Chapter III Chap III

PAYMENTS AGREEMENTS

When war broke out the U.K. had already concluded a number of Financial Agreements with foreign countries. The Debts Clearing Offices and Imports Restrictions Act of 1934 had empowered the Treasury to set up Clearing Offices (on the Continental model) in cases where it appeared to them that payments or transfers to the U.K. from foreign countries were subject to restriction.

In the 18 months which preceded the setting up, in Jan. 1936, of the first Clearing (with Spain) the Treasury, armed with the powers conferred upon them by the Act, concluded Payments (or Transfer) Agreements, which they hoped would avoid the necessity to have recourse to full Clearing procedure, with the following countries:-

Germany	Anglo-German Payments Agreement	1st Feb.1934
Hungary	Anglo-Hungarian Payments Agreement	1st Feb.1936
Italy	Provisional Agreement between H.M.Government and Italian Government relating to imports from the U.K. to Italy	18 March 1935
	Exchange of Notes regarding trade and payments	27 April 1935
Roumania	Anglo-Roumanian Payments Agreements	8 Feb.1935 3 Aug.1935
Turkey	Agreement respecting trade & payments	4 June 1935
Yugoslavia	Anglo-Yugoslav Commercial Agreement	27 Nov. 1936

The responsibility for the carrying out of the terms of these Agreements rested with the foreign countries concerned, who were called upon to mobilise the sterling exchange deriving from their exports to the United Kingdom and to allocate it to U.K. creditors in agreed proportions. Only Germany's foreign exchange control was equal to the task of collecting the amount of sterling necessary for the smooth operation of the Agreement, and in consequence all these Agreements, with the exception of the Anglo-German, were more or less failures.

The following Agreements were subsequently replaced by full Clearings on the undermentioned dates:-

Roumania	May 1936
Turkey	September 1936
Italy	November 1936.

The remaining

The remaining Agreements (with Germany, Hungary and Yugoslavia) continued in force until suspended by hostilities.

The Clearing Agreements with Spain, Roumania, Turkey and Italy operated through central accounts maintained at the Bank of England by the Clearing Office - a separate Government Department set up by Treasury Order. Payment to the Clearing Office was mandatory on all U.K.importers from the countries concerned, control over the payment of the debts being maintained through the Customs. Goods could be invoiced in third currencies but all debts had to be settled and paid in to the Clearing Office in sterling. The balances on the central accounts were earmarked for and used to pay U.K.creditors. A similar procedure was followed in the foreign countries concerned - each Clearing Office paying out local currency to creditors in its own country against particulars of amounts due furnished by the other.

As no other form of foreign exchange control was in force in the United Kingdom when these Clearings were negotiated it was considered neither practiceble nor expedient to prescribe peyment to the Clearing Office in the United Kingdom of financial debts due to the other countries concerned. On the other hand, certain financial remittances were made to the U.K.from those countries through the medium of the Clearings - a proportion of the sterling collected being allocated for this purpose.

On the whole the Clearings achieved what they were set up to do; since the balance of trade was in every case adverse to the United Kingdom and the sterling collected by the Clearing Office therefore sufficed to meet current trade and other debts due to the United Kingdom and even to reduce outstanding arrears. Business was interrupted less than had been expected, but direct contact between buyers and sellers was severed to the extent that communications passed through the Clearing Offices and, of course, long established practices of dealing for settlement through traders' accounts had to be abandoned.

When the war came the Italian and Roumanian Clearings were suspended. After the Armistice with Italy was signed the Treasury, in order not to prejudice the re-establishment of trade with Italy

outside

outside the Clearing, revoked the Order requiring payment for Italian goods imported into the U.K. to be made to the Clearing: but the winding-up of the Italian Clearing was left over until the making of peace. The Spanish and Turkish Clearings continued to function during the war, although in the latter case the concentration in the hands of the U.K.Commercial Corporation of most U.K.purchases of Turkish goods meant that little was paid in to the Clearing Office in London, the settlement of the U.K. Commercial Corporation's transactions being effected through channels outside the Clearing.

All these pre-war Agreements (Payments, Transfer and Clearing) were inter-governmental, and the Clearing Agreements were implemented in the U.K. by Treasury Order.

Comparison between Payments Agreements & Clearings

Under Clearing Agreements payment for goods to the main account was mandatory on the U.K. resident. The Agreements were negotiated by the two Governments concerned and were implemented in the U.K. by Act of Parliament. They operated through central accounts maintained at the Bank of England by the Clearing Office. The Clearing funds were earmarked and used to pay the U.K. exporters and other creditors. To the extent that the communications were in the hands of a Government Department, relations between the buyer and seller were severed, otherwise business proceeded as usual.

By contrast, Payments Agreements -

(a) Were secret and had no legal force in themselves. They could not enforce payment of a debt but only stipulated that if a debt were paid it should be paid in a certain way. They could be varied by mutual agreement between the monetary authorities concerned.

(b) They provided, in some cases, for the mutual supply of currencies and fixed the official Dollar/Sterling rate as the basis of the foreign countries' rates for Sterling.

(c) They

(c) They restricted the use of a country's sterling in the first place to the Sterling Area (this was relaxed administratively in some measure so that sterling could be used outside the Sterling Area in certain cases). They covered both trade and financial debts. In the majority of cases they gave guarantees against the depreciation of sterling.

The war compelled the negotiation of further Agreements; and now it was no longer a question only of collecting debts due to the U.K. from a few countries having weak exchanges, but of organising the defence of sterling to ensure the imports necessary to the whole Sterling Area for the prosecution of the war.

The huge turnover in sterling which soon developed on free exchange markets abroad at heavy discounts on the Bank of England's official rates had the inevitable consequence of reducing the flow of hard currencies to the Sterling Area Exchange Controls, since payments to the Area were commonly made in sterling bought cheaply abroad. Moreover, foreign suppliers tended to invoice in U.S. dollars. Sterling's position as an international currency was thereby impaired. A remedy was sought in the negotiation of bilateral agreements with foreign countries to enable trade to be conducted in sterling on the basis of the official sterling rate for U.S. dollars and to prevent the liquidation on free markets of surplus sterling balances of the countries concerned. The main object was to secure that the sterling received by the country with which the Agreement was made was either spent in the Sterling Area, or if not spent, held as sterling instead of being converted into dollars.

Clearing being out of favour for political and other reasons, two methods of approach were open. There was the possibility of some formal inter-governmental type of agreement

covered

covered by an Act of Parliament with the details available to the public, or the alternative of a gentleman's agreement loosely defined as regards detail, easy to alter in the light of experience and secret in nature, to be negotiated if possible between the Bank of England, acting on the Treasury's behalf, and the Central Bank or other monetary authority of the foreign country concerned. The latter alternative was
15? adopted, and of 14 such Payments Agreements all but two were negotiated by the Bank of England. It was not desirable for H.M.Government to make formal arrangements purporting to lay down how payments should be made and monies spent where the rest of the Sterling Area was concerned. The other independent governments willingly left it to the U.K. to make the arrangements, but if the full formalities had been observed there would have had to be separate agreements with each Dominion every time some arrangement was made. A list of these Agreements (in alphabetical order) follows - those negotiated between Governments being marked with an asterisk.

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Hungary but not Denmark or Norway given in Sayers' "Financial History 1939/45"

Argentina	2	25 Oct.1939	Paraguay	13	18 Dec.1940
Bolivia	14	31 Mar.1941	Peru	15	17 Nov.1941
Brazil	6	2 Aug.1940	Portugal	10	20 Nov.1940
Chile	9	30 Oct.1940	Roumania	5	17 June 1940
Denmark	4	27 Mar.1940	*Spain	11	2 Dec.1940
≠Greece	7	22 Aug.1940	Sweden	1	20 Dec.1939
Norway	3	18 Mar.1940	*Turkey	12	2 Dec.1940
			Uruguay	8	11 Sept.1940

Although a few of these Agreements were concluded in the early months of the war, it was not until the Registered Account arrangements made with the U.S.A. and Switzerland in July 1940 effectively crippled the principal free exchange markets for sterling that the way was cleared to negotiate the remainder.

The basic

≠No agreement was formally concluded, but following cabled notification by the Bank of Greece of the Greek Government's assent Payments Agreement procedure was applied (between 2nd September 1940 and the date of the enemy occupation) to payments between Greece and the Sterling Area.

The basic provisions of the Payments Agreements were as follows:

1. Payments to be in sterling.
2. Post-Agreement payments from the Sterling Area to be made only to new accounts designated "Special Accounts" opened by the Central Bank and by commercial banks and, in some cases, firms approved by the Central Bank and the Bank of England.
3. Payments to the Sterling Area to be made only from Special Accounts.
4. Payments from Special Accounts to third countries not normally to be permitted.
5. The local currency value of sterling and of dollars to be based on the official rate of $4.025/4.035 = £1.
6. Existing sterling balances to be transferable to Special Accounts.
7. "Sterling Area Accounts" for private persons to be on the lines of restricted "Special Accounts".
8. Revaluation Guarantee (see below).

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The Bank attempted to get the countries concerned to accept sterling and nothing but sterling in payment for their goods and services; but this was not always possible where the U.K. had a consistently adverse balance and needed to buy from them. If part payment in foreign exchange were then demanded the Bank usually offered gold (which might not easily be exported), U.S. dollars being reserved to meet requirements in U.S.A.

The powers on which the Agreements were based were the Defence (Finance) Regulations, of which the chief relevant Regulations were 3C and 5B. Subject to any exemptions which might be granted by the Treasury, the former provided that no payment might be made to a person outside the Sterling Area and the latter prescribed the manner in which payment might be received for goods exported from the U.K. When an Agreement was concluded (or in some cases when the other Central Bank agreed to the application of Special Account procedure in advance of signature) a Regulation of Payments Order was made giving exemption from the provisions of Regulation 3C. This Order enabled payments to be made with Treasury permission, to a Special Account or Sterling Area Account of the country concerned; permitted transfers from a Special Account to other Special Accounts or Sterling Area Accounts of the same country and transfers between Ordinary Accounts of the same country; and further prescribed payment from the Special Account

as the

as the manner in which payment for U.K.goods exported to that country must be received to conform with the requirements of Regulation 5B.*

The other Sterling Area countries took corresponding measures to bring their Exchange Control procedure into line. The Bank of England, as Agent of the Treasury, issued the necessary instructions to the London Market to ensure that all post-zero in-payments from the Sterling Area and out-payments in respect of exports from the Sterling Area would pass through the Special Accounts, and that the latter would not be credited with sterling from sources outside the Sterling Area except with the Bank's permission.

In this way all post-zero sterling income (with the important exception of Central America, not dealt with until 1941)** was safely tied up, but there remained the existing sterling balances. The great blow at the conversion of these balances was struck in July 1940 by the adoption of the Registered Account system, under which, as the previous chapter has shewn, the free Sterling Market in New York was closed. It was in the six months following that most of the Special Account Agreements took effect. During this period the closing of the New York Market and the increase in the number of Special Account countries were greatly restricting the opportunities of disposing of sterling, and most holders were glad to take advantage of the clauses by which they could transfer their ordinary pounds to Special Account.

Essentially, Special Account Agreements provided that the local authorities should co-operate with the U.K.Control to see that payments from residents in the country concerned to residents in the Sterling Area should only be made from Special Accounts. All that the Sterling Area Controls could do was to insist that payment for goods exported from parts of that area was received through the appropriate channel; only the Foreign Exchange Control authorising payment could effectively control the way in which payment was made.

Sterling Area Accounts. The logical conclusion of the Payments Agreements would have been the closing of the existing accounts of residents of Agreement countries when their pre-Agreement

balances

* Payment in Kronor was also permitted for U.K. exports to Sweden.

**as described in the previous chapter.

balances were exhausted. By agreement with the countries concerned these accounts, to be known as "Sterling Area Accounts" were maintained in order that foreigners, as well as the large number of British residing permanently abroad, should not be deprived of certain normal banking facilities, e.g., the collection of dividends, payment of insurance premiums, school fees.

Special Accounts and Sterling Area Accounts are dealt with more fully in Appendix...., which contains (i) a detailed description of the particular arrangements, concessions, etc., affecting the bi-lateral Agreements made with 13 countries (Argentina, Bolivia, Chile, Paraguay, Roumania, Spain, Turkey, Russia, Norway, Sweden, Portugal, Switzerland and France) and the later Agreements signed with Sweden, Portugal and Turkey in 1945/6; and (ii) a short memorandum on "Arguments for Bilateralism with reference to Special Accounts".

By the Autumn of 1942, the Special Account countries were, generally speaking, long of sterling and should have been able to meet more freely their financial indebtedness to the U.K. Unfortunately, some of them claimed that it was difficult to use their sterling, e.g., for redemption of debt, as it would involve raising corresponding sums on their internal loan market and would thus interfere with their budgets. Nevertheless, there were strong indications that these countries had used their excess sterling to buy back considerable portions of their external debt at low prices resulting from past defaults.

The general tendency was for the Payments Agreement countries to mulct the U.K.by way of price raising and other manoeuvres for as much gold as was possible under the terms of the Agreements.

Russia was an exception. Our Agreement with the U.S.S.R. covered neither private trade (which since the outbreak of war had been virtually non-existent) nor the delivery of military supplies, but was designed exclusively to provide finance for civilian supplies sent to Russia through the co-ordinating medium of the U.K.C.C. Certain subsidiary payments such as insurance premia and claims and payments under the old E.C.G.D.Credits scheme were also covered. It worked with outstanding smoothness from the date of its inception in the Autumn of 1941, a bare four months after the German invasion of Russia. It can be regarded as one of the arrangements which did a good deal to promote technical co-operation between the U.K.and Russia. By contrast with the other Payments Agreements, it proved to be a useful source of gold - by the opening of 1944, the U.K. had received over £15mn. gold from U.S.S.R. All other payments were made through ordinary Russian

Sterling

Sterling accounts, and no restrictions were placed on the disposal of the balances to third countries with whom there were no Special or Registered Account arrangements.

Allied Remittances

With the establishment in London of the Refugee Allied Governments the need arose to assist them as far as possible to obtain foreign currencies for normal types of current expenditure such as for diplomatic representations. Where the currencies required were those of countries with payments agreements, a decision had to be taken as to whether remittances should be passed over the Special Accounts or effected by the sale of dollars in the country concerned.

Although the payments agreements did not specifically provide for allied remittances, it was decided to treat these payments as falling within the scope of the agreements and to pass them through the Special Accounts without prior reference to the receiving countries.

As the war progressed the foreign currency requirements of the Allied Governments expanded - for the maintenance of their nationals in neutral countries to which they had escaped and for purchases of foodstuffs in those countries for the relief of nationals in the occupied neutral countries.

At various times Special Account countries raised objections to this principle or imposed limitation on the amounts which could thus be remitted; but with one exception they sooner or later accepted it. The exception was Argentina, and in order to avoid further embarrassment, from March 1943 Allied remittances were made to Argentina in dollars.

During the latter part of 1942 the reimbursement of remittances made for the Allies through Special Accounts came under review by the Bank and Treasury. Reimbursement had generally been chargeable in U.S.dollars where there was a gold liability under a payments agreement (Portugal, Sweden and Turkey), for the paying Allies had the funds available. From

March

March 1943 sterling reimbursement was accepted (except for Dutch and Norwegian payments to Sweden for post-war purchases). After 1st July 1944 reimbursement for all payments to Special Account countries on behalf of the Dutch and Norwegians had to be in gold or U.S.dollars.

Dollar Payments from Special Account countries

One of the basic provisions of payments agreements was settlement between a Sterling Area country and the other contracting party in sterling. It was, in fact, implicit in earlier and explicit in later agreements that the countries concerned should keep their Special Accounts in funds by selling dollars to the U.K.Control; but the principle was not universally observed and at times importers in Special Account countries became short of sterling.

An acute shortage arose in South America when U.K. purchases were drastically curtailed in 1941; and the South American countries then offered payment in dollars. These dollars came mostly either from importers' private accounts or from the Black Market. In June (though it meant some risk that the U.K. exporter importer might not get paid at all) the Control's policy was to refuse the dollars unless either the Treasury representative on the spot advised acceptance or the dollars were offered by companies incorporated in the U.S.A. for Sterling Area exports to South America, when they were accepted without question. With the progressive rise in Special Account balances payment in Special sterling was increasingly insisted upon.

Refusals, as distinct from offers, to pay dollars occasionally arose when Special Account countries did not share the view that the Control could always require payment for goods purchased outside the Sterling Area and shipped to Special Account countries in the currency (usually U.S.dollars) paid for the goods by the British merchants.

Some General Conclusions

The Payments Agreements may be said to have achieved their

their objects without causing friction with the foreign countries concerned, though difficulties increased as sterling piled up in 1942/43. The three main aims of the Agreements were: to persuade the particular country to hold restricted sterling; to provide the U.K. with that country's foreign exchange against sterling and to ensure that sterling was dealt in at the official rate. The other terms of the Agreements were, for the most part, so worded that they should not interfere with the operation of the U.K. Exchange Control requirements, and should be adaptable to changing circumstances. Much depended, of course, upon the size of the sterling balances held and the efficiency of the Exchange Control in the country concerned. Argentina and Sweden, for example, had first-class Exchange Controls; but with Chile most of the responsibility for the successful operation of the Agreement fell upon the Bank of England and the Treasury's representatives in South America.

It was an advantage of drafting in general terms that it became possible to make administrative arrangements to transfer sterling from one country to another, from Special and even from Registered Accounts, thus introducing a measure of multilateralism. If, for example, a country was unexpectedly short of sterling, the Bank could in this way avoid a purchase of goods to put it in funds, at the same time seizing the opportunity to drain sterling away from another country where Special Account balances were giving concern.

But the loose drafting of the Agreements, though it made them easy to alter, caused difficulties of interpretation and administration, particularly noticeable with Spain and Turkey, where the Clearing and Special Account systems were co-existent.

There were other disadvantages:

1. There was no reference to the origin of goods, and when they were imported from a "third" country this meant that decisions had to be taken in each case in the light of the particular circumstances.

2. The absence

2. The absence of clauses compelling a foreign Central Bank to make immediate payment to its nationals, after instructions from the U.K., or compelling foreign nationals to make payment of a debt when due and binding the relative Central Bank to make transfer. Central Banks would only transfer such items as suited them, and had to be constantly worried by U.K. diplomatic and financial representatives.
3. In some Special Account countries a fluctuating spread of the exchange rate round the agreed middle rate made it necessary for U.K. banks, when requesting foreign Central Banks to make payment, to ask to be advised of the rate applied (before debiting their U.K. debtor customer).

An awkward feature of the system (the result of guarantees) was the tendency for Central Bank funds to accumulate at the Bank of England*, involving the Bank in commercial transactions outside its normal business.

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*At December 1941 Special Account sterling amounted to £33 million: by June 1945 the total had grown to £234 million (of which Argentina 89 and Portugal 77).