The Sterling Crisis of 1947 and the British Response to the Marshall Plan[1]

By C. C. S. NEWTON

The Marshall Plan was the response of the United States to Europe's rapidly developing dollar shortage in 1947. American policy-makers feared that, if unchecked, the dollar shortage would precipitate an economic crisis which would destroy all the wartime hopes for the construction of an open world economy.[2] The Truman Administration believed that the crisis would either destabilize the continent and hand it to the Soviet Union by undermining postwar European recovery or that it would drive European nations to control their demand for dollars by resorting to autarkic policies. The United States hoped that in the short term the Marshall Plan would stimulate European production sufficiently to remove the imbalance between Europe and the western hemisphere. In the long term, Washington's objective was the construction of a viable, closely knit European community, drawn together by British leadership, capable of containing Soviet pressure, and integrated into a multilateral world economy.

The United Kingdom shared America's fear of communism and commitment to multilateralism; but common policies did not follow from shared principles. The British prescription for the cure of the dollar shortage was developed from an analysis of how their own international financial position as simultaneously banker to the sterling area and the world's greatest debtor might be reconciled with the liberal-socialist programme of the Attlee Government. British Ministers and civil servants in the Treasury and Foreign Office argued that global economic expansion was essential to conquer the dollar shortage. Merely increasing European production without at the same time relieving the underdeveloped and developing countries of the Far East of their need for hard currency was an inadequate and misconceived policy. London, therefore, tried to widen the scope of the Marshall Plan without committing itself to any endorsement of European political and economic integration, but in so doing provoked American criticism for an unwillingness to become "a good European".

Scholars, too, have often criticized Britain's half-hearted approach towards integration. Historians of postwar British foreign policy and of western European development after 1945 have frequently attributed this failure to an anachronistic determination to continue playing a world role, albeit at the

[1] The author is particularly grateful to Prof. A. E. Campbell, and to Dr B. R. Tomlinson and other members of the Economic History Department at Birmingham University for their helpful comments and suggestions.

[2] Details of Washington's wartime planning for the postwar shape of the world economy can be found in Gabriel Kolko, *The Politics of War* (New York, 1968), passim.

centre of a Commonwealth rather than at the heart of an Empire.[3] This article, based on research into recently released British Foreign Office, Treasury, and Cabinet documents suggests that the traditional picture of British policy towards European integration needs substantial revision. Policy was governed by economic necessity rather than by political arrogance. The nature of Britain's involvement in postwar European co-operation was profoundly influenced by the need to maintain the viability of the sterling area. The 1945-51 Labour Government possessed "a consistent theory of the relationship of the international economy to domestic socialism":[4] a new look at the 1947 sterling crisis shows that the health of the sterling area was central to the success of the Government's domestic programme.[5] Britain's position as banker to the sterling area did involve her in a world role after 1945 but there is no need to invoke antiquated imperial ambitions to explain it.

Finally, it is argued that the British analysis of the causes of and cures for the dollar shortage was vindicated by events between 1947 and 1950. By 1950 it was clear that the dollar shortage would outlast the end of Marshall aid in 1952: a new dollar crisis was averted only as a result of American rearmament, stimulated by the Korean War.

I

At the end of World War II Britain was the world's leading debtor country: not only did she owe more than £3,000 million to her wartime creditors, most of whom were in the sterling area, but she faced a prospective cumulative balance of payments deficit of £1,250 million between 1945 and 1950. Furthermore, at home the Labour Government was committed to the construction of the social-service state and to the maintenance of full employment.

This massive balance of payments deficit meant that these domestic commitments could be fulfilled only in an international context of economic expansion. Keynes, the dominant figure in the formulation of British economic foreign policy, was convinced that sustained international expansion depended on the willingness of the United States, which was the world's largest creditor, to provide generous foreign credits, maintain high levels of internal demand, and keep tariffs low. Thus, in the autumn of 1945 Britain attempted to negotiate an interest-free credit, or even a grant of $5 billion, from the United States in order to cover her likely deficit to 1950.

Although multilateralism was favoured by the United States, the way to achieve an expansion of global trade was believed to lie not in concerted national policies of domestic expansion but in the elimination of barriers to trade. Indeed, throughout the war the postwar objective of both American commercial and financial policy had been to secure international agreement to the dismantling of all discriminatory trade practices. For American policy-makers the term "multilateralism" embraced both non-discrimination in trade

[3] See, for example, Walter Laqueur, *Europe Since Hitler* (1970), pp. 102-3; F. S. Northege, *Descent from Power* (1974), p. 142; and Ernst H. van der Beugel, *From Marshall Aid to Atlantic Partnership* (New York, 1966), p. 224.

[4] See Gabriel and Joyce Kolko, *The Limits of Power* (New York, 1972), p. 64, for the opposite view.

[5] Richard N. Gardner's *Sterling-Dollar Diplomacy* (New York, 2nd edn. 1969) does not explore the domestic policy implications of the 1947 sterling crisis.

and currency convertibility.[6] For this reason, the Americans viewed the sterling area, which during the war had seen the introduction of rationing hard currency through the operation of the gold and dollar pool, as a discriminatory economic bloc which impeded progress to an open world economy. Hence the unwillingness of the United States to provide more than a credit of $3,750 million, repayable over fifty years at 2 per cent interest; and only on condition that Britain made sterling convertible for current transactions into any other currency one year after the President had signed this Financial Agreement, which meant that the date for convertibility became 15 July 1947.

The attempt to build multilateralism on the basis of sterling convertibility was doomed from the start, however, because of the upheaval in the world economy which had resulted from the war. The pre-1914 pattern of international settlements, centred upon Britain's ability to finance deficits with continental Europe and the United States by earning trade surpluses with Australia, West Africa, and above all with India, had barely survived between 1918 and 1939. After 1918 continental Europe as well as Britain ran a deficit with the United States, which had emerged from the Great War as the world's largest creditor. Until 1928 Europe's need for dollars was met by expedients such as the Dawes Plan and by an outflow of short-term funds from the United States. In 1929, however, capital flows from the United States to Europe began to peter out, and in 1931 they were reversed. The consequent difficulties of earning dollars from an American economy which offered neither substantial market opportunities nor long-term loans to its commercial rivals led to the organization of trade along regional or bilateral lines. The 1930s were characterized by a trend to self-sufficiency throughout the world: in east Asia, for example, under Japanese dominance; in central Europe under Nazi German control; and within the British Commonwealth and Empire under the impetus of Imperial Preference. Nevertheless, multilateral settlements remained possible largely because of Britain's ability to finance her dollar deficits with gold newly mined within the sterling area.[7]

Not even this shadow of the old multilateral system survived the Second World War. In 1945 the United States was the world's greatest supplier both of manufactures and capital goods. Western Europe, Britain, and Japan were therefore heavily dependent on the United States to supply capital equipment and consumer goods, for recovery and an improvement in living standards. After the war neither Britain nor the countries of continental Europe were able to finance their deficits with the United States through offsetting surpluses because war had reduced the dollar-earning potential of Far Eastern countries. For example, in 1945 production of oil and tin in Indonesia, Burma, and Malaya fell below prewar levels.[8] India found that many of her needs for the capital goods essential to industrialization as well as for food could be met only by the United States. At the same time, the British surplus with the tropical areas, already shrinking before the war, had been transformed into a heavy deficit, reflected in London's accumulation of sterling balances. This

[6] This exceedingly complex subject is ably dealt with in ibid. pts. I-III.
[7] Elliot Zupnick, *Britain's Postwar Dollar Problem* (New York, 1957), pp. 37-8.
[8] Alan S. Milward, *War, Economy and Society, 1939-1945* (1977), p. 355.

was not just a British problem: the Economic Commission for Europe noted that "while aggregate overseas imports into Europe were only seven per cent above prewar in 1947, the volume of imports from the United States was 130 per cent higher than in 1938."[9] Nine-tenths of the increase was in the form of relief and reconstruction goods, such as grain, foodstuffs, tobacco, coal, timber, iron, steel, machinery, vehicles, chemicals, and ships. In 1946 the consolidated deficit of all European countries in their trade and other current transactions with the rest of the world amounted to $5·8 billion, rising to $7·5 billion in 1947. The deficits with the United States only in both years were, respectively, $4·2 billion and $5·4 billion, which represented over 70 per cent of the total. These were symptoms of a disequilibrium in the world economy at this time which resulted from the emergence of the United States as the world's largest creditor, combined with the collapse of the prewar conditions which had sustained multilateral trade. The central problem facing any nation in deficit with the United States was how to finance all the essential goods it could obtain from across the Atlantic without experiencing a severe fall in living standards in the circumstances of what became known as the "dollar shortage".

The extent of Europe's dollar difficulties began to cause alarm in the United States early in 1947. Policy-makers, such as Dean Acheson, then an Under-Secretary of State, feared a European collapse. Such a collapse, it was argued, would be a boon to Soviet expansion and disastrous for American interests.[10] During the war it became the conventional wisdom in Washington that the national security of the United States was dependent on Europe's freedom from domination by a single power. Washington's determination to contain Soviet pressure on western Europe was signalled by the announcement of the Truman Doctrine in March. Further, the State Department argued that the Truman Doctrine should be complemented by a plan that would lead to European recovery and prevent the Soviet Union from exploiting western Europe's economic crisis for its own ends.

Some Americans believed that even if the Soviet Union failed to take advantage of it a European collapse would adversely affect America's economic strength, which had been greatly stimulated during the war. Officials, such as Will Clayton, Under-Secretary of State for Economic Affairs, feared that the fully extended American war economy would suffer from overcapacity in peacetime unless export markets worth at least $14 billion a year could be secured. After the war American exports had been sustained by loans and by relief payments through UNRRA, until its termination at the end of 1946. The Bretton Woods institutions were unable to fill the dollar gap: the International Bank's lending power was inadequate at $2·3 billion, and it had never been intended that the International Monetary Fund should be used for reconstruction purposes. The anxiety in Washington was that unless the flow of hard currency from the United States could be maintained, European nations would try increasingly to eliminate the dollar from intra-European trade by resorting to bilateralism, state trading, and exchange controls.

[9] United Nations, Economic Commission for Europe, *A Survey of the Economic Situation and Prospects of Europe* (Geneva, 1948), p. xiii.

[10] See Joseph M. Jones, *The Fifteen Weeks* (New York, 1955), passim.

Europe's commitment to liberal capitalism, therefore, was seen as essential to the continuation of American economic prosperity.[11]

This commitment was to be secured by a heavy transfusion of dollars and by increased European production, the two assumptions which underpinned the Marshall Plan when it was launched in a speech made by Secretary of State Marshall on 5 June 1947. In it he encouraged European countries to produce a co-operative plan based on mutual aid and self-help, which with American assistance should aim to eliminate Europe's dollar deficit by 1951-52.

II

Ernest Bevin, together with the French Foreign Minister Georges Bidault, took the initiative in organizing the European response to the Marshall speech. Following the decision of the Soviet Union and of the east European nations within its sphere of influence to withdraw from the preliminary talks, the Committee of European Economic Co-operation (hereafter C.E.E.C.)[12] which met in Paris, became a west European body. In September the C.E.E.C. produced a report which predicted the total needs of participating countries in 1948-51, after the fullest degree of mutual aid and self-help. The assumptions of the report were based on national estimates of likely export performance, import requirements, and productivity.

American policy-makers who favoured Britain to spearhead the European reconstruction programme welcomed Bevin's initiative in particular. Further indications of American ideas for organizing European recovery were given to the British by Will Clayton at the end of June. At meetings with senior cabinet ministers and civil servants on 24 and 25 June, Clayton emphasized that the United States believed there should be no further piecemeal aid, country by country, but that henceforward assistance of any kind must form part of a general plan: "This applied equally to the U.K. and he thought he would be lacking in frankness if he did not make it clear that the U.K. could only receive assistance as part of a general European plan."[13] Clayton stated that the dollar shortage, from which "the whole trouble arose . . . represented failure of Europe to produce".[14] He told the British that the United States wanted a plan "which will restore European production within a stated period to a level which will render unnecessary Europe's present abnormal dependence upon imports", especially of food and fuel. He suggested a liberalization of trade and exchange controls, and even the formation of a west European customs union.[15] Washington wanted to make sure that there would be no return to the protectionism and cartelization of the 1920s and 1930s.

[11] Kolko, *The Limits of Power*, p. 21.

[12] The countries participating in the C.E.E.C., Britain and France apart, were Austria, Belgium, Denmark, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Sweden, Switzerland, and Turkey.

[13] PRO FO 371/62405, UE 5388/168/51, minutes of a meeting in the Prime Minister's office on 24 June 1947.

[14] *Foreign Relations of the United States*, III (1947), (hereafter *FRUS*), pp. 276-83. Summary of the meeting between Clayton and British Cabinet members, 25 June 1947.

[15] PRO FO 371/62404, UE 5296/168/53, Treasury memorandum 1 July 1947.

The free flow of men, goods, and capital, it was believed, would both assure economic efficiency and undermine economic nationalism within western Europe. Further, the creation of a regional European bloc was to be the first step towards world-wide convertibility and multilateral trade. Robert Triffin, then Director of the International Monetary Fund's Exchange Control Division, later emphasized that Washington hoped to create "a large and stable area of freer trade, gradually drawing non-member countries into its orbit."[16] American officials envisaged a new form of international system in which the United States would find a partner not in a single west European country only, but with an integrated western Europe which would co-operate with the United States both in the policy of containing Soviet expansion and in achieving multilateralism.

The British defined the American approach to the problem of European recovery as "continental",[17] and expressed two principal misgivings about it. First, they felt it ignored their central position in the world economy as "the bridge between the Western and Eastern Hemisphere", traditionally financing deficits with the west from surpluses with the east. Secondly, they argued that it was not Europe's failure to produce but the "postwar world supply crisis"[18] which was at the root of the dollar shortage. Such was the dependence on the western hemisphere caused by the failure of primary production in the rest of the world, that Britain's dollar drain had increased from under $100 million a month in the second half of 1946 to over $300 million a month by May 1947. Were this dollar drain to become unmanageable, argued the British, the alternatives would be either to cut even further the "present threadbare" living standards of the domestic population, or "abandon the whole concept of multilateral trading and seek to eke out a painful existence on the best terms of bilateral trade which we can secure . . . unless sufficient steps can be taken to fill the gap in the world's dollar supply we shall be confronted with the choice as hard fact which has to be faced."[19] But it was argued that if the United States made "some special arrangement" for Britain, dollars could be re-cycled through London to Empire and Commonwealth nations, many of which were primary producers. By increasing the world's supply of dollars, an Anglo-American financial partnership would stimulate the recovery of the eastern hemisphere. Thus, dependence on the western hemisphere would diminish and the world economy would move back towards balance.

The British arguments presented in the summer of 1947 derived directly from those employed in their financial talks with the Americans in 1944 and 1945. Then they had emphasized that creditor nations should take a large measure of responsibility for correcting imbalances in international payments. When Bevin informed the United States Embassy in London of his reactions to Marshall's speech, his

[16] Robert Triffin, *The World Money Maze* (New Haven, 1966), p. 400. Triffin is not simply expressing his own view of what might result from regional integration. From 1946-51 Triffin was closely involved in the formulation of American economic foreign policy, first as director of the Exchange Control Division of the International Monetary Fund (to 1948), then as an observer to the Intra-European Payments Committee of the O.E.E.C., and from 1949-51 as special adviser on policy, trade and finance to Averell Harriman, special representative for the Economic Co-operation Administration in Paris.

[17] PRO FO 371/62404, UE 5296/168/53, Treasury memorandum 1 July 1947.

[18] PRO FO 371/62377, UE 4755/168/53, Treasury memorandum for U.S. Department of State, 16 June 1947.

[19] Ibid.

> concluding observations were that the U.S. was in the position today where Britain was at the end of the Napoleonic wars. When those wars ended Britain held about 30 per cent of the world's wealth. The U.S. today holds about 50 per cent. Britain, for eighteen years after Waterloo "practically gave away her exports" but this resulted in stability and a hundred years of peace.[20]

Whether this historical parallel was accurate or not is irrelevant. Bevin's point was that as the world's largest creditor the United States should take the initiative in correcting the global disequilibrium. Such information which the British gleaned from American officials prompted scepticism among the former that the Marshall Plan was sufficiently wide in conception to succeed in this objective.

Nevertheless, the British hoped to use Bevin's initiating response to the American offer of help for Europe to widen the scope of the Plan and to draw as many dollars as possible from Washington. This policy did not square with the objectives of the State Department, and as the Paris discussions of the C.E.E.C. progressed Washington became increasingly anxious lest the Europeans, instead of producing a genuinely co-operative plan in which they met each other's needs as far as they could, merely presented sixteen "shopping lists".[21]

III

The British reactions to the Marshall Plan were governed by the rapidly developing drain of dollars from their reserves during the summer of 1947. The reserves had fallen dangerously low even before the implementation of convertibility:

Table 1. *Course of the British Reserves 1946-7 ($ millions)*[22]

	June 30 1946	*Dec. 31 1946*	*June 30 1947*
Gold and Dollar Reserves.	2,240	2,640	2,410
Undrawn U.S. credit.	3,750	3,150	1,700
Undrawn Canadian credit.	1,090	710	550
Total	7,080	6,500	4,660

The reserves had declined by $580 million in the second half of 1946, and by $1,840 million in the first half of 1947. British overseas expenditure, and drawings made by sterling area countries for their current requirements at a time of great dependence on the dollar area, were partly responsible for this alarming situation, which after February 1947 was exacerbated by the operations of the transferable account area. For example, by joining the transferable account area countries such as Belgium and Sweden became entitled to earn convertible sterling before July. They built up surpluses with the United Kingdom by restricting imports from Britain, particularly of

[20] *FRUS*, III (1947), p. 255, Bevin reported in telegram from Gallman (Chargé d'Affaires at U.S. Embassy, London) to Marshall, 16 June 1947.
[21] *FRUS*, III (1947), pp. 372-5, Lovett to Marshall, 24 Aug. 1947.
[22] PRO CAB 129/20, CP (47) 227, memorandum by the Chancellor, 16 Aug. 1947.

textiles and consumer goods, and by increasing their exports to her.[23] After 15 July this process was generalized throughout much of Europe, leading to intense competition for hard currency. Britain's trading partners were, in effect, using convertibility to pass on to her their own dollar problems.

After 15 July, the monthly dollar drain increased from $315 million to $498 million, and in the following month, until convertibility was suspended, the figure increased to $650 million;[24] in the first half of 1947 the balance of the loan had been reduced by $1,630 million, and in just under two months, from 1 July to 23 August 1947, $970 million disappeared.[25] Had convertibility not been suspended on 20 August the credit as a whole would have been exhausted by the end of September, leaving Britain no alternative but to draw on her gold reserves.

A Central Economic Planning Staff paper of July 1947 pointed out that if this drain was left unchecked the consequences for Britain would be dire. Britain's lack of hard currency would necessitate sharp reductions in imports of food and raw materials, the intensification of rationing, and cuts in the building programme, and industrial output would be likely to fall as factories went short of capital goods. Britain would attempt to form a "new sterling area" including the colonies, Australia, New Zealand, and possibly Denmark. This new sterling area would pool its meagre dollar resources and each member "would make its supplies available within the group". But not even the unashamed pursuit of autarky would be likely to prevent unemployment rising as high as four millions.[26] Britain was heading not for the New Jerusalem, but for Starvation Corner. One source of the drain was the operation of convertibility at a time of dollar shortage, which forced Britain to pay her suppliers in dollars if requested, but imposed no reciprocal obligation, either to import British goods or to convert their own currencies. Two other problems arose from the inadequate nature of the Financial Agreement itself: first, the assumption that sterling could be made convertible for current, but not for capital, transactions; and secondly, the assumption that London would be able to scale down the sterling balances.[27]

The commitment to scaling down the sterling balances caused great problems for London. First, the existence of the balances markedly increased British purchasing power. In the summer of 1947 the balances stood at £3,557

[23] These two countries benefited from their ability to supply commodities badly needed by their European partners. Belgium herself provided exports of wool and textiles, and used the resources of her colony in the Congo to supply copper. Sweden's most profitable two exports were iron ore and timber. See H.M. Board of Customs and Excise, *Trade of the United Kingdom*, 1947, vol. 4.

[24] PRO T 267/3. Treasury Historical Memorandum: 'The Convertibility Crisis of 1947', p. 30. This document was written by Sir Hugh Ellis-Rees on his retirement from the Treasury in 1961. He had full access to confidential papers, and his report was made available within the P.R.O. in August 1980.

[25] Ibid. p. 31.

[26] PRO T 229/136, memorandum by R. W. B. Clarke, 15 July 1947; interview with Sir Austin Robinson, 5 June 1979.

[27] The distinction between current and capital transactions was made to prevent Britain's creditors switching their reserves away from sterling into dollars and so undermining the position of sterling as an international currency. The sterling area arrangements in Clause 10 of the Financial Agreement were designed partly to stop Britain using her creditors' accumulated sterling balances as a means of building up export markets for herself and thereby excluding American businessmen from overseas markets, and partly to ensure that on convertibility the British reserves would not be put under strain as sterling balances were converted into dollars.

million, compared with £3,136 million on 30 June 1945.[28] By allowing the sterling balances to accumulate throughout 1946 and the first half of 1947, Britain had been able to import food and raw materials without immediately having to pay for them. Thus, Britain had used her international financial prestige as banker to the sterling area to facilitate her reconversion to a peacetime economy. Secondly, Britain had committed herself under Clause 10 of the Financial Agreement to "adjusting" the sterling balances. But any adjustments were to be made with the consent of the holders, rather than by unilateral action on the part of the British Government. Nevertheless, early in 1946 Keynes led a move from within the Treasury to draw a line across the balances, leaving blocked sterling on one side and freely convertible sterling on the other. The Bank of England successfully opposed Keynes's view, and argued that simultaneously maintaining sterling as an international currency and blocking sterling balances were contradictory policies: "if this [blocking] were done sterling would become disreputable: the London balances of sterling area banks were their first line of liquid assets and to interfere with them in this way would lead to a first-class banking crisis."[29] In consequence, Britain hoped to scale down the balances after talks with each creditor. But the reduction of sterling balances during these negotiations was rendered practically impossible, because Britain's most important bargaining counter had been removed in the commitment to make sterling convertible on 15 July 1947. The Bank was merely able to obtain from holders of sterling balances agreements that their national authorities would supervise the conversion of sterling and request it only when it was necessary to finance the current transactions of their residents.

Political as well as economic circumstances militated against downward adjustments of the balances. India, for example, held more than one-third of all sterling balances. Between 1945 and 1947 the Labour Government was conducting a series of extremely difficult negotiations with Indian political leaders, with the aim of giving the country its independence within a multi-racial Commonwealth.[30] In 1946 and 1947 India was plagued with food-supply problems, and lacked the foreign investment which neither the United States nor the International Bank appeared willing to provide but which was essential to any agricultural and industrial modernization programme. The British concern at that time was that the financial consequences feared by the Bank would be exacerbated by the political problems likely to develop in the Anglo-Indian relationship after independence, if excessive pressure was brought upon India to scale down sterling balances.[31] The second difficulty was the practical difficulty of maintaining the distinction between capital and current transactions, as the events after 15 July showed. Indeed, the chances are that the distinction would only have been observed had the financial

[28] During 1946 sterling area sterling balances belonging to west European nations and to the non-dollar western hemisphere rose from £351 million to £363 million, and from £163 million to £212 million respectively. See H.M. Treasury, *United Kingdom Balance of Payments, 1946-57* (1959), Table 11, pp. 42-3.

[29] PRO T 267/3, Ellis-Rees, 'The Convertibility Crises of 1947', p. 12.

[30] D. C. Watt, 'Britain and the Far East, 1945-1954', in Yonosuke Nagai and Akira Iriye, eds. *The Origins of the Cold War in Asia* (New York, 1977), p. 97.

[31] Interview with Sir Austin Robinson, 5 June 1979.

operations of its creditors been controlled in London. As it was, some countries made not even a formal pretence of observing the gentlemen's agreements they had concluded with Britain.[32] Other countries, which financed their dollar deficits by demanding conversion not merely of net but of gross earnings of sterling, could maintain that they were acting within the letter of their agreements with Britain. Yet, in reality, if the countries in question already possessed dollar reserves such a conversion implied a transfer of reserves from sterling into dollars.[33]

On 16 August 1947, Hugh Dalton, Chancellor of the Exchequer, produced a memorandum giving details of the dollar drain which amounted to $868.5 million between the start of July and 15 August.[34] The speed with which dollars disappeared from London demonstrates that sterling was not being converted merely for current transactions but for capital transactions also. American credit had already been drawn upon three times in August, before Dalton presented his paper to the Cabinet, each time for $150 million. Dalton argued that the free convertibility of sterling must be suspended to stop the drain of dollars, and this occurred on 20 August, following Anglo-American consultations to ensure that such action fell within the terms of the Financial Agreement.[35]

The immediate cause of the convertibility fiasco, then, was the drain of dollars which resulted not only from current but also from capital transactions. Britain's creditors within the transferable account area and within the sterling area were responsible.

Table 2. *U.K. Provision of Dollars for Sterling and Non-Sterling Countries, July 1946—September 1947 ($ million)*[36]

	1946	*1947*		
	July-December	*Jan.-March*	*April-June*	*July-Sept.*
European and Other Countries	−40	—	35	165
Sterling Area countries	−5	90	248	395

Belgium was one country which took full advantage of convertibility to draw upon its sterling balances and effect transfers into dollars. In the six months between 1 January and 30 June 1947 Belgium had transferred £18·3 million to the dollar area; in the seven weeks between 1 July and 20 August the figure was £34·4 million. Belgium's sterling balances, meanwhile, rose by £21·6 million between 1 January and 30 June, but fell by £23·2 million from 1 July to 20 August.[37]

So great, indeed, was the general flight from sterling, and so heavy were the transfers from sterling into dollars during the summer of 1947, that it is probably not too melodramatic to suggest that the sterling area itself might

[32] PRO T 267/3. Ellis-Rees, 'The Convertibility Crisis of 1947', p. 30.
[33] Lionel Robbins, 'Inquest on the Crisis', *Lloyd's Bank Review*, Oct. 1947, pp. 18-19.
[34] PRO CAB 129/20, CP (47) 233, memorandum by the Chancellor, 16 Aug. 1947.
[35] Gardner, *Sterling-Dollar Diplomacy*, p. 313.
[36] Derived from statistics published in Sir Richard Clarke, *Anglo-American Economic Collaboration in War and Peace, 1942-1949* (Oxford, 1982), pp. 187-9.
[37] House of Commons Debates, Vol. 443, written answers, cols. 219-20.

have faced disintegration had the British not suspended convertibility. Once the wartime exchange arrangements had been abolished, the sterling area depended for its existence on the willingness of countries to hold their reserves in sterling. The world-wide dollar shortage, however, was so intense that many nations seized the opportunity of convertibility to abandon sterling for dollars. As bankers to the sterling area, the British had to finance these transactions through their own dwindling reserves. Since a large part of the non-dollar world's financial reserves was held in sterling, a continuation of the British dollar drain would have resulted in a very substantial reduction in the amount of liquidity at the disposal of the non-dollar world, leading to a shrinkage in the volume of global trade.

By insisting that discrimination and exchange controls were the central obstacles to a multilateral world, and by forcing the liberalization of sterling, in effect the Anglo-American Financial Agreement placed the burden of adjustment to the world disequilibrium on Britain, the world's greatest debtor. The traumatic events of 1947 convinced British Ministers and civil servants not that multilateralism was an unattainable goal, but that it could not be achieved in the absence of measures to correct the imbalance between the dollar and non-dollar areas of the world. The British view was that as the United States was the world's largest creditor Washington should take the initiative in correcting the disequilibrium.

IV

After the suspension of convertibility the sterling area became a discriminatory economic bloc once more. The dollar-pooling arrangements were reintroduced, and in September 1947 the leading members of the area agreed to tighten both their import controls against dollar goods and their exchange controls to prevent leakages of hard currency. Through this recreated sterling bloc Britain was able to insulate herself from the deflationary pressures of the dollar shortage and simultaneously sustain a multilateral system of trade and payments throughout the Commonwealth and Empire.

Yet the post-convertibility sterling area was a source of strain as well as a source of strength to Britain. The benefit of the sterling area dollar pool to independent sterling area members was that it offset their dollar deficits against the dollar surpluses of dependent members, thereby providing more hard currency than they would have been able to obtain outside the area. Since Britain was banker to the area it was her responsibility to prevent the central reserves falling to the point at which this advantage of membership would disappear. Britain's gold and dollar reserves were not only hers but represented the first line of defence for the sterling area as a whole. Thus, a threat to the British reserves would threaten the continued existence of the sterling area and in doing so jeopardize the Labour Government's full-employment policy. In consequence, the health of the reserves became the reference-point by which the success of British economic policy was judged. This overriding priority was to leave its mark on British policy towards the Marshall Plan.

After 20 August it became necessary to renegotiate all payments arrangements with members of the transferable account area. Belgium was included in these negotiations as a member of the transferable account area. The result of these talks was a series of new bilateral payments agreements by which both parties agreed to hold certain amounts of each other's currency as a condition of converting it into gold. After long and difficult negotiation, in March 1948 it was agreed that Belgium would have to accumulate a surplus of £12 million before transferability became possible. Under convertibility Belgium had naturally appreciated the chance to earn sterling from Britain; consequently Brussels reacted sharply when convertibility was suspended. The desire of the British Treasury to block all transfers of sterling to Belgium by third countries was a further cause of tension between London and Brussels.[38]

The convertibility crisis, the British deficit with Belgium, and the worsening of relations between the two countries in combination inevitably affected London's policy at the Paris Conference of nations which brought together countries participating in the Marshall scheme.[39] At the end of July and beginning of August the Benelux representatives at the Paris talks produced proposals for European monetary integration as a step towards stimulating more intra-European trade and higher production. These proposals were made at an inopportune moment for Britain, and elicited from Sir David Waley, Third Secretary to the Treasury, the complaint that:

> This paper hardly refers at all to currencies being made convertible when the apposite conditions have been fulfilled. It deals with steps to make payments arrangements more multilateral and American aid to enable one country in Europe to pay dollars to another when the Credit Margins have been exhausted . . . . In general United Kingdom delegates pointed out that position of sterling is very different from that of other European countries and it might be impossible for us to hold other currencies so long as other countries can turn all the sterling which they hold into United States dollars.[40]

The flight from sterling which had accelerated so rapidly after 15 July was then approaching its height, at a time when Belgium was a leading non-sterling holder of sterling balances. The British lack of enthusiasm for a scheme permitting inter-convertibility of European currencies was rooted in the conviction that if the proposals were put into practice Britain would face a further deterioration of her dollar drain because of her deficit with Belgium. Such pressure would, first, weaken any contribution Britain might be able to make to European recovery, not only by reducing the level of her dollar grants to Germany but by forcing her to lower imports from continental countries. Secondly, as we noted in the last section, since Britain was banker to the sterling area, an intensification of a pressure on her reserves which was already extremely heavy would threaten the collapse of the area itself and lead to a restriction of world trade. Thirdly, the deterioration of Anglo-Belgian economic relations after the suspension of convertibility did nothing to smooth

[38] PRO T 267/3, Ellis-Rees, 'The Convertibility Crisis of 1947', p. 40.

[39] The pivotal importance of sterling area viability and balance of payments questions in the formulation of British policy towards European integration ensured the closest co-operation between the Treasury and the Foreign Office. This co-operation was co-ordinated by the Economic Relations and European Recovery Departments of the Foreign Office.

[40] PRO FO 371/62632, UE 7196/6877/53, Minute by Waley, 12 Aug. 1947.

London's anxieties about the Benelux proposals. Britain's view was that the liberalization of payments arrangements in western Europe could not be achieved until the countries participating in the Marshall Plan had been relieved of anxiety about the state of their reserves. The British were aware, as a result of bitter experience, that in the absence of such relief convertibility would stimulate a competition for hard currency. A Cabinet Office paper of early September clarified the argument by defining "the immediate problems of Europe" as "the need for increased production and the need to balance Europe's payments with the rest of the world".[41] These two aims were unlikely to be achieved, either by the introduction of inter-European transferability, or by the creation of a European Customs Union (which would take many years to accomplish in any case). In the circumstances, the best course was to ensure that C.E.E.C. members received adequate aid from Washington and to help European recovery by lifting "avoidable restrictions"[42] on the movement of goods between participating countries.

London's preoccupation with the importance of adequate dollar aid for western Europe left its mark on the development of the C.E.E.C. report and created considerable unease in Washington. During talks with European governments early in the summer, Clayton, together with the American ambassadors to participating countries, had emphasized that the C.E.E.C. report should show that dependence on assistance from Washington would steadily decline over the next four years. American representatives were anxious that unless the report demonstrated the ability of European nations to pay their own way by 1951 Congress would be unlikely to approve the Marshall programme.[43] But Sir Oliver Franks, the British chairman of the C.E.E.C., said that participating countries, including the western zones of Germany, would still face a deficit of \$5·8 billion with the American continent by 1951, and that the total deficit for the period between 1948 and 1951/2 would amount to \$28·2 billion. The only hopeful sign was the probable disappearance by 1951 of the European deficit in manufactured goods, but a deficit of \$5·8 billion would remain attributable to food and oil imports.[44]

These were not inflated requirements. The food imports included in the figures in fact showed a lower rate of average consumption per head than in 1934-8. Further, the figures took into account the development of indigenous production and the growth of imports from eastern Europe equivalent to the level obtained in 1938. Franks was entitled to argue that, given the scale of the dollar shortage, the C.E.E.C's assessment of western Europe's needs was modest. Nevertheless, Franks told Bevin that Washington must contemplate not a four year programme but a more ambitious scheme lasting six or even eight years. And should "Europe . . . get less than the full amount shown in the figures for the four-year period, the aid would be totally insufficient and Europe would inevitably fall into economic distress and political unrest."[45] Customs unions would not eliminate the deficit: the only courses Washington

[41] PRO FO 371/62565, UE 7330/5865/53, Cabinet Office paper, 9 Sept. 1947.
[42] Ibid.
[43] PRO FO 371/62632, UE 7852/6877/53, Minute by Roger Makins covering Frank's visit to London, 23 Aug. 1947.
[44] Ibid.
[45] Ibid.

could adopt if it insisted Marshall aid should cease after four years would lie either in willingness to accept larger imports from Europe by reducing tariffs, or by an encouragement of "triangular trade".

The State Department was unsatisfied by the proposals emerging from the C.E.E.C. Lovett complained that the Paris Conference had merely produced "sixteen shopping lists"[46] whose grand total was disappointing, not only in its size but also because it implied that even the vast sums desired by the C.E.E.C. would not establish rehabilitation by 1952. In these circumstances, a consensus developed in Washington that the United States should "lend friendly aid in drafting"—"friendly aid" meaning pressure for more co-operation; and the most effective sanction lay in suggesting that the Republican-dominated Congress, hostile to large programmes of federal spending, would refuse to approve a plan on the scale of that proposed in the C.E.E.C report.

From the middle of August 1947, therefore, Washington began to exercise a positive influence on the C.E.E.C. in the direction of greater economic co-operation. Robert Lovett informed Jefferson Caffery, the American Ambassador in Paris, that among the "essential elements" of the Marshall Plan which should be embodied much more precisely in the C.E.E.C. report, were "concrete proposals" for the recovery of agriculture and basic industries—coal, steel, transport, and power—throughout western Europe. In particular, the United States wanted to see higher production of grain in France, and of coal in the Ruhr and in Britain. Secondly, C.E.E.C. members should be more willing to stabilize their economies through such measures as "currency reform, [and] the correction of grossly inflationary fiscal practices". Thirdly, multilateral intra-European trade should be developed.[47] Finally, the State Department argued that west European production would be inadequate to the task of freeing participating countries from dependence upon the Americas without the incorporation of the three western zones of occupation in Germany (the Anglo-American bizone and the French zone) into the recovery programme. West Germany, therefore, was to be a participant in the Marshall Plan and an integral part of the new western European economy Washington was now attempting to construct.

Despite Lovett's endeavours, the final C.E.E.C. report reflected British concerns rather than American objectives. Far from emphasizing the urgent need for economic integration all the way to a customs union, it concentrated on the global nature of the dollar problem: ". . . the traditional method in which Europe has paid the American continent has been by an export surplus with the rest of the world. It is therefore essential that there should be an adequate flow of dollars to the rest of the world so that the participating countries and western Germany may be able to earn dollars not only directly by their exports to the American continent but also indirectly by their exports to other countries."[48] The British hoped that a large American foreign investment programme in underdeveloped countries, many of which were in the sterling area, would relieve their immediate dollar problem and lead to

[46] *FRUS*, III, (1947), pp. 372-3, Lovett to Marshall, 24 Aug. 1947.
[47] *FRUS*, III, (1947), pp. 383-9, Lovett to Caffery, 26 Aug. 1947.
[48] Committee of European Economic Co-operation, *General Report* (1947), p. 71.

the disappearance of the long-term dollar shortage, first by stimulating a return to, and then an expansion of, world trade. Through the C.E.E.C. report the British were attempting to push the United States into endorsement of a Keynesian international economy. By taking the initiative to correct the disequilibrium on the basis of a sterling-dollar partnership the United States would be helping to construct a global environment in which Britain could reconcile full employment with multilateral trade.

But the Americans resented the way in which the British used their chairmanship of the C.E.E.C. to balance their interest in European revival with an attempt to gain some financial ballast for their international economic position at the centre of the sterling area. As Marshall told Ambassador Douglas: "Brit[sic] wish to benefit fully from a European program as suggested by Sec[sic] State while at the same time maintaining the position of not being wholly a European country."[49] And unfortunately for the British the extent of the aid they were likely to receive through the Marshall Plan was going to depend not so much on what they thought necessary as upon what Washington felt it could provide. In response to American pressure the projected deficit likely to obtain between the Americas and Europe from 1948 until 1951/2 was reduced in the final version of the C.E.E.C. report to $22 billion. But this was still too much for the United States. In the autumn of 1947, Sir Oliver Franks led a delegation from the C.E.E.C. members to Washington. The Truman Administration, committed to its vision of an integrated Europe and pressed by the economy-minded Congress, had decided to establish a network of technical committees to screen the requests of the Paris report. The aim was to encourage the C.E.E.C. to reduce its dollar requirements further, by making capital programmes more modest and by reinforcing the commitment to "self-help and mutual aid". It was not surprising, then, that when Franks arrived in Washington with the C.E.E.C. delegation he found the Administration "completely unconvinced that the work done in Paris had been useful from their point of view."[50] By December, through the work of the technical committees, the United States had whittled the request for $22 billion in the C.E.E.C. report down to $17 billion. In addition, the participating countries were strongly encouraged to form a continuing organization, so that the criterion of closer and lasting European economic co-operation could be satisfied.[51] Meanwhile, in the gap before the first instalment of Marshal aid was to arrive, Congress authorized interim aid worth $522 million for France, Italy, and Austria, and the Administration allowed Britain to draw the $400 million remaining out of the American loan's original $3,750 million.

The implications of British policy toward the Marshall Plan during the summer and autumn of 1947, therefore, led away from the closely knit, economically self-supporting community of nations for which Washington was planning. London emphasized the global nature of the dollar crisis, a point burnt into the minds of British Ministers and civil servants by the traumatizing effects of the convertibility crisis, when for six weeks Britain found herself taking the strain for the world's demand for dollars. Without

[49] *FRUS*, III, (1947), pp. 418-19, Marshall to Douglas 8 Sept. 1947.
[50] PRO CAB 129/22, CP (47) 340, 'European Recovery Programme', 22 Dec. 1947.
[51] Van der Beugel, *From Marshall Aid to Atlantic Partnership*, p. 113.

action to relieve the disequilibrium, the British argued, the gains arising from higher continental production and from a large reduction of barriers to trade and payments between C.E.E.C. countries were likely to be merely short-term. This technical economic argument implied also a political judgement about how much European economic integration was necessary, and about the extent to which Britain should herself become associated with European affairs. The stance taken by London in the summer of 1947 on proposals to make European currencies inter-convertible, on the size of the aid required from the United States, and on the place of the United Kingdom within the Marshall Plan, did form the basis of the British attitude towards the development of western Europe to 1950 and beyond.

The British welcomed Marshall aid because it would enable them to avoid the choice between massive austerity or severe deflation, or a combination of both likely to result from the exhaustion of their reserves. Since they, like the Americans, were concerned about Soviet expansion they agreed that western European nations should co-operate to offset the power of the Soviet bloc in eastern Europe. But the United Kingdom believed that membership of a closely knit European community would cut across its role as banker to the sterling area, and damage its internal economy. Since the sterling area was in deficit with Belgium, and to a less extent with Switzerland, the area reserves stood to lose large amounts of hard currency in any sweeping liberalization of European exchanges. For this reason, Britain tried to counter American, and continental, pressure for European integration, by sponsoring through the O.E.E.C.[52] an intergovernmental form of western European political association which would enable her to reconcile her world economic role and her commitment to full employment at home with the imperative of European co-operation. If Bevin's call for a "western union" is seen in this light, rather than as a bold advocacy of supra-nationalism, the mystery of his "loss of vision of European unity between January and March 1950"[53] evaporates.

There appears to have been a "loss of vision" because the bold rhetoric of Bevin's "western union" speech concealed caution and pragmatism.[54] Continental enthusiasts for European integration, such as the Belgian socialist leader Paul-Henri Spaak, mistook the rhetoric for the reality, and expected more from Britain that she was ever prepared to deliver. By the start of 1949, the British Government had decided that it could not make any irreversible commitment to European integration.[55] But at the same time, the United Kingdom did not disabuse the Europeans of the idea that integration could not proceed without its leadership: it was not in its interest to opt out of the process publicly lest it was faced by the establishment of a large continental market protected against its imports.[56] Therefore, Britain wanted neither to join in European integration nor to pay the price of not joining.

[52] Organization for European Economic Co-operation, established by participating countries in April 1948.

[53] 'Did we fall or were we pushed?' Review article by D. C. Watt, *Times Higher Educational Supplement*, 24 July 1981, p. 14.

[54] See C. C. S. Newton, 'Britain, the Dollar Shortage, and European Integration, 1945-1950' (unpublished Ph.D. thesis, University of Birmingham, 1982), pp. 150-4.

[55] See PRO, CAB 134/221, EPC (49) 6, 25 January 1949.

[56] PRO, FO 371/78/103, UR 10098/306/98, letter from Eric Berthoud to Roger Makins, 1 October 1949. There is very little published material on the attitude of British Industry towards postwar European

But the Schuman Plan, launched as a result of a French initiative in May 1950, implied that Britain must choose between Europe and her priorities in foreign and domestic policy. For the British such a choice was no choice at all. Faced with a call for the irreversible commitment, they had decided they would never be able to make the British decide not to join the conference of countries interested in establishing a European Coal and Steel Community. Over the subsequent thirty years, the two-tier development of European co-operation, in the E.E.C. under Franco-German leadership and in N.A.T.O. along an Anglo-American axis, was clearly heralded by the publication of the Schuman Plan.

V

British scepticism that the principal cause of the dollar shortage was merely "Europe's failure to produce" was borne out by events between 1947 and 1950. At the turn of 1949-50 western Europe's industrial output reached the highest point since the war, 122 per cent of the level achieved in 1938. Yet the dollar problem remained serious. On 16 February 1950, Dean Acheson, Marshall's successor as Secretary of State, wrote that:

> At the end of E.R.P.[57] European production will have been restored and substantial recovery achieved. But the problem of payment for American goods and services will remain. The countries of the free world will still require from us a volume of exports which they will not be able to pay for if their exports to the United States remain at present levels. Put in its simplest terms, the problem is this: as E.R.P. is reduced and after its termination in 1952, how can Europe and other areas of the world obtain the dollars necessary to pay for a high level of United States exports, which is essential both to their own basic needs and to the well-being of the United States economy.[58]

At the start of 1950 one-third of America's exports of $16 billion were being financed through foreign assistance; once this assistance was terminated the problems of 1947 would quickly reappear.

The idea that with higher production Europe would be able to balance its trade with the United States flew in the face of economic reality. Before the war, Europe had not balanced its trade with the United States directly, and after 1945 it was unable to earn the offsetting surpluses it had achieved up to 1938. Further, the great strides in productivity by American industry during the war made the American market difficult to prise open, since many European exports tended to be uncompetitive. In consequence, as European production increased, the trend was for exports to flow to the currency areas affiliated to metropolitan O.E.E.C. nations—Britain, Belgium, the Netherlands, France, and Italy. Since within these currency areas there were available non-dollar sources of essential imports, the overall effect of the Marshall Plan was not to drag the world towards multilateralism but to push western Europe towards autarky. In 1949 American policy-makers in the

---

integration. In general the Federation of British Industries appears to have supported the policy of the Labour Government. See Sir Norman Kipping, *Summing Up* (1972), p. 113; and Stephen Blank, *Industry and Government in Britain* (1973), p. 143.

[57] The European Recovery Programme.

[58] *FRUS*, III (1950), pp. 834-5 memorandum by Acheson to President Truman, 16 February, 1950.

Treasury and the State Department became so alarmed at this development that they pushed participating countries, in the end with success, towards a series of currency devaluations relative to the dollar.[59]

Far from European recovery being a prerequisite for the world's return to multilateralism, a return to multilateralism proved to be achievable only by the conquest of the dollar shortage—which had been the British view throughout. The only sure means of overcoming the disequilibrium would have been through a co-ordinated programme of dollar aid and investment for the world, or, failing this, through a Marshall Plan for the sterling area. This would have enabled European countries, including Britain, to earn hard currency in trade with eastern countries, and thereby finance their imports from the western hemisphere. The Truman Administration showed signs of grasping this truth when it launched the Point IV programme, but the budgetary conservatism of Congress limited the value of this initiative.[60] In the end, it was the rearmament programme, started early in 1950 and given a powerful impetus by the Korean War, which reduced the dollar gap to a manageable level.[61] In 1950 the United States imported strategic raw materials from the Far East, and in succeeding years sent military aid and equipment, as well as thousands of troops bearing dollars, to Europe and Asia. The inability of non-dollar countries to sustain large trade imbalances with the United States after 1929 had led to a sharp decline in international trade during the 1930s.[62] But for a decade the extravagence and relish with which the United States played the role of world policeman after 1950 did much to stimulate international economic expansion.

University College, Cardiff

[59] C. C. S. Newton, 'Britain, the Dollar Shortage, and European Integration, 1945-1950', ch. VII.

[60] The Point IV programme started operations in 1950. It worked with resources of $35 million only.

[61] The American military establishment certainly appreciated the benefits of rearmament for Washington's economic foreign policy. Tracy S. Vorhees, the Under-Secretary for the United States Army, advocated in April 1950 increasing dollar assistance to Europe to expand the military production of participating countries. He wrote that his plan "would contribute to the solution of the 'dollar gap' problem" (*FRUS*, III (1950), p. 48, 5 April 1950).

[62] M. E. Falkus, 'United States Economic Policy and the 'Dollar Gap' of the 1920s', *Econ. Hist. Rev.*, 2nd series, XXIV (1971), pp. 599-623.