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INTERNATIONAL CAPITAL ACCOUNTS OF THE UNITED KINGDOM

Charles R. Harley

The major features of the United Kingdom balance of payments on current account have been widely discussed and will not be considered here. The capital account, while causing considerable comment of a general nature, has not been studied in detail. One reason for the comparative neglect of this account lies in its complexity, a second in the inadequacy of the data on which analysis must be based. The capital account, however, holds the explanation for the very rapid deterioration of the British reserve position in 1947 and is accordingly well worth examination.

Data from the British "Economic Survey for 1948" (Cmd. 7344) are rearranged in the following table to show in broad outline the salient factors of the international capital accounts for 1946 and 1947.

Summary of United Kingdom International Capital Accounts, 1946 and 1947

(In millions of pounds sterling)

	(1) 1946	(2) 1947	(3) Difference (2) - (1)	(4) Sum of (1) & (2)
Items requiring use of international means of payment.				
1. Current account deficit	380	675	+295	1,055
2. Decrease in sterling balances	-40	112a/	+152	72
3. Other capital outflow	-154	190	+344	36
4. Gold and dollar subscriptions to International Fund and Bank	7	51	+ 44	58
Total	193	1,028	+835	1,221
Items representing use of international means of payment.				
5. Drawing on U.S. and Canadian credits	280	812	+532	1,092
6. Reduction in gold and dollar holdings	-54	151	+205	97
7. Reduction in other foreign exchange	-33	5	+ 38	-28
8. Drawings on International Monetary Fund	-	60	+ 60	60
Total	193	1,028	+835	1,221

(Minus signs in this table indicate a movement opposite from that indicated in the corresponding descriptive stub.)

a/ The corresponding figure from Cmd. 7344 is £142 million; the difference represents gifts of £30 million from Australia and New Zealand. Both the gifts and the corresponding offset item are excluded from this table.

Whether or not column 3 has any economic relevance may be questioned. The data are of interest statistically in showing the extent to which the shift from a substantial capital inflow to a large capital outflow (lines 2 and 3) accounted for the great discrepancy between the £835 million increase in the use of means of payment between 1946 and 1947 and the increase of £295 million in the current account deficit. On the other hand, any critical comments which might be made on the rate of capital outflow from the United Kingdom in 1947 would be concerned primarily with the data on the net outflow for that year alone. The shift from the preceding year might be relevant, however, in appraising the urgency of the foreign needs which the British capital outflow was designed to meet; were countries which were able in 1946 to extend loans to the United Kingdom or to moderate their demands for repayment of earlier credits desperately in need of capital assistance in 1947?

Column 4 introduces a new suggestion--that the differences between 1946 and 1947 should be disregarded and the two-year period (during which more than three-fourths of the $3,750 million loan from the United States was used) be examined as a unit. Over this longer period we find that the current account deficit totaled £1,055 million while the net[1]/use of international means of payment amounted to £1,163 million. Net capital outflow thus accounted for no more than £108 million or approximately $432 million. Two-thirds of this amount represented net repayment of sterling balances accumulated during the war. Net repayment of sterling balances over the two-year period thus amounted to less than 2½ per cent of the total volume of sterling indebtedness to foreign countries reported at the end of the war.

In view of the contradictory implications of column 3 and column 4--the first suggesting that Britain has managed its capital accounts badly, the second that it has successfully resisted pressure for excessive liquidation of its wartime indebtedness--both additional data and additional analysis are required for a fair appraisal of the nation's capital transactions. If it were to be shown that the capital outflow of 1947 were principally repayment of the foreign credit extended to Britain in 1946, the validity of regarding the two-year period as a unit would be much enhanced. One could argue that a condition of the receipt of credit in the earlier year was that prompt repayment would be forthcoming as British recovery progressed. As a matter of fact, such additional data as are available indicate that little direct relationship existed between the 1946 inflow and the 1947 outflow.

Selected Items in the Capital Accounts of the United Kingdom
(In millions of pounds sterling)

	1946	1947	Total
Increase in sterling indebtedness			
Non-sterling area	76	23	99
Sterling area	-36	-135	-171
Other capital transactions			
Non-sterling area	116	-9	107
Sterling area	38	-181	-143

(In this table minus signs indicate a decrease in the foreign liabilities or an increase in the foreign assets of the United Kingdom.)

The table shows that repayments of United Kingdom sterling indebtedness have been directed to sterling area countries while the non-sterling area has continued to extend credit to Britain. Similarly, the other capital outflow for the period as a whole has been toward the sterling area while the United Kingdom has disposed of investments in, or received capital investment from, countries outside the sterling group. Moreover, the table still contains a large amount of "netting," since transactions of different sign are offset within each group of countries. It is known, for example,

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1/ The figure is net in the sense that the gold and dollar subscriptions to the International Bank and Fund (line 4) have been offset against the reduction in gold and dollar holdings (line 6); these subscriptions represent a shift in reserves rather than a capital outflow from the United Kingdom.

that South Africa (in the sterling area) accumulated sterling balances during 1947 to the value of £40-£50 million:[1] gross repayments to sterling area countries must accordingly have exceeded the net figure shown by a considerable margin.

Funds made available to the sterling area in 1947 through the outflow of capital from the United Kingdom (including repayment of sterling balances) amounted to £316 million or more than $1\frac{1}{4}$ billion dollars. In addition, the sterling area acquired sterling claims of £84 million from the sale of gold to Britain. The area thus had available £400 million of foreign exchange resources in addition to its earnings from exports other than gold. These funds appear to have been used as follows:

To meet the sterling area deficit with the United Kingdom	£ 80 million
To acquire gold and dollars from the United Kingdom:	
To meet the sterling area deficit with the dollar area[a]	£266 million
To cover subscriptions to International Fund and Bank	£ 7 million
To meet the sterling area deficit with other areas	£ 47 million[b]
	£400 million

a/ The "dollar area" includes the United States, Canada, and other American account countries.

b/ This is a residual figure. Insofar as this deficit was eventually paid in gold or dollars (as it presumably was in large part), the £47 million would represent the sterling area's (excluding the United Kingdom) share of the £157 million reported in Table II of Cmd. 7324 as the gold and dollar payments of the whole sterling area (including the U.K.) to countries outside the dollar area.

A reasonable estimate of the manner in which the principal members of the sterling area were responsible for the dollar drain represented in the foregoing table may be derived from a glance at their deficits on merchandise account with the United States and Canada as shown in the table on the following page; for most of these countries the total deficit on current account would be somewhat larger. With the exception of India, and the possible exception of Eire, the countries with the largest dollar deficits cannot be regarded as among the more needy nations of the world. South Africa is in the midst of boom conditions, while both Australia and New Zealand are enjoying a high degree of prosperity. To some extent the dollar drawings of the latter two countries represent the conversion into dollars of current earnings of sterling; those of South Africa were made possible in part through the influx of capital from the United Kingdom.

1/ See p. 6 of this issue of the Review for discussion of the complex of capital and current account items in the balance of payments of South Africa.

Deficits on Merchandise Account with the United States and Canada[a]
(In millions of dollars)

	Deficit with the United States	Deficit with Canada	Total
Union of South Africa[b]	302	62	364
Australia	110	46	156
India	148	1	149
Eire	86	18	104
New Zealand	51	27	78
Total	697	154	851

a/ Compiled from trade statistics of the United States and Canada.
b/ South African gold sales are not regarded as merchandise exports in this calculation.

The impression gained from examination of available data is that the United Kingdom in 1947 was more generous in the release of sterling balances than the economic requirements of her creditors demanded and that capital movements within the sterling area (which were virtually uncontrolled) were costly in terms of the United Kingdom's hard currency reserves.[1] This is doubtless the impression which underlies recent Continental charges that the United Kingdom has shown excessive regard for the economic well-being and recovery of the sterling area. The result, according to these critics, is that trade with Western Europe has not been fully encouraged; exports and credits to the area have been smaller than they might have been if the sterling area had not constituted so sizeable a drain on British resources both through the receipt of unrequited exports and the receipt of dollars from the reserves of the United Kingdom. Countries enjoying a favorable current account balance with the United Kingdom contend that convertibility of sterling earnings could be more widely granted if the drain of the sterling area were smaller.

A satisfactory answer to this criticism could perhaps be given if all facts were known. It is clear that political and military considerations have dictated comparative generosity in the release of sterling balances for the use of certain Middle Eastern countries and India. Many of the other releases of balances and freedom for capital movements within the sterling area might be defended on the ground that failure to maintain and increase the strength and coherence of the sterling area at this time would be the course of folly. One may hope that the five-power treaty of Western European nations and successful functioning of the Economic Recovery Program will assure the United Kingdom that full cooperation with Western Europe promises continuing economic progress and political stability.

1/ This is particularly true with reference to the capital outflow to South Africa (see pp. 6-8 of this Review). Theoretically, capital movements to other sterling area countries might not lead to a hard currency drain; it is probable, however, that the additional reserves to which the capital inflow gave rise stimulated imports from both hard and soft currency areas.

THE FLOW OF BRITISH CAPITAL TO SOUTH AFRICA

Robert Solomon

The serious nature of the flow (and flight) of capital from the United Kingdom to the Union of South Africa was confirmed recently when the South Africa Reserve Bank took steps to limit the transfer of capital between the sterling area and South Africa.1/ That there has been a sizeable capital flow both for "productive investment" and in the form of "hot money", there is little doubt. In view of the worsening international position of the United Kingdom, it can ill afford this loss of capital, for such sterling accruals may be used by South Africa to finance its sterling area deficit, which otherwise would be settled in gold.

There have been a number of estimates of the magnitude of the capital flow from the United Kingdom to the Union. Dr. Hugh Dalton estimated that it amounted to £35 million for the year ended June 30, 1947. It is generally agreed that the flow has increased in recent months and most estimates for the calendar year 1947 range between £75 million and £100 million. It is likely that the proportion of "hot money" in the total outflow also increased during the second half of 1947, after the convertibility crisis. Perhaps the most reliable estimate of the total capital inflow from the United Kingdom is that of the Minister of Finance of the Union of South Africa, who announced a figure of £80 million for the year 1947.

An attempt will be made here to indicate how this estimate may be justified and under what conditions the inflow of capital from the sterling area may have exceeded £80 million.

It was reported recently2/ that gold exports from South Africa amounted to £144 million during 1947. It was also reported that South Africa incurred a deficit on trade account of £186 million. In addition, it is known that the Union made a payment of £25 million to the United States in final settlement of its lend-lease debt and a payment of about £6 million in gold on its quota in the International Monetary Fund. At the same time, foreign exchange reserves increased by £43 million during the year; since South African short-term dollar assets do not appear to have increased in 1947, it will be assumed that the entire increase was in sterling reserves.

On the basis of these facts, together with U.S., Canadian, and U.K. statistics on merchandise trade with South Africa during 1947, the following tentative balance of payments may be constructed:

1/ While the regulations of the South Africa Reserve Bank apply to the sterling area as a whole rather than to the United Kingdom, it may be assumed that the flow of capital into South Africa from parts of the sterling area other than the United Kingdom was of minor proportions.

2/ Financial Times, London, March 12, 1948. This figure may be checked by taking data for gold reserves at the end of 1946, production during 1947, and reserves at the end of 1947. With the assumption of no change in earmarked gold abroad during the year, one gets a total of gold exports amounting to £142 million.

Total merchandise deficit (millions of pounds)		186
United States	76	
United Kingdom	67	
Canada	15	
Other	28	
Payment to International Monetary Fund		6
Lend-lease payment		25
Increase in sterling reserves		43
		260
Gold sales[a]		144
To United Kingdom	70	
To rest of world	74	
Minimum net capital inflow		116

a/ The figure of gold exports to the United Kingdom from Economic Survey for 1948 (Cmd. 7344). On the basis of past experience it may be assumed that the remainder of South African gold exports were shipped to the United States. Statistics of U.S. imports of gold from South Africa cannot be used since they include imports for the account of other countries.

This estimate of capital flow to South Africa must be regarded as a minimum figure, since the invisible items in South Africa's balance of payments have been neglected, because of lack of data. An estimate of the Union's balance of payments for 1946 shows a deficit on invisible account of over £30 million.[1]

In estimating how much of the capital influx consisted of sterling, it may be assumed that dollar capital receipts were used to finance a portion of South Africa's Western Hemisphere deficit, rather than to meet payments in the sterling area. This assumption appears reasonable in view of the fact that South Africa is understood to have drawn on the sterling area dollar pool during the year. On the basis of this assumption, and neglecting for a moment South African purchases of U.S. and Canadian dollars in London, it may be stated that sterling capital receipts of South Africa were at least equal to the merchandise deficit with the United Kingdom (£67 million) plus the increase in South African reserves of sterling (assumed to be £43 million), minus sales of South African gold in London (£70 million).[2] The resulting figure of £40 million represents that part of South Africa's sterling area deficit on merchandise account plus the increase in holdings of sterling exchange which are not accounted for by sales of South African gold in London. It would appear conservative to add £10 million for South Africa's sterling deficit on account of invisibles, including payments for freight, insurance, and remittances of interest and dividends.

1/ S.F.T. Greaves, "The Union's Balance of Payments", Journal of the Institute of Bankers in South Africa, July 1947.

2/ The Union's deficit with the sterling area other than the United Kingdom was relatively small in 1946 and it is assumed here that trade was balanced in 1947.

Since no information is available on the amount of South African drawings of dollars in London, it can only be stated that the net capital flow from the sterling area was at least £50 million plus the amount of sterling used by the Union to purchase dollars in London.

To sum up, it appears that the net capital inflow to South Africa in 1947 from all sources was at least £115 million. Probably it was greater, since South Africa's deficit on invisible account has not been included. It is likely that the major portion of this capital came from the United Kingdom. On the basis of the assumptions made above, the £80 million estimate by the Finance Minister would be substantiated if the South African drawings of Canadian and American dollars had amounted to about £30 million;1/ to the extent that these drawings exceeded £30 million or South Africa's deficit on invisibles with the sterling area exceeded £10 million, the estimate of an £80 million capital inflow from the rest of the sterling area would appear to be low.

In reference to the recent attempt to restrict this flow of sterling capital, it should be noted that the regulations were issued by the Reserve Bank of South Africa with the approval of the Union Treasury. They set forth the purposes for which South African banks in London may sell South African currency against sterling, and appear to be designed primarily to prevent the direct transfer of deposits from the United Kingdom to South Africa. While the transfer of idle money is thus restricted, prospective purchasers of South African securities may still acquire South African currency against sterling from South African banks in London. The action of the Reserve Bank is in line with the United Kingdom-South African loan agreement which provides that the two countries will consult concerning measures for controlling or preventing movements of capital from the United Kingdom which are not required for any useful purpose in the Union.

There is some indication that European and other non-residents of the United Kingdom have been transferring capital to South Africa via the United Kingdom, using sterling acquired at a discount in continental markets. The United Kingdom authorities, on April 5, took steps to supervise more closely "switching" by non-residents from British to South African securities.

It appears that the capital flow from the United Kingdom to South Africa accelerated during the first quarter of 1948, on the basis of the Union's increasing reserves of sterling, and official announcements and regulations. It remains to be seen what further steps, if any, will be taken by the United Kingdom and South African authorities to limit this movement of capital.

1/ Actually, it is likely that these drawings were greater than £30 million in view of the magnitude of the Union's dollar deficit not covered by gold sales to "rest of world". To the known dollar payments shown in the table there would have to be added that part of the deficit with "other" areas which was settled by dollar payments plus South Africa's dollar deficit on invisible account. To the extent that this total dollar deficit in excess of gold sales to "rest of world" was not covered by an inflow of dollar capital, it must be assumed that it was financed with dollars acquired in London.

THE ANNUAL RATE OF U.S. TRADE IN JANUARY AND FEBRUARY Gretchen H. Fowler

The value of U.S. merchandise exports was at the highest level in history during 1947, and January and February of 1948 are still registering over a billion dollars a month. Foreign aid for 1948, becoming effective in April, is not expected to alter the commodity composition of exports before July 1948, although the trend during the second half of 1948 will probably be toward a decreasing proportion of foodstuffs and a larger share of capital goods and raw materials for economic recovery purposes.

The annual rate of U.S. domestic merchandise exports during January and February 1948 was $12.9 billion, a drop of $2.3 billion, or 15 per cent, from the 1947 total of $15.2 billion. Shipments under the Department of the Army Civilian Supply Program are included in both figures. The following table gives the value of merchandise exports and imports for 1947 and an annual rate for 1948 based on January and February 1948 figures by economic classes.

U.S. Trade by Economic Classes
(In billions of dollars)

Class	Exports of Domestic Merchandise		Imports for Consumption	
	1947	Annual rate 1948	1947	Annual rate 1948
Crude Materials	1.6	1.3	1.8	2.3
Crude Foodstuffs	1.3	1.3	1.0	1.3
Manufactured Foodstuffs	1.8	1.3	.7	.5
Semimanufactures	1.8	1.5	1.2	1.5
Finished Manufactures	8.7	7.5	1.0	1.1
Total	15.2	12.9	5.7	6.7

The greatest decline in exports during the most recent period is in the finished manufactures category. Some of this decline is no doubt due to the sharp decrease in sales of merchant ships. In 1947, over $600 million was used for the purchase of merchant vessels from the United States. Since the authority to sell surplus ships to foreign owners, set up under the Merchant Ships Sales Act of 1946, was terminated February 29, 1948, these sales should be negligible during 1948. Import embargoes against non-essential, consumer-type goods enacted late in 1947 and early in 1948 by Canada, the sterling area countries, Sweden, and certain Latin American countries (chiefly Argentina, Brazil, and Mexico) will probably hold exports to these areas from the United States to a lower level this year than last. The U.S. export figures for January and February 1948 were the first to show the accumulated effects of these embargoes, as well as the decline in buying by those countries awaiting U.S. action on the European Recovery Program. Consequently, the two-month rate should not be given undue weight in judging the trend of trade for 1948.

Imports during the early months of 1948 are expected to be unusually high as a result of tariff reductions, effective January 1, 1948, which were negotiated in the general agreement on tariffs and trade at Geneva last fall. The tempo of these imports may not be sustained in the latter part of 1948.

There is also a seasonal factor in imports of crude materials and crude foodstuffs early in the year which tends to make an annual rate based on these early months an overstatement of what may be expected as to the total for the year. In 1947 the annual rate based on January was $6.4 billion, compared with the actual 1947 import value of $5.7 billion.

The following table shows the broad geographical distribution of U.S. trade for 1947 and an annual rate based on January and February 1948.

U.S. Trade by Continents
(In billions of dollars)

Continent	1947 Exports[a]	1947 General imports	1947 Excess of exports	1948 Exports[a]	1948 General imports	1948 Excess of exports
North America	3.8	2.2	1.6	3.1	2.2	.9
South America	2.4	1.2	1.2	2.1	1.7	.4
Europe	5.7	.8	4.9	4.8	1.0	3.8
Asia	2.4	1.1	1.3	2.1	1.3	.8
Australia	.3	.2	.1	.2	.1	.1
Africa	.8	.3	.5	.8	.4	.4
Total	15.4	5.8	9.6	13.1	6.7	6.4

a/ Exports of domestic and foreign merchandise, including shipments made under the Department of the Army Civilian Supply Program.

The annual rate of exports to Europe in the first two months of 1948 is substantially lower than the anticipated exports for the calendar year. United States exports to countries now subject to assistance through the Economic Cooperation Administration totaled $5.3 billion in 1947 and are expected to equal $5.0 billion in 1948. Eastern Europe, which received approximately $400 million worth of goods in 1947, will probably receive somewhat less this year as a result of stringent restrictions on this trade enacted in the aid bill.

The following table shows a tentative schedule of U.S. exports to the ECA countries for the second quarter of 1948 and the fiscal year 1948-49. The grouping into economic classes is based upon commodity data submitted by the Administration to Congress in support of appropriation requests.

Tentative Schedule of U.S. Exports to 16 ECA Countries
and Western Germany
(In billions of dollars)

Class	4/1/48-6/30/48	Per cent of total	6/30/48-6/30/49	Per cent of total
Crude Materials	.3	25.0	.9	17.0
Crude Foodstuffs	.2	16.7	.8	15.1
Manufactured Foodstuffs	.1	8.3	.4	7.5
Semimanufactures	.1	8.3	.4	7.5
Finished Manufactures	.5	41.7	2.8	52.9
Total	1.2	100.0	5.3	100.0

Source: European Recovery Program, Estimated Balance of Payments on Current Account of the Participating Countries, April 1, 1948-June 30, 1949.

These tentative commodity schedules for shipments under ECA during the second quarter of 1948 indicate that emphasis will be placed upon consumer-type goods in the early stages of the program. No shipments are scheduled for agricultural machinery, mining machinery, freight cars, steel equipment, timber equipment, electrical equipment, or petroleum equipment in the second quarter of 1948 under the ECA program. The largest exports tentatively scheduled for the second quarter of 1948 are cotton, coal, tobacco, grains, dairy products, chemicals, and miscellaneous equipment, whereas the fiscal 1949 program includes a larger proportion of machinery and equipment of all types.