

GENERAL AGREEMENT ON  
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## CONTRACTING PARTIES

STATEMENT MADE BY THE REPRESENTATIVE OF  
THE INTERNATIONAL MONETARY FUND  
AT THE FIRST MEETING OF WORKING PARTY "K"  
ON CONSULTATIONS UNDER ARTICLE XII:4(b)

1. I am very happy to present the views of the Fund. Our remarks will deal with (1) the Nature of the United Kingdom's Balance of Payments Difficulties; (2) the steps taken by the United Kingdom to cope with those difficulties; (3) alternative corrective measures; (4) the present outlook for the balance of payments position; and finally (5) a conclusion.

I. Nature of the United Kingdom's Balance of Payments DifficultiesThe reserve position

2. In the spring and summer of 1949 the gold and dollar reserves of the United Kingdom were subjected to pressure, and the available information indicates that some measures to correct the drain were required at that time. In the second quarter of 1949, the reserves of gold, U.S. and Canadian dollars held by the Exchange Equalization Account--the central reserves of the sterling area--declined by \$262 million, from \$1,912 million on March 31 to \$1,651 million on June 30th. From June 30th to September 18, 1949, when sterling was devalued, the reserves fell another \$311 million to a level of \$1,340 million.

3. In the months following devaluation and the intensification of restrictions, the drain on the central reserves was arrested and there has subsequently been a substantial increase. Between September 18, 1949, and the end of the year, the reserves rose \$348 million. During the first half of 1950 the increase continued--at an annual rate of \$1,468 million, lifting reserves by \$734 million to \$2,422 million. The most recent information available indicates that the increase persisted in the third quarter, raising the reserves to \$2,756 million.

The balance of payments position

4. After a favourable start in the first quarter of 1949--when the central reserves increased by \$56 million--the balance of payments position of the United Kingdom deteriorated in the second and third quarters. Those transactions of the United Kingdom which affect the central reserves showed unfavorable movements. The U.K. deficit with the dollar area, which must be settled through the use of external aid or drawing on the central reserves, rose from \$232 million in the first quarter to \$399 million in the second. The dollar deficit fell somewhat--to \$332 million in the third quarter. This, however, appears largely to have been explained by an inflow of capital (apart from ECA aid) from the United States. The current deficit continued to increase. Increased imports, decreased exports and an increase in the current invisible deficit all contributed to the continuing deterioration of the U.K. current position with the dollar area. Meanwhile, the rest of the sterling area's deficit with the dollar area (net of gold sales to the United Kingdom) rose from \$25 million in the first quarter of 1949 to \$146 million in the second and--at \$107 million--remained at a high level in the third quarter. Gold and dollar payments on behalf of the whole sterling area to non-dollar countries rose slightly but steadily over the first three quarters of the year. Thus the gold and dollar deficit of the sterling area rose from \$330 million in the first quarter to \$632 million in the second and amounted to \$539 million in the third quarter of 1949. In the second and third quarters of the year, external aid was insufficient to cover this deficit, so that the central reserves were subjected to the substantial drains already noted.

5. Following the intensification of restrictions on imports from the dollar area and the devaluation of sterling, the U.K. dollar balance of payments showed a marked improvement. Despite the non-recurrence of the third quarter capital inflow, the U.K. deficit with the dollar area was cut from \$332 million to \$115 million between the third and fourth quarters of 1949. The improvement appears to have continued, so that the U.K. deficit with the dollar area, excluding the surplus of the dependent sterling territories, has been further reduced and is possibly being eliminated. Contributing to this improvement has been the reduction of imports from the dollar area by more than the 25 per cent target, the development (at least in the fourth quarter of 1949) of an invisible surplus with the dollar area, and a rise in exports to the dollar area from the low pre-devaluation and immediate post-devaluation levels.

6. Besides the intensification of restrictions and devaluation, other favorable factors at work on the U.K. position included the curtailment of certain inflationary pressure, the increasing availability of supplies in the United Kingdom and other soft currency countries, and the higher level of demand in the United States. It is to be noted, however, that--comparing the first half of 1949 and the first half of 1950--in the case of the nine most important commodities accounting for the decline in the dollar value of imports from the dollar area and other hard currency countries there has, by and large, been an overall reduction in the volume of imports. Increases from soft currency countries have not, in general, offset the reduction in the volume of these commodities from the hard currency countries. Nor has the reduction in U.K. stocks of these commodities been of universal importance--although it has occurred in some commodities. Increases in U.K. production have presumably facilitated some import reductions, while higher sterling prices resulting from devaluation may have aided in curtailing consumption. These factors may also have facilitated the expansion of exports. For some goods, on the other hand, the actual dollar cut, because of a drop in dollar prices, did not require proportionately as large a drop in volume--at least up to the middle of 1950.

7. More recently, the outbreak of hostilities in Korea and the actual and expected increases in armament expenditures have introduced new elements--some favorable to further increases in the central reserves, some unfavorable. On the favorable side, U.S. demand for the products of the United Kingdom has undoubtedly increased. It is probable that United Kingdom demands for goods from the dollar area will rise as a result of increased military activity and rearmament. So far, however, most recent developments appear, on balance, to have been favorable as far as the gold and dollar accounts of the sterling area as a whole are concerned. In the third quarter of 1950, the sterling area had a gold and dollar surplus of \$187 million, \$7 million above that in the previous quarter. Some part of this surplus may have resulted recently from the flow of "hot money" from the dollar area and from speculative payments in advance of debts owing in sterling. Nevertheless, available data indicate that the improved reserve position results essentially from normal trade and commercial developments.

8. The favorable developments in the direct dollar accounts of the United Kingdom appear to have been paralleled by an increase in the surplus of the dependent sterling territories and the rest of the sterling area with the dollar area and by a reduction in the payments of gold and dollars to non-dollar countries by the sterling area as a whole. Much the same factors appear to have brought about this improvement as in the case of the United Kingdom relations with the dollar area. Thus the sterling area's gold and dollar deficit of 1949 has been converted into a gold and dollar surplus in each of the three quarters of 1950. Because of this development of a gold and dollar surplus, external aid has, in effect, been available to increase the central reserves.

## II. Steps Taken by the United Kingdom to Cope with the Balance of Payments Difficulties

9. Prior to July 1949, the United Kingdom's restrictive system limited imports on private account from all countries by licensing. Imports on Government behalf accounted for roughly half of all imports. The licensing system was applicable to practically all commodities, and particularly restrictive in its application to imports from "hard" currency countries, i.e. those countries, payments to which were likely to lead to a loss of gold or dollars. The scale and nature of imports from the dollar area were determined by advance programing covering imports both on private and Government behalf. Bilateral arrangements existed between the United Kingdom and many other countries and these determined the volume and, in some cases, the nature of licensed imports from those countries. These bilateral arrangements also insured that payments between the sterling area and those countries were made through specific channels. There was also a limitation on payments in respect of non-contractual invisibles particularly applicable to "hard" currency countries.

10. In July 1949, the British Chancellor of the Exchequer announced the further restriction of United Kingdom imports from the dollar area as a result of the decline in the central reserves of gold and dollars which had set in in the second quarter of the year. Initially, this intensification of import restrictions took the form of a "stand-still" arrangement. In October 1949, a new program was settled on involving a 25 per cent, or \$400 million, reduction from the 1948 level of United Kingdom imports from the dollar area. Similar action was taken by other countries in the sterling area. The United Kingdom program did not consist of a series of firm commitments but was rather a set of decisions to guide government buying and licensing of private imports.

11. On the other hand, at the end of September 1949, the United Kingdom announced relaxations in import licensing affecting mainly imports from soft currency countries. This relaxation took the form of an Open General License effective October 5, 1949, permitting without limitation the import of certain commodities from all countries except those in the dollar area and certain others - trade with which might lead to a possible loss of gold or dollars. The list of commodities to which this arrangement applied has been considerably lengthened by successive stages, and the countries to which it extends have been increased by the inclusion of the Belgian Monetary Area and Western Germany.

12. At the same time as import restrictions were intensified, the British authorities stressed the necessity of the continuance of the dollar export drive. In particular, care was taken to insure that the intensification of the import restrictions did not result in supply difficulties in those



industries providing dollar exports. In October 1949 the Government also announced that certain reductions in U.K. domestic investment and in Government expenditure were being taken as counter-inflationary measures and to assist in the export drive.

13. Meanwhile, in September 1949, talks regarding import restrictions and other matters were held between American, British and Canadian officials in Washington. On September 18, sterling was devalued from £1 = \$4.03 to £1 = \$2.80 after approval of the International Monetary Fund.

### III. Alternative Corrective Measures

14. As noted in the previous section, the U.K. program, at the time the import restrictions were intensified, stressed the continuance of the dollar export drive. Without fundamental changes, such as intensified disinflationary measures or devaluation, it was not, however, possible in mid-1949 to overcome through increased exports the urgent difficulties which beset the United Kingdom. As noted, the devaluation of sterling took place rather soon after the intensification program was adopted. Other alternatives were either not feasible or too slow in their desired effects. Under the circumstances of the time, it seems reasonable that both devaluation and the intensification of import restrictions were employed as devices to correct the U.K. balance of payments disequilibrium.

15. At the present time, with the central reserves at a much higher level, the question of alternatives is much less relevant than it was in the summer of 1949. The basic question today is the extent to which the discriminatory import restrictions can be relaxed as a result of the increase in reserves. The devaluation of sterling has already taken place. The problem on inflation today is to hold the line in order to prevent further price increases resulting from expected increases in Government spending consequent upon rearmament. This will facilitate the continuance of the export drive to the dollar area.

### IV. Present Outlook for the Balance of Payments Position

16. Even before the outbreak of hostilities in Korea, there appeared to be some inflationary pressure in the United Kingdom, although not enough to offset the effects of devaluation. Continuing vigilance, nevertheless, appeared to be required. On the external side, the introduction of EPU was not expected to have any substantial immediate effect upon U.K. demands for dollar imports nor upon U.K. ability to export to the dollar area. It is possible that there will be some increase in U.K. exports to the rest of the sterling area which might affect the ability to export to the dollar area; in addition, U.K. industry might require increased supplies of certain dollar commodities. On the other hand, the basic improvement in the U.K. position vis-à-vis the dollar area seemed likely to be maintained as long as conditions in the United States remained prosperous. On balance, therefore, a continuation of the improved U.K. position vis-à-vis the dollar area seemed to be expected. A similar expectation held for the rest of the sterling area. Thus, while the rate of increase in the central reserves might decline somewhat, the expectation was that a further rise in the central reserves would likely occur under the then-existing conditions.

17. As noted earlier, the outbreak of hostilities in Korea and expected increased expenditures on armament introduced both favorable and unfavorable elements into the situation. The net effect of these developments on the central reserves is particularly difficult to determine since a number of crucial decisions are still to be made or implemented. So far, the developments appear to have been favorable, although speculative movements may have had some role in increasing reserves. Whether an increase in the U.K. demand for dollar imports will offset the increased dollar receipts will depend upon a number of factors, including the availability of supplies in non-dollar, as well as in dollar countries, the ability to control new inflationary pressures, and the level of external assistance.

V. Conclusion

18. The present level of the reserves and the current rate of gold and dollar earnings make feasible a progressive relaxation of restrictions by the United Kingdom. At the same time, caution in the degree and rate of such relaxation is justified, having regard to the difficulties of determining the amount of demand for imports which is being controlled by the existing restrictions, to the adverse reactions on net earnings which may arise from the economic and financial burdens undertaken to cope with the international situation, and to the undesirability of a serious decline in the reserves from the present level.