area (and therefore, by implication, in the future position of the United States, as a world trader) by eliminating British control over the dollar earnings of the sterling countries. The British view was different in that, (a) it never recognized the exercise of any control by the United Kingdom Government over the behaviour of the members of the pool, and (b) the pool was a strictly voluntary war-time arrangement which would disappear after the difficulties that resulted from the war were over.

It hardly serves any purpose to assess the validity of any of the foregoing opinions on objective grounds. The question is not what was said, but why it was said. The answer lies in the awareness of the Americans of their emergence as the greatest industrial power and the accompanying desire to re-assert their position in places in which the British had established an exclusive preserve. The settlement of the balances, on the other hand, was intended as the lever that would destry the foundations of the dollar pool by disrupting a network of obligations forming, in a somewhat peculiar way, the basis for future trade connections.

The assumption was borne out by the developments which followed the reconstruction period, incidentally. In ordinary thinking, at least that part of the American proposal suggesting 'adjustment' of balances should meet with acceptance on the part of the United Kingdom authorities. Moral foundations for the elimination of such an onerous burden could be established without much difficulty. However, the resistance of the British against any 'solution' of the problem of sterling balances indicates that much more was at stake. Any solution had apparently to be based on the assumption that the British would have first ' to perform a drastic operation - removing the bulk of these balances from the banking system and replacing them with non-negotiable certificates of indebtedness'.[14] The British arguments against the proposals varied with the source of the public sector which was expressing them. However , the attitude of many officials of the Board of Trade according to whom the balances would be a convenient device for the expansion of British exports, seems to have grasped the meaning of the American pressure better than all others, though some of the latter were not entirely unrelated to the preservation of the area as a _par excellence_ trading partner. In view of the difficulties in the legalistic formulation of the settlement, the evasion of the terms presented a relatively easy solution. The problem of the sterling balances was ultimately ignored. As indicated in previous chapters the British Government decided not to block or fund any of the balances to the extent proposed by the Americans and it notified the United States Government accordingly. Several informal arrangements were reached[15] with creditor countries as to the rate at which drawings from the accumulated balances could be made, whereas no scaling-down of any balances was provided for in any of these agreements.

Thus the language of life proved stronger than the language of diplomacy once more. The American diplomats could only express their dissatisfaction with the British inconsistency of purpose and stand helplessly by.

The second and third major subjects of the agreement i.e. current transactions of the United States and current transactions with third countries will not be discussed here, for they cover somewhat broader aspects, although the ideal of convertibility permeates the spirit under which they were negotiated. Those of their elements which are related to the subject of the Sterling Area have been in essence highlighted in the discussion of the pool and the sterling balances.

C o n c l u s i o n s

The foregoing discussion does not give the full picture of relations between the sterling and the dollar areas. Such was not the purpose of the presentation. An idea as to the nature of the subjective forces at work was given, to supplement the discussion of objective forces which were described in chpters two and three.

Any attempt to evaluate the results brought about by the loan itself would be futile, for,isolating its role from other contemporary moves in the fields of politics and economics within and without the area would be incongruous in terms of economic logic. However, the fate of the loan as an accounting value is a different story which may be of some interest as a historical curiosity. It will not be repeated here, except with reference to the fact that it was exhausted in a fraction of the period for which it was originally planned.

A SYNTHESIS ON STERLING AREA

The following few paragraphs do not constitute an attempt towards an abstraction of higher order. The conclusions at the end of each chapter are intended to perform such a function. Some freewheeling in the realm of intellect based on the material experiences of the previous chapters may serve the purpose of this thesis better.

To try to identify parameters along which the future behaviour of the Sterling Area would be forecast, would pressupose the existence of a Value. The Sterling Area does not comply with the definition of value. The latter is usually assumed as a logically homogeneous entity, and the Sterling Area does not satisfy this condition. On the contrary, it appears to be a field more interesting for the array of conflicting forces than for the community of substance of its components. No teleology is discernible in its existence. Whenever anything to that effect is spelled out it is more likely to represent one vested interest, with a large number of rivals ready to counter it, than to express a commonly entertained notion of unity. Events are moving quite swiftly. The explosion in the oil situation of the Middle East is only the starting signal for a chain of events which will remove the last vestiges of purpose, reminiscent of an once historically justified entity.

Denying the term Value as descriptive of the group is not equivalent to describing any moral aspects of the arrangement. It is simply another way of stating that the centrifugal forces in the group are more powerful than the centripetal, not only because of the action of the elements of the group, but also because of the operation of outside factors. Even if it survives as a convenient name for a group of countries the impact of these factors will have brought about such a series of mutations that the science of semantics will probably be as necessary as the sciences of politics and economics to explain the new conditions.

1. The countries that were members of the Sterling Area and the changes of membership are given as a separate item in an appendix.

2. Some people refer to even pre-World War II set-up as Sterling Area. See, e.g., Ref (11) p.47.

3. Ref (4) p.XXIV.

4. Cf introduction.

5. Ref (11) p.47 and Ref (1) p.149.

6. Similar indeed, mutatis mutandis, to the question on whether the IMF agreement bears any resemblance to arrangements under the gold standard. It occurs to me that Prof. Williams assured us of the similarity of the two modi operandi whereas J. M. Keynes took the reverse view.

7. A chain of central banks was established in the Dominions during the Thirties, most of them with the encouragement and assistance of the Bank of England. In some cases, personnel from the Bank of England was responsible for setting them on their course. The discussion of relationships of the London money market and the Rest of Sterling Area has been mainly based on the exposition of Mr. Nurkse in Ref (11).

8. Cf remarks at the conclusion of the section with respect to vulnerability of the system to the vagaries of the international trade cycle.

9. For a thorough discussion of the purposes and modus operandi of the Exchange Equalization Fund, cf W. M. Dacey, The British Banking Mechanism, Ch.X.

10. Ref (11) Ch.III.

11. W. M. Dacey, op. cit. p.103.

12. Cf Ch.III Section A.

13. Ref (11) p.65.

14. Cf Ch.III Section B.

15. Cf Ch.III Sections A & B.

16. Cf Ch.III Section B for changes.

17. Cf Ch.III conclusion..

18. Ref (7) p.456.

19. Members of the group whose monetary affairs do not fall under the jurisdiction of the boards mentioned above, are administered either through currency commissioners or local currency representatives of the British Treasury.

20. Cf ".... and the role of the British Government is important in establishing policies on foreign trade and exchange that shape the place of the dependencies in the Sterling System". Ref (7) p.178.

21. Cf Ch.III Section A.

22. The latter usually constitute a small fraction of the total foreign exchange.

23. IMF Second Annual Report On Exchange Restrictions, 1951.

24. N.Y. Times, Nov. 13, 1950, 6:4, as quoted by Ref (4).

25. Cf Ref (10), p.79.

26. Cf Ref (9).

27. Finance Minister of India, Financial Times, Oct. 6, 1949 as quoted by Ref (1). The case of devaluation, though not associated with the pool, in its technical aspects, is nevertheless mentioned here, i.a., because of the ultimate effects that it has had on the overall condition of the pool.

28. Blocked Accounts were designated as No. 2 Accounts with the Bank of England, whereas accounts from which current payments could be made were designated as No. 1. However, portions of accounts No. 1 of some countries had been restricted by special agreements with Great Britain, providing for consultation as to the use of the portions.

29. See, e.g., agreement signed in 1951 with Egypt, Britain's second largest sterling holder, whereby £150 million of a total of £230 million of No. 2 Accounts would be released over the next ten to thirteen years.

30. Cf cases of Iran where balances were blocked as a result of the oil controversy, and later of Egypt, as a result of the Suez Canal incident.

31. U.K. Balance of Payments, 1949 to 1951, Cmd 8808, H.M.S.O., London 1953.

32. For a detailed presentation of these regulations, see Digest of the U.K. Exchange Regulations, 10th Ed. District Bank Limited. Regulations pertaining to movements of funds to or from the U.K. for non-trade items imposed from time to time by the U.K. government will not be discussed here, for their influence has been stronger on the U.K.'s economy as a unit than on the Sterling Area as a whole.

33. Non-resident accounts are balances held in British banks for natural or legal persons not residents of the Sterling Area. (Cf Ref (6) p.233) Strictly speaking, the regulations refer not to the balances but to the transactions carried through these accounts, as can be seen from the description of their workings.

34. The foregoing remarks pertain to the technical relationships of Sterling Area-Canadian trade. It may be opportune here to refer to a tendency among writers and journalists to consider to substance of the relations between the Sterling Area and Canada as identical to that with the U.S.A. Apart from those who draw the comparison from the sameness of name of the monetary unit of U.S.A. and Canada, others fail to recognize the existence of a "dollar" problem for Canada in her relations with the U.S.A. While for purposes of general discussion such an omission would be of no consequence, since so far as the Sterling Area is concerned, the difference between the two countries is one of degree; it would be inexcusable whenever application of positive measures for the increase of the share of Sterling Area's transactions with Canada are contemplated.

35. Cf Ch.9, p.195 Ref (6).

36. For a detailed description of the arrangements pertaining to each of the "unclassified countries", see Ref (6), p.236.

37. For details of the structure and the workings of E.P.U., see Ref (6) p.496 etc. and the February issue of Midland Bank Review. Here only the details necessary for establishing the connection of Sterling Area and E.P.U. will be included.

38. Cf Ref (3) p.128.

39. Cf Ch.IV.

40. Canterbury Chamber of Commerce Bulletin No. 325 (January 1952) as quoted by Ref (4) p.223.

1. Ref (2) Preface.

2. Cf Ch.III.

3. The deficit in cotton will become greater with Egypt's decision to leave the "Area" after the war and the virtual cessation of trade of any significance thereafter.

4. Cf Ch.III.

5. Compare table of Net Imports & Exports in Appendix I to this chapter.

6. Canada is included on the table for purposes of general information. It is not included in the comparison, for this would not serve our immediate purposes.

7. For a detailed tabulation of traded items, see Ref (2) graphs 3 & 4.

8. Ref (4) p.284.

9. Information on the section (though not the approach itself) that follows is based to some extent on Ref (4) Ch.X.

10. Cf Ref (2) chart 66.

11. Cf Ref (4) p.324. See contra in Ref (2) p.210.

12. Cf Ref (2) chart 66.

13. Except in cases of war or similar emergencies where major countries may be buying for stockpiling. Even so, Australian wool is imported to the U.S.A. despite the high tariff, but the difficulties in this market grow worse.

14. Especially since the time of devaluation of the Indian rupee and Pakistan's refusal to devalue its currency that resulted in major disadvantages for India's trade balance with Pakistan.

15. See Ref (2) chart 5. However, how much do they not produce of what they could consume?

16. Cf Ref (4) p.325.

17. Ref (6) p.256.

18. Ref (2) p.266 table 91.

19. The subject has already been tentatively broached in Chapter I in connection with dollar contribution of the colonies to the pool. A more elaborate discussion will be undertaken in subsequent sections.

20. Ref (5) p.456.

21. Ref (5) p.456.

22. Ref (5) p.469.

23. See App.I of Ch.II.

24. Questions posed by Ref (4) p.327 related to non-convertibility are somewhat incongruous as to the overall spirit of the argument.

25. See App.II of Ch.II.

26. See App.II of Ch.II.

27. Ref (4) p.328 L II.

28. Ibid. p.330.

29. Ibid. It seems strange how contradictory several points of the argument of the author are.

30. Ref (4) p.332. This and some subsequent arguments are being used here as a basis for the discussion.

31. Cf J.V. Stalin, Problems of Socialism in the U.S.S.R.

32. Cf similar discussion on the above concerning the U.S. competition.

33. Although recent publicity has been heavy on the subject, it may be useful to mention here that barter proposals of the type described have included exchanges of commodities extending from Egyptian cotton to Burmese rice and South American coffee, of which the Russians incidentally have not appeared fond of drinking in the past. Would it possibly be politically expedient to do so in the future?

34. Some action on the part of major western countries is shaping up lately; though not co-ordinated on a world-wide scale, it appears that it moves on the assumption that the Soviet moves are part of a long-term master plan.

35. The Economist, Dec. 21, 1957, p.1007.

36. G.D.A. MacDougall, "British and American Exports, etc." Part I Econ. Journal, Dec. 1951.

1. Cf J.R. Hicks, Value and Capital, Introduction.

2. Although the subject had been tackled in a similar way in the section dealing with monetary and banking arrangements in Chapter I, the distinction had not been carried to its logical conclusions, for the problem of cohesion had not been formulated and background material was still lacking.

3. Cf Ref (2) p.509, Table 260.

4. Ref (2) p.514, Table 267.

5. Cf Ref (1) p.44.

6. Cf Ch.I above on monetary & banking arrangements of dependent countries.

7. Cf Ref (7) p.187. The analysis in this chapter has been considerably assisted by the collection of data developed by J. Polk in Ref (7).

8. See appendix to this section.

9. Ref (7) p.194.

10. Cf raison d'être of International Monetary Fund.

11. Cf Ref (2) Table 107. This and a major part of the information on commodities is based largely on the statistical material of Ref (2).

12. Ref (8) p.8.

13. For reasons of historical curiosity, it might be mentioned that Lord Reith, the manager of the C.D.C. in 1951, summarized the story as follows: "(a) In April 1951 there was an epidemic of New Castle disease which wiped out the poultry flock. (b) That was the end of poultry farming." Cf Ref (17) p.50.

14. Cf Hansard, May 14, 1956, Col.1802, as quoted by Ref (8).

15. Ref (8) p.10, Table 1.

16. This is, of course, a tentative order-of-magnitude comparison in monetary terms, indicative of a trend rather than of an absolute situation, and should be interpreted as such.

17. Ref (8) p.12 Table 2.

18. Source: Table 5 Ref (8).

19. For instance, an official estimate (Hansard, June 20, 1956 Col.1509) puts U.S.A. investment in the colonies at £30 million for the years 1950-55, including investment in copper mines in Rhodesia.

20. Ref (9) p.574.

21. Ref (4) p.271.

22. Cf I.C. Greaves "The Sterling Balances of the Colonial Territories", Econ. Journal, June 1951, & "The Character of British Colonial Trade", The Journal of Political Economy, February 1954.

23. Ref (4) p.273.

24. Cf Hazlewood. A "Sterling Balances of the Colonial Currency System", E.J. Dec. 1952, as quoted by Ref (4) p.273.

25. Cf Ref (7) p.183 "There seemed general agreement that at least in the case of the colonial currency reserves of sterling, the history was one of earnings, not of borrowing ...."

26. Ref (7) p.183.

27. Ref (2) p.515.

28. Ref (2) p.512.

29. For reliable statistics, although extending only to the year 1948 on the subject of oil as commodity of the S.A. and in its world perspective, see Ref (2) Chapter 17.

30. Cf The "Economist" in Business Notes & Letters, March 1, 15229, with J. Alsop, R. Harrod & The Economist as participants.

31. "New York Herald Tribune", February 24, 1958, Joseph Alsop.

32. Cf R. Harrod, ibid. p.1125.

33. Ibid. p.779.

34. Cf Ref (7) p.146.

35. Cf Ref (7) p.153.

36. The following piece of conversation impressed this writer at a students' meeting some years ago on the McGill campus: A Canadian asked an Indian student whether India's policy was pro-Western or pro-Russian. The Indian simply answered: "Pro-Indian". This puzzled greatly the local students, for until that time they could recognize only two political and economic entities.

37. A case in point is, _mutatis mutandis_, the decision reached by Malthus as to the general applicability of his law-of-population and which is still carried on in our time despite its failure in the West.

38. Cf Ref (7) p.158 and Ref (9).

39. Cf Ch.I.

40. Cf in Financial Times, November 30, 1949, Sir Stafford Cripps' statement to Parliament that the Government had no intention of entering a counter-claim against the sterling balances for services rendered by the U.K. during the war.

41. Cf Ch.II, discussion on Blocked Accounts.

42. See Summary of such agreements in Ref (4) p.39 etc.

43. See mentioned Summary of Agreements, Ref (4) p.39.

44. Ref (7) p.164.

45. Ref (7) p.164.

46. Cf Ref (1) p.124.

47. Ref (1) p.165.

48. Cf previous section.

49. It is followed, to a large extent, by Ref (8) also, from which most estimates on investment in I.S.A. have been taken.

50. Ref (8) p.2.

51. This small ratio is indicative of the decline of the role of the foreign-owned "public debt" even in a country that reduced its obligations the least, as established above.

52. Ref (8) p.4.

53. Cf Table III. 10.

54. Ref (8) p.7.

55. Ibid.

56. Cf Table III. 11., Note (a).

57. Cf Chapter II.

58. Ref (17) p.39.

59. This may, indeed, sound as an unfortunate expression, if the dollar contribution of the Colonies were taken into account. However, it may be necessary, sometimes, to abide by the standard nomenclature.

60. Cf ref (17)

61. Cf Ref (18) p. 175

62. Cf The Economist, Dec. 21, 1957, p. 1067

63. Cf Ref (4) p. 399

1. Speech by H. D. White, 9 April 1946 (in his private papers, Princeton University Library) as quoted in Ref (4)

2. Cf Ref (16) p. 6

3. This reference to Gold Standard assumes the latter in its static aspects, as they are usually presented in textbooks. Otherwise, the subject of the Gold Standard may turn out as controversial as any theory on International Trade; such a treatment is not intended here.

4. Cf e. g. Ref (20)

5. Especially the insistence of J. M. Keynes on his buffer stocks proposals.

6. For the text of the Agreement, see Cmd 6708 (London 1945)

7. Ref (20) p. 306

8. ibidem, p.210

9. Analysis of the strictly technical terms will not be made here, since the purpose of the chapter is not the analysis of the Loan *per se*.

10. Ref (20) p. 214

11. Article 7 of the Agreement.

12. Article 10 of the Agreement.

13. For a detailed account of the controversy, cf Ref (20) Ch XII.

14. Cf Ref (20) p.326

15. Cf Chapter I, Section on Blocked Accounts.