Japan's Postwar Economic Recovery and Anglo-Japanese Relations 1948–1962

Noriko Yokoi

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The origins of Japan's 'miraculous' economic growth in the 1960s has been a topic that continues to interest academic inquiry. The initial focus upon internal factors has been supplemented by greater emphasis on the role played by the United States and the Western allies in promoting Japan's economic welfare. This book provides the British perspective on Japan's postwar economic recovery. It refutes the accepted view that Britain's policy towards Japan was driven by fears that the latter's economic recovery through greater trade relations with Southeast Asia would encroach upon Britain's sphere of influence. Through a close examination of Britain's sterling and trade policies towards Japan, the book illustrates the complex, often contradictory, yet daring British vision of Asia as a whole in the immediate postwar world.

Noriko Yokoi received her Ph.D. from the London School of Economics and Political Science. She has taught Asian history at Pace University in New York. Her research interests include international history and Japanese history.

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To my parents

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Usage and Abbreviations

The usual conventions concerning Japanese names are observed throughout this book with the family name followed by the given name. The exceptions are for Japanese scholars who publish in English. The terms Far East and East Asia have been used intermittently in the book due to the popular usage of the term Far East in the 1950s. An attempt has however been made to use East Asia wherever possible.

AA	Automatic Approval
cif	cost, insurance, freight
COCOM	Coordinating Committee
CHINCOM	China Committee
CLC	Commonwealth Liaison Committee
CPCE	Committee on Preparations for Commonwealth Economic Conference
ECA	Economic Cooperation Administration
ECAFE	Economic Commission for Asia and the Far East
ECOSOC	Economic and Social Council
EPB	Economic Planning Board
EPC	Economic Policy Committee
EPU	European Payments Union
ERP	European Recovery Program
ESB	Economic Stabilisation Board
ESC	Economic Steering Committee
ESS	Economic and Scientific Section
FEC	Far Eastern Commission
FECB	Foreign Exchange Control Board
FE(O)C	Far Eastern (Official) Committee
FOA	Foreign Operations Administration
GARIOA	Government and Relief in Occupied Areas
GATT	General Agreements on Tariffs and Trade

IBRD	International Bank for Reconstruction and Development
IC/DV	Import Certificate, Delivery Verification
ILO	International Labour Organisation
ISA	Independent Sterling Area
IMF	International Monetary Fund
ITO	International Trade Organisation
IWA	International Wheat Agreement
IWC	International Wheat Council
l/c	letter of credit
MFN	Most Favoured Nation
MITI	Ministry of International Trade and Industry
MOF	Ministry of Finance
MOFA	Ministry of Foreign Affairs
NAC	National Advisory Council
NATO	North Atlantic Treaty Organisation
NSC	National Security Council
OGL	Open General License
ONC	Overseas Negotiations Committee
OPA	Open Payments Agreement
PRC	People's Republic of China
RFB	Reconstruction Finance Bank
ROC	Republic of China
RSA	Rest of the Sterling Area
RTA	Reciprocal Trade Agreements
SCAP	Supreme Commander of the Allied Powers
SEATO	Southeast Asia Treaty Organisation
UKLM	United Kingdom Liaison Mission
UN	United Nations
VER	Voluntary Export Restrictions

1
Introduction

Since Japan's high-speed growth in the 1960s, there has been a growing amount of scholarly work on Japan's postwar success, and this peaked in the 1980s when Japan became the world's second strongest economy and the world's largest creditor nation. The focus of the inquiry was the Western desire to understand how a country deficient in raw materials, devastated in the Second World War and stripped of its empire could have recovered so quickly from defeat and risen to become one of the strongest economies in the world in a matter of few decades.[1] Much of the focus on Japan's so-called economic miracle examined the peculiarities of Japan's political and economic framework, such as the emphasis on consensus and cooperation between the ruling party, the bureaucracy and big business.[2] There have also been studies of institutional characteristics such as the seniority wage system and the practice of life-time employment.[3] Other factors that have been highlighted are Japan's education system, the 'paternalistic orientation behind the notion of labour and management…enthusiastic acceptance of benevolent guidance, the work ethic and an inclination to save'.[4] Although there have been numerous works emphasising one aspect of Japan's society or the other to explain the reasons for Japan's economic miracle, these explanations have become clichéd over the years. At times, they have fuelled the notion that Japan is unique which has not been very constructive nor particularly insightful.

Diplomatic historians, with their reliance on publicly released government documents, have had an opportunity to contribute to this body of literature since the thirty-year rule availed them of postwar documents. Hence historians have been publishing books on Japan's economic recovery since the mid-1980s. Initial research results have identified the Cold War in Asia as the major factor behind the US decision to 'reverse' its postwar policy towards Japan in order to maintain a balance of power in the region. A subsequent wave of historical inquiry has shifted the emphasis to economics and trade as the reason for the US decision to sponsor Japan's economic recovery. Scholars representing this view have argued that the United States saw urgency in sponsoring the economic recovery of key countries in Europe and Asia as a means of pursuing its vision of a multilateral trading system, even in a compromised form in the immediate postwar period. The impetus behind this decision was both to enable the United States to sustain the Western economic trading system, and also to maintain the health of the US economy during the period of trade disequilibria known as the dollar gap.

This book follows the historical inquiry pursued by the latter group of historians, but the focus of the research will be on the British perspective, which has been mentioned tangentially but not addressed fully in the existing works. Specifically, the book will focus upon the argument cited frequently by US historians that Britain opposed the US-sponsored Japanese economic recovery due to a conflict of interest with its own policies. The book will explore the two themes that have been presented by scholars as examples of British opposition to Japan's economic recovery. The first is the impact of Japan's economic recovery on Britain's sterling policy in Asia; the second is British fears of a revival of the cut-throat competition of the pre-war period and its effects upon British industries if Japan were allowed to pursue its economic recovery with little restraint from the postwar international trading community at large.

Britain has often been viewed as being opposed to US attempts to resuscitate the Japanese economy through an intricate triangular trading system whereby the United States supplied raw cotton to Japan, which was used to manufacture cotton goods for export to Southeast Asia in exchange for raw materials that were sold on to the United States for dollars. This was because the US plan allegedly impinged upon the postwar British triangular trading system, which was centered on its Southeast Asian colonies as the dollar-earning pivot. It has been argued that Britain subsequently regulated Japan's economic activity with the countries that fell within the Sterling Area's jurisdiction in order to stifle Japanese competition, thereby limiting Japan's chances of resurrecting its economy through trade with the Sterling Area members, who were far-flung across Southeast Asia, South Asia, Australasia, the Middle East, Europe and Africa,[5] and accounted for a quarter of the world's trade between 1951 and 1957.[6]

Moreover, scholars argue that Britain's attempts to postpone Japan's GATT (General Agreement on Tariffs and Trade) entry in the postwar period represents further evidence of Britain's opposition to Japan's economic recovery. British industrial representatives, particularly those representing Lancashire's textile concerns, lobbied for protection against perceived as well as actual Japanese competition. They were particularly fearful of the repetition of the pre-war, unfair trade competition, which consisted of price dumping, government subsidies and copyright infringement, which contributed to the overall erosion of Britain's export market share. Their views were represented by the Board of Trade, which was responsible for Britain's commercial policy; in this way the industry lobby withstood internal cabinet opposition to postpone Japan's GATT membership until 1955. In addition, Britain refused to base its trade relations with Japan on the spirit of the postwar multilateral trading system of free and fair trade until 1962—a full six years after the most-favoured-nation treatment clause in the 1951 peace treaty had expired.

This book will explore the two inter-related issues between 1948 and 1962, in order to assess whether Britain's overall policy towards Japan was based upon a comprehensive effort to block the latter's economic recovery. The year 1948 has been chosen as the starting point of the research because it was the year that official trade relations began between the two countries in the postwar period. The year 1962 is seen as the natural end of this research because it was the year that the two countries signed the treaty of commerce, establishment and navigation that formalised bilateral commercial relations. The intervening years are treated chronologically to analyse the validity of the hypothesis, and to examine the impact of Britain's decisions upon its relations with Japan and its postwar sponsor, the United States.

The book's structure follows the evolution of Anglo-Japanese sterling and trade relations, which can be divided into three phases: the Open Payments Agreement (1948–51), the Sterling Payments Agreement (1951–7), and bilateral trade agreements (1958–62), with an expanded focus upon the middle phase. The book follows the development of each of the three agreements—albeit loosely—to illustrate the strategies formulated by British policymakers and to assess how closely they adhered to, or how far they deviated from, the original blueprint. The middle phase, from 1951 to 1957, has been covered in most detail because that period encompassed Britain's greatest activity and investment in the success of the postwar Sterling Area and by extension, its interest in Japan as an important sterling partner in East Asia.

The first phase, covered in Chapter 2, was characterised by bilateral agreements between the respective Sterling Area countries and Japan. The trading countries controlled trade balances with little supervision from the United Kingdom. The bilateral nature of the agreement, however, restricted countries from expanding their trade relations with Japan. To circumvent the limitations, Britain invited sterling countries that had a rough balance of payments with Japan into a participant pool, where members grouped their trade volume for economies of scale. Sterling Area relations with Japan never exceeded the minimum during this first phase because the dollar clause in the agreement permitted the SCAP (Supreme Commander of the Allied Powers) to convert any excess sterling into dollars twice a year. Although the SCAP never activated the dollar point, the potential for a dollar drain through Japan deemed the latter a hard currency country, thus the Sterling Area countries were discouraged from expanding their trade relations beyond the necessary level.

The second phase, covered in Chapters 3 to 8, was characterised by Japan's signing of the Sterling Payments Agreement. Britain initiated the change in order to introduce Japan to an established Sterling Area trading system of the postwar period. As part of this transition process, the dollar clause was abrogated to open the way for Japan to become a soft currency country. Britain's aim behind the shift from the Open Payments Agreement to the Sterling Payments Agreement was governed entirely by self-interest. The postwar Sterling Area and its vitality was Britain's paramount concern. Britain realised Japan's potential role for stimulating intra-Asian trade as the regional 'workshop', and in the process, revitalising sterling as the trading currency of choice in the region. Thus she encouraged Japan's use of sterling as an international currency for multilateral trade. The additional benefit of inviting Japan to expand trade relations with the Asian Sterling Area countries was the affordability of Japan's manufactured goods, which were appropriate in price and quality for many of the 'under-developed' colonies. The results of Britain's strategy are clearly illustrated in Figures 1.1 and 1.2, where 67 per cent of Japan's imports from the Sterling Area are shown to have come from the Asia-Pacific region, which included Australia, New Zealand, Pakistan, India, Ceylon, Burma, Malaya, Hong Kong and Singapore.[7] Exports to these countries accounted for 81 per cent of Japan's exports to the Sterling Area. Thus the British policymakers' blueprint reveals that Britain saw Japan as an important economic partner in Asia, who could contribute to the

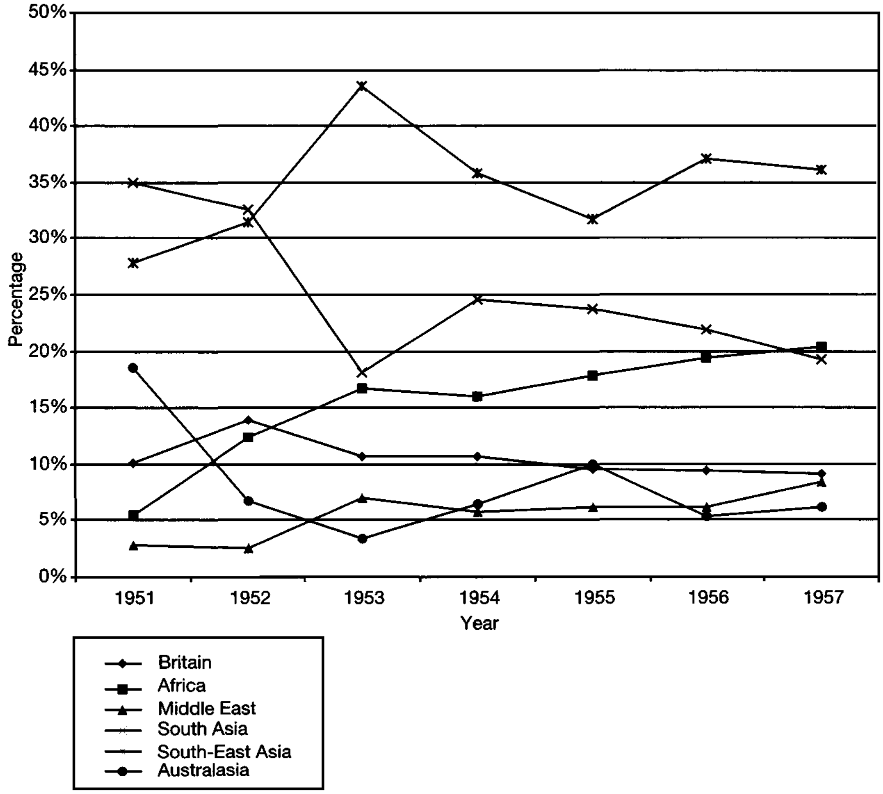

Figure 1.1 Japan's exports to the Sterling Area, 1951–7

Source: Bank of Tokyo 1969.

resuscitation of sterling in the region, which underlies the fact that Britain did not pursue a comprehensive plan to thwart Japan's economic recovery.

Britain's sterling policy towards Japan in the second phase was clouded, however, by its inability to reconcile Japan's membership in a postwar multilateral trading system that was governed by liberal economic principles. The three underlying components of economic liberalism were the open door policy, the most-favoured-nation treatment and the principles of comparative advantage.[8] During the 1950s Britain was unable to extend a single component of these postwar ideals to Japan due to strong domestic resistance. The open door policy, for example, was never truly functional, because most soft currency countries took advantage of the temporary privilege extended to them to use quantitative restrictions to limit imports of goods from certain hard currency countries, during their balance of payments crises or the dollar gap. In some instances, quantitative restrictions were used as an excuse to limit imports of manufactured goods that competed with their domestic production, as in the case of Britain and its restrictive licensing of Japanese goods. Moreover, Britain reserved its rights to extend *de jure* MFN (Most Favoured

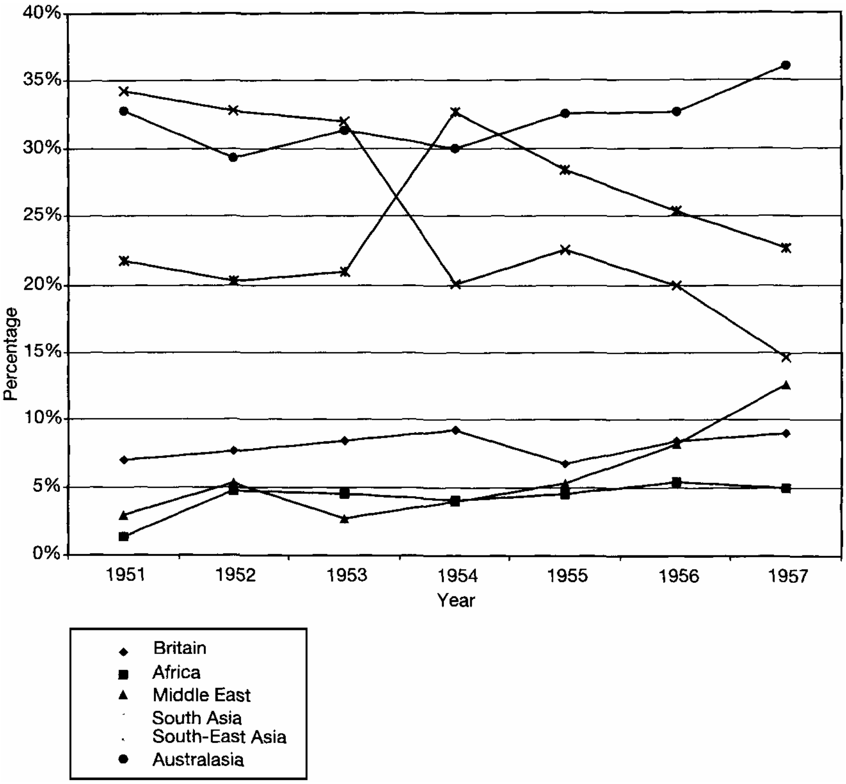

Figure 1.2 Japan's imports from the Sterling Area, 1951–7

Source: Bank of Tokyo 1969.

Nation) rights to Japan throughout the 1950s through its decision not to apply the GATT rules to Japan. The decision stemmed from two factors. The first was Britain's hopes of protecting its market share in the Commonwealth bloc against Japanese competition via the continuation of a preferential tariff system that discriminated in favour of Commonwealth goods. Britain's plans to engineer lower Commonwealth tariffs were not granted due to the GATT's no-new-preference rule, which precluded any member from increasing preferential treatment without extending it to all members. Thus Britain felt that it could not invite Japan into an association that did not allow for protection in its traditional market. Second, Britain felt that the GATT rules on adverse competition by a member country relied too heavily on consensus building and discouraged swift action by a country wronged by unfair competition. Unable to reconcile herself to the proposed rule, Britain felt uncomfortable inviting Japan into the GATT until a more decisive regulation was enforced within the GATT framework or until Japan exhibited more 'responsible' behaviour within the trading community. Last, the US vision of a multilateral trading system based upon competitive advantage failed to function in regard to Britain in the 1950s because the latter could not come to terms with the fact that more competitive labour and raw material sources existed elsewhere for the production of inexpensive manufactured goods for the world market. This was especially true in the case of textiles manufacturing, where Britain asked countries such as India, Pakistan, Hong Kong and Japan to adhere to voluntary export restrictions in order to protect its own domestic industry from losing market share to foreign competition. Thus the second phase saw a conflict of interest between British policymakers who saw opportunities to be gained from Japan's economic recovery, and those who sought to protect themselves from its revival. Thus Britain sent mixed messages to Japan and the United States about its policy. This second phase lasted for seven years, but came to an end with Britain's decision to abrogate the outdated Sterling Payments Agreement and the accompanying exchange of letters.

The final phase, treated in Chapter 9, was characterised by the unravelling of the postwar Sterling Area as a result of the diminishing importance of a centralised dollar reserve. This was due to the return of dollar convertibility, and to the increasing independence of individual Sterling Area members' economic policies. Britain, which viewed itself as providing strategic guidance to the postwar Sterling Area, viewed Japan with less importance as a result of Britain's diminished role in the Asian Sterling Area. Thus, by the third phase, Japan's relevance to British policy became proportionate to the actual level of Anglo-Japanese trade, which was miniscule in comparison to their respective total trade (see Figures 1.3 and 1.4). This explains why Britain did not prioritise the signing of a formal commercial policy to legitimise trade relations after the lapse of the Sterling Payments Agreement. The period of lull continued from 1956 until 1959, when Britain's export potential in the booming Japanese market became an opportunity that the former could not resist. Thus this period saw a shift in emphasis, as British exporters gained greater national influence while the political impact of domestic manufactures such as textiles waned in comparison.

Survey of the literature

As mentioned in the introductory paragraph, most of the research on Japan's economic recovery has focused on internal factors. In spite of this trend, the last fifteen years have seen a steady output of scholarly study of the external factors behind Japan's economic recovery, with the release of American and British government documents. Works of note are Michael Schaller's *The American Occupation of Japan;* Andrew J.Rotter's *The Path to Vietnam;* and William Borden's *The Pacific Alliance*. Schaller's work focuses on Washington's decision to reverse the course of the occupation due to the intensifying of the Cold War, and places the role of the Supreme Commander of the Allied Powers during the occupation, Douglas MacArthur, firmly back in its proper perspective. Moreover, Schaller highlights the decision by American policy-makers to promote Japan's 'greater co-prosperity sphere' by linking its economy with that of Southeast Asia, in order to promote its economic recovery and to ensure that Southeast Asia did not enter the communist orbit. Rotter has gone one step further by linking American policymakers' decision to sponsor Japan's economic recovery with the eventual American involvement

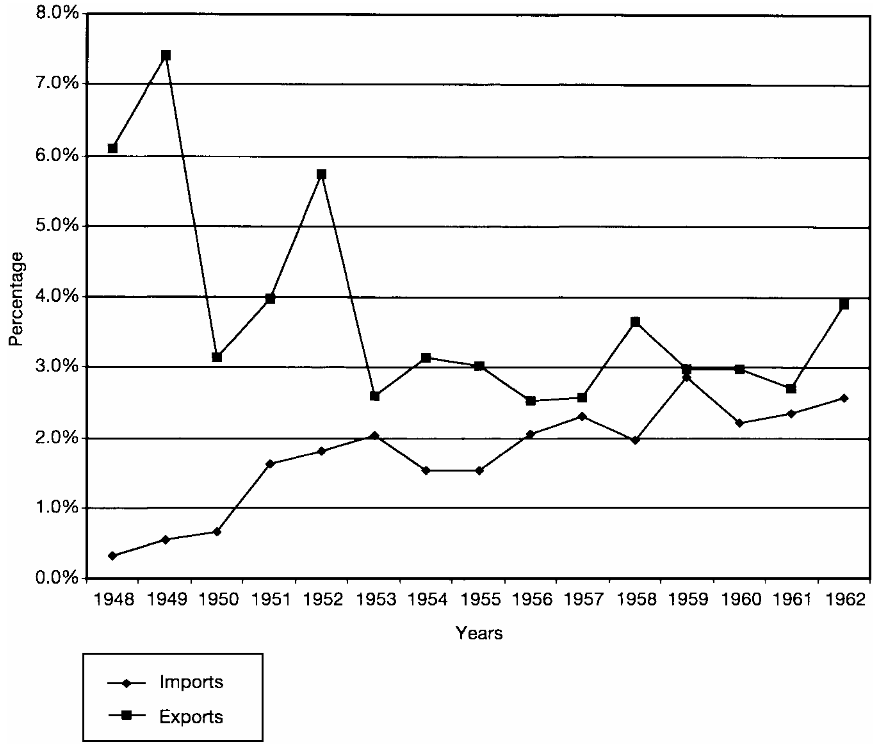

Figure 1.3 Britain's share of total Japanese imports and exports, 1948–62

Source: United Nations 1952–67.

in the Vietnam War. Although Borden also argues that the United States actively supported Japan's economic recovery, he highlights the importance of Japan's economic recovery to America's plans for a multilateral trading system in the non-communist world. For such a system to succeed, the United States needed to provide sufficient economic aid to Europe and Asia, to enable the 'free' world to continue purchasing American products.

All of the three works cited above refer in passing to Britain's postwar Asian interests. Schaller has dealt the least with Britain's perspective, while Borden has conducted some research based on American documents. Rotter, who has conducted archival research at the Public Record Office in Kew, deals in greater detail with Britain's interests in Southeast Asia. All three indicate the importance that Britain placed on its economic ties with Southeast Asia, and argue that British industrialists felt threatened by Japan's economic links with the region, but they produce little research on Britain's response to Japan's trade recovery. The problem with the approach of the three scholars mentioned above has been their acceptance of the argument that Britain felt threatened by Japanese competition in Southeast Asia. This is largely due to the fact that these scholars accepted the contemporary American view of British policy. In fact, this argument, cited as early as

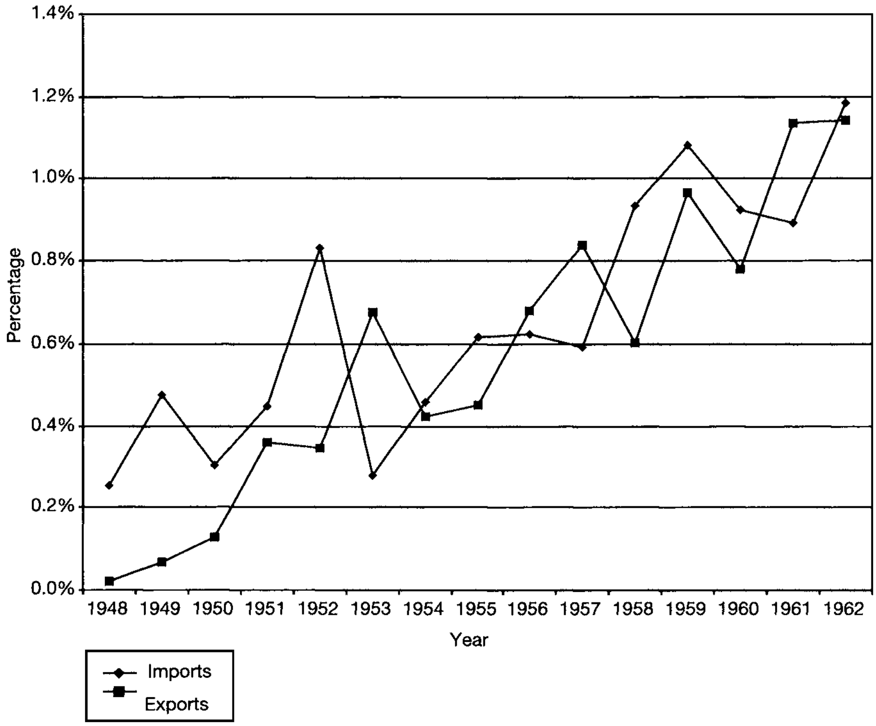

Figure 1.4 Japan's share of total British imports and exports, 1948–62

Source: United Nations 1952–67.

1979 in John Dower's *Empire and Aftermath*, has become proverbial in that it has been widely accepted by American scholars dealing with this area of research. This is evident in the work of scholars such as Sayuri Shimizu and Aaron Forsberg, who have published studies on the Eisenhower administration's policy towards Japan in the 1950s.[9]

Conversely, there has been comparatively less interest in Britain with regard to Japan's economic recovery and Britain's role *vis-à-vis* Japan in the postwar period. The most comprehensive study undertaken in the 1980s was Roger Buckley's *Occupation Diplomacy*. Buckley undertook research on Britain's occupation policy towards Japan from 1945 to 1952 in order to highlight an alternative perspective on the Allied occupation experience. He elucidated the differences between the American and British policymakers' views towards the occupation, and British policy towards Japan in the immediate postwar period. Although Buckley argues that Anglo-Japanese relations in the postwar period were primarily based on commercial relations, his work is lacking in Treasury, Board of Trade and Bank of England document citations. Buckley has managed to argue his case using Foreign Office documents (primarily FO 371 papers) but one is left wondering about the views of the other ministries in Whitehall.[10] Another scholar who has been working extensively on Britain's policy towards East Asia in the 1950s is Peter Lowe. Lowe has undertaken extensive research on British policy towards Korea, China and Japan, but his focus has been primarily diplomatic.[11] There has been a small but growing collection of works on Britain's business relations with Japan in the 1950s, starting with Davenport-Hines and Jones' *British Business in Asia since 1860,* as well as case studies of Anglo-Japanese commercial relations in the recently published volume of *The History of Anglo-Japanese Relations, 1600–2000, Volume 4,* edited by Janet E.Hunter and S.Sugiyama. These provide a greater understanding of British commercial interests in Japan and the strategies undertaken by selected companies with various degrees of success in penetrating a highly protected and regulated market; but a comprehensive work on Britain's commercial policy towards Japan in the 1950s has yet to be published.[12]

The reason why Anglo-Japanese relations have not enjoyed greater academic interest in Britain is the fact that historians have expressed a stronger interest in topics relating to its former empire and the decolonisation process. One of the topics which has fuelled an extensive amount of research among scholars has been the Sterling Area system. The Sterling Area, as an informal economic and financial 'club', has been seen as one of the factors that kept the British empire together, and thus a number of scholars, such as Cain and Hopkins,[13] have conducted research on the ties between the City of London and Britain's formal and informal empire, while others have concentrated on the Sterling Area system. The most comprehensive work on banking and the Sterling Area in the 1950s has been carried out by Catherine Schenk. John Singleton and Paul L.Robertson have recently published a more concentrated study on the relations between Australia, Britain and New Zealand. All these works have provided the author with a more solid conceptual understanding of the workings of the Sterling Area.[14] Moreover, they have provided a framework for evaluating whether Japan's dealings with the Sterling Area was unique or whether it was part of the overall sterling strategy towards non-Sterling Area countries. This study will show that the overall sterling policy was decided by Britain with the consensus of the core Commonwealth countries. Thus the decisions that drove Anglo-Japanese trade relations were taken by the Sterling Area policy makers or by the members of the Overseas Negotiations Committee, which was in charge of the high-level strategies, thus substantiating Cain and Hopkins' thesis that decisions were made at the centre, not the periphery. Where Cain and Hopkins' argument concerning gentlemanly capitalism does not apply to Britain's relations with Japan, is in the importance that the latter placed upon 'salesmanship' from foreign exporters and their drive to enter the Japanese market. Such characteristics matched the 'entrepreneurial drive' found in the manufacturing sector, and were not those of gentlemanly capitalists from the financial sector. Thus the later years hinged upon the success of a different group of British capitalists.

In Japan, although there has been an increasing number of historians conducting research on Japan's postwar external relations, most have concentrated on her relations with the United States for obvious reasons. Some academics have, however, focused on British and Commonwealth policy towards Japan—scholars such as Hosoya Chihiro and Kibata Yôichi. The former has written an outstanding account of the lead-up to the San Francisco Peace Treaty, but does not deal with post-occupation relations. The latter has conducted extensive archival research in Britain, Malaya and Australia, but his emphasis has been on

Malaya.[15] On Japan's entry to the GATT, Akaneya Tasuo's work is the most comprehensive to date in any language.[16] Akaneya has, however, gathered most of his documentary evidence in Australia, and thus his perspective on British policymaking is limited. Although there has been growing interest in Japan's trade relations with the Sterling Area, publications to date suggest that scholars are examining Japan's bilateral relations with former Sterling Area countries without reference to Britain's sterling policy.[17] An exception to this is Junko Tomaru's work on Japan and Malaya's postwar rapprochement, which is by far the most comprehensive work to date on Britain's gradual acceptance of Japan's return to Southeast Asia.[18] Tomaru's meticulous research is apparent from the range of sources used to build her argument. She argues convincingly that Britain allowed Japan back into Malaya by 1954 because of Britain's overall focus on Malayan stabilisation ahead of its independence. Her study thus refutes the view that Britain was opposed to Japan's return to Southeast Asia. This book will support Tomaru's central argument, but where our works differ is in her reliance on the Colonial Office and Foreign Office documents and the views of British officials in the region, whereas this book will focus on the views of British officials who made the strategic decisions concerning Sterling Area-Japanese trade in the Economic Policy and the Overseas Negotiations Committees. Thus this book will provide an overlay to Tomaru's research by providing the views of officials at the centre.

Last, although this study deals primarily with foreign economic diplomacy, one cannot ignore the voluminous amount of research that has been generated on Japan's postwar economic development. The research has provided the author with a better understanding of the key elements in Japan's economic success, which were a combination of bullish Japanese companies, technology imports from abroad, and government planning authorities' efforts to remove barriers to economic growth.[19] Nor can any research on Japan's economic recovery be conducted without the author being fully aware of the decades of research that have led to an accumulation of knowledge concerning the developmental versus the liberal forms of capitalism, with particular emphasis upon the Japanese institution that has underpinned the developmental form of capitalism, namely the Ministry of International Trade and Industry, or MITI.[20] In more recent years, much of the admiration for Japan's economic model has been replaced by criticism, as the country's economic woes have highlighted weaknesses in the developmental economic model. These criticisms aside, one cannot ignore the important role that industrial policy played in Japan's miraculous economic growth in the immediate postwar period.

2
The Open Payments Agreement with Japan

Introduction

The postwar economic system was designed to prevent the world from returning to the economic nationalism, discriminatory trading blocs and 'beggar-my-neighbour-policies' of the inter-war period.[1] In order to achieve international stability it therefore aimed at full employment and economic growth on the domestic front, and beyond this the establishment of a stable world economic order where countries had fixed exchange rates and fair and competitive tariff rates.[2] The plan for the postwar economic order was discussed as early as 1942, and negotiations for the blueprint of such a world order began between Britain and the United States in 1943. The two economic experts who prepared documents for the negotiations were John Maynard Keynes and Harry Dexter White.[3] Disagreements occurred between the two sides during the course of discussions, but US economic dominance guaranteed that the American plans would be implemented at the Bretton Woods Conference of 1944.[4] The two institutions established at Bretton Woods were the IMF (International Monetary Fund) and the IBRD (International Bank for Reconstruction and Development). The IMF's role was to monitor exchange stability and balance of payments, while the IBRD's function was 'to encourage long-term international investment'.[5] As a by-product of the conference, the GATT was established in 1946.[6] It was initially a temporary meeting between the original member countries until the ITO (International Trade Organisation) Charter was ratified. However, with the failure of the United States to ratify the charter, the ITO was never realised as an organisation.[7] Instead, the GATT became the alternative body that replaced the ITO as the third pillar of the postwar economic system. The two aims behind the GATT were first 'a multilateral and non-discriminatory approach to international trade' and second, 'condemnation of quantitative trade restrictions'.[8]

Although much planning and discussion had taken place to establish the Bretton Woods system, in reality, the world that emerged after the war was in no condition to implement it. The reason behind this was the physical devastation in Europe and Asia, which meant that governments were far more concerned with domestic reconstruction than with liberal international trade. One of the countries most affected by the war was Britain. During the war, it had run down its gold and dollar reserves as well as its overseas assets. Furthermore, Britain had accumulated huge sterling liabilities with the Sterling Area countries in order to finance the war. The loss of its overseas assets, continuing military commitments abroad and the sterling liabilities meant that Britain faced a very serious balance of payments problem. In addition, Britain, like so many other countries, was facing a dollar shortage or a 'dollar gap', where it sought American goods but did not have enough foreign exchange to buy them. Furthermore, the abrupt decision by the United States to end the Lend-Lease (Mutual Aid) programme on 17 August 1945, in order to prevent the recipient countries from using American aid for reconstruction, only exacerbated British difficulties.[9]

Recognising Britain's financial problems, the United States agreed to extend a loan, which was signed on 6 December 1945.[10] There were several conditions to the loan. First, the loan of $3.75 billion was not interest-free. Britain was to pay 2 per cent interest on the loan from 31 December 1951 in fifty annual installments. Second, Britain had to pledge to make sterling convertible to countries outside of the sterling and dollar areas on all current transactions after 31 December 1946. Third, an attempt was made to solve the sterling balances, and it was agreed that 'some balances would be written off, some funded, and some immediately released'.[11]

After the signing of the loan agreement, Britain made preparations for the convertibility of sterling by concluding bilateral agreements with holders of sterling, starting with the Anglo-Argentine Agreement of September 1946.[12] Britain expected the convertibility of sterling to be carried out in an orderly fashion, and furthermore, expected many countries to continue holding sterling as a medium of foreign exchange. However, when convertibility was put into place on 15 July 1947, dollars began to drain rapidly from Britain. In order to stop the tide of the dollar drain, convertibility was suspended from 20 August and full convertibility did not take effect until 1958. The failure of attempts to make sterling convertible signified that convertibility of currencies was premature. Given that there was an overall sterling surplus and dollar shortage, it should have been clear to officials that sterling convertibility would not work. Furthermore, an attempt to convert sterling in a world where most currencies were inconvertible was a recipe for disaster.

For the first half of its period of inconvertibility, therefore, the Sterling Area was established into a trading bloc with four different account areas: the sterling, the American, the transferable and the bilateral. Sterling transfers within each bloc were permissible, with the exception of the bilateral account. Bilateral account countries were able to transfer sterling automatically to sterling account countries, but were unable to transfer sterling to another member of the bilateral account without the approval of the Bank of England. Transferable account countries were able to transfer sterling within the account group and to sterling account countries, but they were not permitted to transfer sterling to the American account group, whose sterling holdings were the most flexible because they were able to exchange their sterling into dollars and vice-versa. They were also allowed to transfer their sterling to the sterling account or the transferable account groups. This complicated division of countries into different groups was designed to restrict convertibility of sterling into dollars (see Table 2.1).[13]

Currency convertibility was not the only deviation from the postwar international economic model. The United States' attempt to rid the postwar international economic