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BRAZIL AS A CREDITOR:  
STERLING BALANCES, 1940-1952

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**Abstract**

This article considers the process of accumulation of British sterling balances by Brazil between 1940 and 1947 and how this Brazilian involuntary loan to Britain at significantly negative real interest rates was settled between 1947 and the early 1950s by the purchase of British assets in Brazil as well as of sterling-denominated public foreign debt bonds.

Much has been written on Brazil's experience as a debtor country in pre-World War II days as well as on the rise and fall of debt-led growth between the late 1960s and the early 1980s. Almost nothing, on the other hand, has been written on Brazil's limited experience as a creditor country during and after World War II. This article considers the process of accumulation of British sterling balances by Brazil and how this debt was settled.

Britain during Second World War II was able to draw important financial contributions to her war effort from other countries. In addition to current exports and the sale of assets abroad, sizeable debts were accumulated to finance British current payments. Part of those debts were related to the Lend Lease and gifts from Commonwealth countries but an important part took the form of increased sterling holdings. In addition to members of the sterling area other countries were "persuaded" to hold increasing amounts of unconvertible sterling as the war went on.\*

Brazil accumulated sterling balances in London during the war and continued to do so until early 1947. Just after V-day Brazilian sterling balances were of about 40 million pounds; in 1947 they reached a peak of 68 million pounds. While these balances are small if compared to total sterling balances - of 3,354 million in mid-1945 - and also to the balances of other countries such as India - 1,116 million - or even Argentina - 86 million - they were rather important from the point of view of Brazil, corresponding to almost 50% of total imports in 1945 and at their peak in 1947 to about 45% of total foreign debt and to 70% of sterling-denominated debt.† Brazil incurred in important losses while holding such balances both in terms of opportunity costs - even taking write ups related to the 1949 sterling devaluation into account - and, in the process of thawing the balances, buying up overpriced British assets in Brazil.

The objective of this article is two-fold: to establish the history of the accumulation and thawing of Brazilian sterling balances - the issue that dominated Anglo-Brazilian economic relations in the 1940s - and to evaluate the net costs incurred by Brazil in lending a sizeable long term loan to Britain.

#### 1. Sterling Balances during the War

In late 1939, the possibility of entering into a payments agreement with Brazil had been rejected in London since the bilateral trade balance was not considered to provide "much of a basis, and over and above that, we have large financial claims which could not be go out successfully, if we annoyed the Americans by what would look like a clearing".‡ The rapid thawing

\* J Sayers, Financial Policy, pp. 15-19, chapters VIII, IX and XIV.¶

† Mid-1945 total figures from Sayers, op. cit., p. 497; country figures from The Banker, May 1950, p. 94.

‡ Waley to Cobbold, 30.11.39 and Niemeyer to Waley, 30.11.39, PRO: Treasury (T)160/F16522/1. The American press was already crying wolf in relation to British payments arrangements. See Christian Science Monitor, 27.11.39.

of Brazilian commercial and financial arrears resulted in the abandonment of a scheme to use frozen mil réis and coal to purchase cotton. Due to increased estimates of cotton and meat purchases in Brazil the British authorities decided to negotiate a payments agreement, since the balance of payments between the two countries was likely to become unfavourable to Britain.<sup>3</sup>

The main factor taken into account in the British approach to financial relations with Brazil was obviously to save financial resources while not hindering the British purchasing programme defined by the war effort: "it has become necessary for HMG to restrict purchases from countries with which they are likely to have an adverse balance of payments unless mutually satisfactory arrangements can be made ... payments between Brazil and the United Kingdom should be regulated by a bilateral payments arrangement. Unless an arrangement can be made, the Treasury would feel it very difficult to authorize purchases from Brazil"<sup>4</sup>

The British proposal, in spite of a Brazilian request, excluded trade matters based on the somewhat groundless sentiment that "we are not going to give the Brazilians more sterling to sell in New York".<sup>5</sup> The draft agreement provided that all payments between the British Empire (with the exclusion of Canada) and Brazil should be contracted in sterling; that all sterling payments to Brazil should be paid into a special account A; funds deposited into this account were to be used to discharge Brazilian liabilities inside the Empire; if the balance in the special account exceeded 1 million pounds, the excess could be transferred to special account B covered by a gold guarantee and Brazil would be exempted from payment in dollars for certain British Empire exports.

The Brazilian counterproposal included the suggestion to include Canada, that Britain should guarantee a 3 million pounds overdraft facility and undertake to buy at least 15 million pounds yearly and to extend the guarantee to cover both accounts. The British offered in return swaps against dollars and the payment of interest on special account A. There is evidence to show that the British were prepared to accept an interest cum revaluation guarantee for Account A, in spite of the fact that other South American agreements (including the Argentinian) which were not so

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<sup>3</sup> Owen's minute, 19.1.40, PRO: T160/F16522/1; Powell to Waley, 2.4.40, PRO: T160/F16522/2.

<sup>4</sup> For an analysis of the factors taken into account by British experts in their approach to the problems of financial relations with South American see Sayers, *op. cit.*, pp. 443-4.

<sup>5</sup> Waley to Fraser, 4.4.40, PRO: T160/F16522/2; Niemeyer to Phillimore, Bank of England and Treasury representative in Brazil, 16.5.40, PRO: T160/F16522/3; Powell to Waley, 9.4.40, PRO: T160/F16522/2; tel. 79, Rio to London, 30.4.40 and tels 77 and 79, London to Rio, 4 and 6.5.40, PRO: Foreign Office (FO)371/A3074/118/6.

generous, would have to be readjusted to include this concession.<sup>49</sup> Treasury officials were horrified with what appeared to be an overgenerous concession: "we oughtn't let the donkey have both carrots". It was thought that there was no need to offer to Brazil a "gold set aside" clause (the Brazilians had mentioned a simple revaluation clause) and that it was preferable to give interest (even generous) rather than a gold guarantee, let alone gold. Quite inexplicably the Brazilians backed down from their initial position which would grant them both interest and gold and accepted a less favourable arrangement. Comments in Treasury were rather tart: "we accept with the greatest pleasure their refusal to take gold and interest".<sup>50</sup>

The actual agreement included the main features of the the British proposal as well that the Bank of Brazil should quote a mil réis-sterling exchange rate based upon a fixed dollar-sterling parity of 4.025; all payments to Brazil should be made into special accounts A (of Bank of Brazil with either the Bank of England or its correspondents; of other banks operating in Brazil with their correspondents); sterling accruing to Special Accounts could be used to settle commercial and financial requirements in the sterling area only; the balance of the Special Account of the Bank of Brazil (which would be fed by balances in excess of 1 million pounds from its account A at the Bank of England would carry a revaluation guarantee based upon the official middle price of gold in London (168/6 per fine ounce); this guarantee should continue to apply after expiry of the agreement; the agreement would remain in force until denunciation subject to six months notice.<sup>51</sup>

Brazilian official views were that the agreement had brought advantages to both parties. Some of the reasons advanced were, however, rather curious. Bank of Brazil's report for 1940 suggested that the main advantage, from Brazil's point of view, was that it assured one of Brazil's desired targets: equilibrium in the balance of payments. The Minister of Finance's arguments were barely more elaborate: Brazil could always use its sterling balances to pay its public foreign debt. As the exchange rate stated in the agreement implied a mil réis devaluation against sterling of more than 30% this resulted on the one hand in making

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<sup>49</sup> No. 188, London to Rio, 31.5.40, Ministério das Relações Exteriores (MRE); tel. 108, London to Rio, 13.6.40, PRO: FO371/A3346/118/6.

<sup>50</sup> Playfair minute, 10.6.40, and Playfair to Powell, 15.6.40, PRO: T160/F16522/3. Sir David Waley's even tartlier remark concerning the Uruguayans that "in future we should not offer the best butter when the dog looks like being quite content with margarine" comes also to mind, Waley to Niemeyer, 18.6.40, T160/F16707/2.

<sup>51</sup> Note that there was no "gold set aside" standard guarantee clause as stated by Sayers, op. cit., p. 446. Agreement's copy, Rio 2.8.40, PRO: FO371/A3837/118/6.

the payment of the public foreign debt more expensive but on the other would foster Brazil's exports to the United Kingdom and save dollar balances required to settle sterling debts.<sup>11</sup> The "advantage" seen by the Bank of Brazil is a good indication of the Brazilian failure to understand the real issues at stake. Costa's points made, in comparison, slightly more sense but showed a misunderstanding of the role which might be played by import elasticities during war time. The Brazilian interpretation of the agreements as indirectly involving a British commitment to maintain the Brazilian account in funds at all times and consequently relieving Brazil dollar balances for other uses, was, however, very clearly stated. But it is impossible to detect any intuition that in the future the accumulation of sterling could become an important issue. Whereas the accumulation of sterling balances in special accounts was welcomed in the British Treasury, it was also thought that it would not be desirable to allow an "excessive" accumulation of sterling since this could lead to reluctance by neutrals to accept it. So views that the price of British exports had ceased to be important as the countries concerned had to choose between buying British goods or holding sterling blocked balances which were equivalent to a loan to Britain, there being no need consequently to promote exports, were countered by the argument that it would be wise to stimulate exports to keep balances within limits: "we should make them hold all sterling we can ... but must always sweeten the pill". Keynes's view concerning the British position were more optimistic as he thought that British bargaining position was "almost infinitely strong" since "there is a prospect of a hideous unsold surplus and market collapse" affecting the exports of many raw materials.<sup>12</sup> This view was vindicated in the immediate future but,

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<sup>11</sup> Banco do Brasil, Relatório 1940, p. 30 and Costa, Panorama Financeiro e Econômico, pp. 109-110. The mil-réis devaluation mentioned by Costa took the quotation of sterling in the free market as basis for comparison. The payments agreement by effectively killing off the sterling black market resulted in a return to a mil-réis sterling rate in line with the dollar-sterling rate.

<sup>12</sup> Minutes, 12th meeting, Inter-Department Committee on Central and South America, 27.6.40, and undated Treasury minute of a letter to Kahn, PRO: T160/F16707/3; Keynes's paper on Foreign Exchange Control and Payments Agreements, 29.4.40, PRO: FO371/A3539/118/6. Sir George Bolton's assertion that the acceptance of payments agreements outside the sterling area depended on "persuasions brought to bear on countries [outside the sterling area to hold sterling in payment for supplies by Treasury and Bank of England representatives] were in many cases political but more frequently of a personal nature" seriously underestimates the strength of Britain's bargaining power in a much reduced world market, Bolton, 'Where Critics are as Wrong as Keynes was', pp. 1385-6.

as the war went on, the Treasury's discomfort with the consequences of blocked sterling accumulation increased due to the rising rate of actual accumulation of those balances in the light of the future role of sterling as an internationally accepted currency in the post-war period.

Not much after the signature of the payments agreement it became clear that Brazil was short of sterling and that one important reason for entering into a payments agreement from the British point of view had ceased to exist. There was fear in London that Brazil would default in relation to the foreign debt service, so ways had to be found to replenish the Brazilian special account. Indeed, Brazil's shortage of sterling remained a problem until mid-1941.<sup>13</sup>

The possibility of allowing third country transfers to the Brazilian account was examined but no important breakthrough was made in time to deal with the immediate problem of Brazil's shortage of sterling. Efforts were concentrated on three other possible solutions: the convenience of increasing British purchasing efforts in Brazil; the expedience of making advances to the Brazilian account duly secured by British future purchases and strengthening the control of British exports to Brazil.

In an effort to avoid Brazil's default it was decided to increase purchases of cotton over and above the purchase which had been decided on the basis of strictly supply reasons. This was, of course, a vindication of the Brazilian stand which was that it was Britain's "duty" to keep the Special Account in funds, and which filled the British authorities with so much disgust.<sup>14</sup>

In the discussions on the imposition of additional controls on exports to Brazil the Foreign Office view was that for political reasons Brazil should not be included in the list which prohibited exports to certain "dangerous destinations". In the end the Treasury view was adopted: in early 1941 some exports were placed under control then exports to Brazil were subjected to an

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<sup>13</sup> Cobbold to Waley, 7.11.40: "as soon as the payments agreement basis is reversed it begins to cause trouble and this has happened in every major South American country, with the exception of the Argentine", PRO: T160/F16522/4. Sayers's argument, that Brazil's shortness in sterling was known before the agreement was being signed - the main reason for entering the agreement being "the anxiety to kill the free market in sterling" - is not that clear from the available evidence, Sayers, op.cit., p. 446. There are grounds to suppose that the seriousness of the position was not fully appreciated by mid-1940.

<sup>14</sup> Minutes of the 21st meeting of Inter-Departmental Committee of Central and South America, 11.12.40, PRO:FO371/A5228/18/51; tels. 343 and 370, London to Rio, 12 and 24.2.40, PRO: FO371/A5026 and 5050/18151; tel. 2 Saving, London to Rio, 9.5.41, PRO: FO371/A3214/381/6; Minutes by Waley and Keynes, 10 and 14.10.40, PRO: T160/F16522/4.

"all goods" control which was not relaxed before the end of the year. The Brazilian reaction was to point out that while it was argued that this was required because the United Kingdom was selling too much to Brazil, the argument could be reversed and it could be argued that Britain that was buying too little from Brazil.<sup>15</sup>

Dollar invoicing was another source of friction between British departments concerning Anglo-Brazilian payments. The difficulties of leaving Brazil "as long as possible in sterling so that in the post-war period she comes to us to use it up" was making the British more than restive, the more so as Brazil was becoming long in dollars. Irregular use of dollar invoicing, in breach of the Payments Agreement, was proposed by the Bank of England and the Treasury but was not widespread.<sup>16</sup>

By mid-1941 Brazil's short position in sterling had eased and the Brazilians had been finally put "in the happy position of having money to spend in other things, i.e., the redemption of their debt, the buying-up of British held interests etc". Brazilian sterling balances increased from a low level by the end of 1941 to almost 15 million pounds by the end of 1942 and 35 million by the end of 1943. Further accumulation was avoided in 1944 and 1945 because uses were found for sterling such the 1943 debt settlement, extraordinary foreign debt redemption and the limited liquidation of British-owned assets (see table 1 for quarterly 1940-47 figures for sterling balances and table 2 for the 1941-47 Anglo-Brazilian balance of payments).<sup>17</sup> From mid-1941 there was a consistent trend in London to underestimate the size of British purchases in Brazil, partly because of unexpected developments in the course of the war, which affected traditional sources of supply, and partly because of specific decisions to

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<sup>15</sup> Hargreaves and Gowing, Civil Industry and Trade, pp. 60 and 146 and no. 174, London to Rio, 26.2.41, MRE. Halifax to Johnstone, 16.12.40, Johnstone to Halifax, 23.12.40, Cadogan to Johnstone, 31.12.40, PRO: FO371/A5170/118/6; minutes, 22nd meeting of the Inter-Departmental Committee on South America, 17.12.40, PRO: FO371/A5228/18/51.

<sup>16</sup> Cobbold to Waley, 23.5.41, PRO: T160/F16707/3; Nosworthy to Waley, 28.5.41, PRO: T160/F16522/7; Mather Jackson's minute, 19.6.41, PRO: FO371/A4744/381/6; Mather Jackson to Waley, 28.6.41; PRO: T160/F16522/8; Mather Jackson minute, 3.7.41, PRO: FO371/A5087/381/6; Grant's minute, 9.6.41, PRO: FO371/F16707/3; tel. P66, Phillimore to Bank of England (BOE), 26.6.41, PRO: FO371/A4852/381/6.

<sup>17</sup> Powell to Nosworthy, 14.11.41, PRO: T160/F16522/1; Phillimore to Powell, no. 119, 19.1.45, PRO: T160/F16522/16. A permanent public foreign debt settlement was negotiated in 1943 entailing rather large sterling downpayments in 1944. For a comprehensive discussion of this question see Abreu, 'Brazilian Public Foreign Debt', pp. 105-40.



purchase which were not directly related either to immediate supply needs or pre-emption as in the case of the constitution of a cotton reserve for post-war use. <sup>18</sup> While the value of British imports from Brazil never rose above 1.9% of total imports, their increase during the war period in relation to 1938 was significantly larger than the average for total British imports and also larger than the rate of increase of imports from countries such as Argentina. A substantial South African deficit was generated in the trade with Brazil, South African exports to Brazil being almost negligible: never more than 20% of the value of imports from Brazil (see Table 2). The bulk of these imports consisted of low grade cotton textiles which acquired a sudden importance during the war due to the dislocation of traditional trade and corresponded for all markets to roughly 10% of total Brazilian exports in 1943-5. <sup>19</sup>

From 1942 onwards Anglo-Brazilian payments were a question of "on the long view ... to keep South America sterling-minded".

Table 1

Brazilian Sterling Balances, End of Quarter, Millions of Pounds, 1940-1952

1940.4	0.3	1944.1	22.4	1947.1	68.0	1950.1	40.9
1941.1	1.1	1944.2	25.2	1947.2	60.0	1950.2	21.3
1941.2	1.1	1944.3	34.1	1947.3	58.0	1950.3	17.1
1941.3	2.5	1944.4	34.6	1947.4	54.1	1950.4	16.2
1941.4	1.6	1945.1	34.8	1948.1	50.8	1951.1	16.2
1942.1	3.2	1945.2	36.0	1948.2	49.6	1951.2	16.1
1942.2	6.9	1945.3	35.4	1948.3	39.2	1951.3	16.1
1942.3	11.5	1945.4	37.8	1948.4	38.6	1951.4	5.8
1942.4	14.4	1946.1	39.9	1949.1	36.9	1952.1	2.6
1943.1	15.7	1946.2	48.0	1949.2	30.6	1952.2	2.5
1943.2	19.1	1946.3	52.5	1949.3	31.1	1952.3	2.0
1943.3	29.1	1946.4	59.7	1949.4	40.9	1952.4	1.9
1943.4	34.4						

Source: Bank of England

\* 1940.4 to 1947.1 Special Accounts; 1947.2 to 1952.4 A Accounts

<sup>18</sup> The constitution of a cotton reserve had been suggested by Keynes who thought that cotton will be very much in demand in the postwar export drive and that world prices would rise considerably. See Abreu, 'John Maynard Keynes e as relações economicas anglo-brasileiras', pp. 44-45

<sup>19</sup> See Sayers, *op. cit.*, pp. 306-20, on the South African reluctance to collaborate with the United Kingdom. Brazilian acceptance of sterling balances generated by South African purchases made the Union less reluctant to accumulate sterling balances.

Of course, the more sterling blocked balances accumulated in London which could not be transformed into exports and seemed as "mere entries to Brazil's credit", the less sterling-minded was Brazil likely to stay. Britain's main concern was consequently to find uses for sterling to avoid increased Brazilian balances. However, exceptions to this line of policy were frequent as over and above accumulations of sterling related to financial and commercial relations between Britain and Brazil, triangular sterling deals were allowed (see Table 2).<sup>20</sup>

The agreement with Canada was the only institutionalized triangular arrangement affecting sterling balances. It was argued that if Canada was buying Brazilian cotton she should be pressed to pay in sterling as this would save her dollars, and Brazil would have sterling to pay her debts. The idea was sold to the

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<sup>20</sup> Waley to Mather-Jackson, 1.1.42, PRO: T160/F18151/018/4; enclosure to no. 316 London to Rio, 29.6.42, MRE.

Table 2

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 Sterling Area Balance of Payments with Brazil, Millions of Pounds,  
 1941-46  
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	1941	1942	1943	1944	1945	1946	1947
1. Payments	14.1	21.6	35.3	40.2	23.6	38.9	43.9
Imports and purchases	11.4	16.5	21.2	29.3	13.2	18.2	27.6
Other Sterling Area payments	1.2	3.0	11.4	8.5	7.8	16.1	9.9
South Africa	0.7	2.2	9.1	4.7	4.6	5.1	...
Other	1.5	2.1	2.7	2.4	2.6	4.6	6.4
2. Receipts	12.0	15.6	13.4	18.7	19.3	25.0	31.2
Exports	3.7	3.8	3.6	2.4	3.7	9.2	15.2
Invisibles	6.0	7.2	6.8	10.6	11.2	11.8	9.8
Debt service	2.0	2.0	2.3	4.3	3.1	3.0	3.0
Other	2.3	4.6	3.0	5.7	4.4	4.0	5.2
3. Surplus	- 2.1	- 6.0	-21.9	-21.5	- 4.3	-13.9	-12.7
4. Compensatory Payments	2.1	6.0	21.9	21.5	4.3	13.9	12.7
Variation in Special Accounts	1.3	12.7	20.0	0.2	3.2	21.9	-60.0
Variation in A Accounts	...	...	...	...	...	...	54.1
Sterling paid to Brazil by other countries	- 0.9	- 6.4	- 0.6	- 1.1	- 1.4	- 7.7	- 8.0
Transferable Accounts	-	-	-	-	-	-	4.5
US \$ balances of Exchange Equalisation Account	...	- 2.0	- 0.3	0.4	0.9	0.5	15.1
Bond redemption	1.7	1.4	2.0	19.9	4.0	2.5	7.4
Expropriated property compensation	-	0.3	0.8	2.1	0.1	0.9	- 0.5
Debt settlement funds with British agents	-	-	-	-	- 2.5	- 4.2	0.1

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 Source: Bank of England Dossiers, November 1943, December 1944, September 1945, June 1947, December 1947 and March 1948, T236/312, 314, 316, 1559, 1563 and 1564.

find uses for sterling to avoid increased Brazilian balances. However, exceptions to this line of policy were frequent as over and above accumulations of sterling related to financial and commercial relations between Britain and Brazil, triangular sterling deals were allowed (see Table 2).<sup>21</sup>

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<sup>21</sup> Waley to Mather-Jackson, 1.1.42, PRO: T160/F18151/018/4; enclosure to no. 316 London to Rio, 29.6.42, MRE.

The agreement with Canada was the only institutionalized triangular arrangement affecting sterling balances. It was argued that if Canada was buying Brazilian cotton she should be pressed to pay in sterling as this would save her dollars, and Brazil would have sterling to pay her debts. The idea was sold to the Canadians with the mention that, as the Brazilians were claiming they had no dollar balances, they could refuse the deal but, on the other hand, they were hard pressed to sell their cotton. The Canadian authorities, while welcoming payments in sterling for cotton, thought that since cotton imports from Brazil had increased only because of the price differential as compared with American cotton, Canada was in a weak bargaining position.<sup>22</sup> In the end, it was agreed that the trade between Canada and Brazil would be conducted in sterling and dollars (50%-50%): the Bank of Brazil would sell US\$0.5 million monthly to the Bank of Canada (against sterling) and at the end of each 6-month period any outstanding balances would be settled.<sup>23</sup> However, the advantages to Britain related to this "admirable triangular arrangement" were limited by the curtailment of Brazilian cotton exports to Canada due to shipping difficulties. After successive renewals until 1944 the agreement was discontinued when the Americans started to subsidize their cotton exports.<sup>24</sup>

Of triangular ad hoc deals those with Spain were the more substantial as they were tied to the liquidation of British assets in Brazil. While it was feared that Brazil could refuse to accept triangular deals it was also thought that more expropriations were likely. Spanish and Brazilian attempts to have sizeable cotton deals approved in London were initially unsuccessful as it was thought that the Brazilian sterling account was too long and that an inflow of sterling to the Brazilian account coming from outside the sterling area would "tempt the Brazilians to rat on their Canadian Agreement". Moreover, no competitive buying was welcomed in Brazil and there was cotton available for Spain in West Africa.<sup>25</sup> Given Brazil's eagerness to sell cotton, it was decided

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<sup>22</sup> Niemeyer to Waley, 5.12.40, PRO: T160/F16522/5; tel. 4239, London to Ottawa, 21.12.40, PRO: FO371/A5184/118/6 and Gordon to Bolton, tel. 393, PRO: FO371/F16522/7.

<sup>23</sup> Tel. P65, Phillimore to BOE, 25.6.41; tel. B62, BE to Phillimore, 1.7.41, and tel. P71, Phillimore to BOE, 10.7.41, PRO: FO371/A4852/381/6. Brazil did not ask to pay for Canadian imports on the same basis as feared in London - but continued to pay in dollars, Powell to Nosworthy, 7.4.41, PRO: T160/F16522/7.

<sup>24</sup> Mather Jackson's minute, 29.4.41, PRO: FO371/A5961/381/6; Phillimore to Powell, no. 119, 19.1.45, PRO: T160/F16522/16; tel. P140, Phillimore to BOE, 19.1.42; PRO: T160/F16522/13; tel. B144, BOE to Phillimore, 4.6.42, PRO: T160/F16522/14; tel. P164, Phillimore to BOE, 31.7.42, PRO: T160/F16522/15; tel. P199, Phillimore to BOE, 23.3.43, PRO: T160/F16522/15. Total transfers to Canada amounted to about US\$15 million.

<sup>25</sup> Mather Jackson's minute, 8.8.41, PRO: FO371/A6015/1116/51; tel. 1227, London to Madrid, 4.9.41, PRO: T160/F18535/01/1 and Nosworthy's minute 4.11.41, PRO: T160/F18535/01/1.

to authorize the Spanish cotton deal if a quid pro quo was offered concerning the settlement of claims related to British-held assets which had been taken over. The policy was to avoid those claims which involved wider issues like the Brazil Railway and concentrate on well defined cases like the nationalization of the Southern San Paolo Railway, Sorocabana Railway and Brazilian Land and Cattle, assets which were valued at 1.65 million pounds.<sup>24</sup>

Alternative ways of dealing with the problem were considered. In the end London decided that it would be dangerous to have a formal agreement tying all triangular deals to the settlement of British claims -- debt redemption included -- as funds could proved to be insufficient and the Brazilians could use the agreement to force the Bank of England's approval of undesirable triangular deals. A gentlemen's agreement was thus considered preferable and was honoured as claims related to debenture holders of the Sorocabana, the Southern San Paolo and the Brazilian Land Cattle were settled after protracted negotiations.<sup>27</sup> Later, as all West African cotton was to be retained for British use and nothing was left for Spain, London, however reluctantly, had to agree to large Spanish purchases of cotton against sterling without a quid pro quo.<sup>28</sup> British doubts concerning these deals were, once again, related to the fear that the accumulation of balances would in some way interfere with the British purchasing programme. These views were not shared by Phillimore, the British financial representative in Brazil, who insisted that the Brazilians were ready to accept the view that "there was nothing to choose between sterling and dollars" and that triangular deals should continue to be allowed. He admitted that the Brazilians could become "restive" especially given the very high opportunity costs of holding such balances in face of the ruling local rates of interest but put the emphasis on finding uses for Brazilian sterling. After making sure that exports were being maximized, profits of of British firms promptly remitted and all outstanding credits (linked to the liquidation of assets) transferred, only two alternatives were left to use balances: to refund in mil-réis sterling issues of public utility companies (a move jeopardized by the weakness of the Brazilian stock exchanges) and increased debt redemptions. He thought that it was regrettable that the debt agreement expired only in early 1944 but the "present surfeit of exchange could hardly have been foreseen in 1940 "and that" the Brazilians should now, of course, ideally make

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<sup>24</sup> Tel. P117, Phillimore to BOE, 19.11.41 and Mather Jackson to Nosworthy, 4.12.41, PRO: FO371/A9523/110/6; Treasury meeting, 24.11.41, PRO: FO371/A18535/01/1.

<sup>27</sup> Tel. 124, Rio to London, 26.1.42, PRO: FO371/A938/19/6; Mather Jackson to Nosworthy, 30.1.42, PRO: T160/F16522/13; tel. 211, Rio to London, 17.2.42, PRO: FO371/A1649/19/6; Powell to Nosworthy, 21.2.42, PRO: T160/F18535/01/1.

<sup>28</sup> Mather Jackson's minute, 24.2.42, PRO: FO371/A1649/19/6.

the spontaneous gesture of offering bondholders more but I fear that it is not in their character to do this, the more so as they can have little real interest in improving their credit standing, so long as traditional financial markets remain closed to them and the Export-Import Bank continues to pour cheap money into their laps".<sup>29</sup>

Brazilian lack of concern with sterling accumulation was surprising but entirely vindicated the bolder line. The only evidence there is of Brazilian worries concerning increasing sterling balances before 1946-47 refers to a non-implemented suggestion from the Brazilian Embassy in London to the Ministry of Foreign Affairs that to get some protection against the decreasing purchasing power of sterling it would be interesting to try to negotiate contracts for future delivery of certain British goods, coal being specifically mentioned. Brazilians were put rather willingly in the "unhappy position of having to go on holding sterling, because they cannot do anything else about it".<sup>30</sup> The much reduced importance of triangular deals in the latter part of the war was probably more related to supply reasons -- cotton was the main Spanish interest and Britain was busy building up a cotton reserve -- than to problems related to the accumulation of sterling balances.<sup>31</sup>

Other similar but less important deals took place during 1942 and helped to increase Brazilian sterling balances. The possibility of asking Argentina to settle the Brazilian peso balances partly in sterling was also considered but rejected by Costa.<sup>32</sup> These triangular deals were allowed because in spite of

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<sup>29</sup> Tel. 228, London to Rio, 10.3.42, PRO: T160/F16522/13; Phillimore to Powell, 11.3.42, PRO: T160/F16522/13. Phillimore's views can be contrasted with those of an important Treasury official: "what we are frightened of is that at a given moment the Brazilians will suddenly realize that the position is getting dangerous and will take fright", Playfair to Ellis-Rees, 30.7.42, PRO: T160/F18535/01/1.

<sup>30</sup> London to Rio, no. 42, 19.1.43, MRE; Rowe-Dutton to Perowne, 18.7.45, PRO: F0371/AS3515/515/51.

<sup>31</sup> Tels. 1161, 1336 and 3086 ARFAR, London to Madrid, 17.10, 10.11 and 29.11.42, PRO: T160/F18535/01/2; tel. B196, BE to Phillimore, 4.3.43, PRO: T160/F18535/01/2 and Powell to Cohen, 9.3.43, PRO: T160/F16522/15. Sayers, *op. cit.*, p. 447, however, states that in the final stages of the war the British authorities rarely agreed to an exception to the policy of bilateralization of payments as it was feared that a market could be created for partially transferable sterling.

<sup>32</sup> This was eventually done after the war. Brazil had signed in 1940-41 a series of agreements on quasi-compensation lines with Argentina. Brazilian willingness to enter into such agreements seems to have been based on the recognition that bilateral trade had been as a rule unfavourable to Brazil. It was not anticipated that, due to the war, Brazilian exports to Argentina would increase much faster than Argentinian exports to Brazil. The agreements had, consequently, blown over the face of Brazilian policy-makers as the accumulation Brazilian peso balances proved very difficult to be kept under control. See *Notas sobre o tratado de comércio assinado pelo Dr. Oswaldo Aranha em Buenos Aires*, 23

there being "on paper little doubt that Britain should shut down all transfers to Brazil from third countries", the temptation proved too great to be resisted, given the Brazilian's apparent lack of concern with the size of their sterling balances.<sup>33</sup> London's doubts concerning which tactics should be adopted in association with the strategic aim of making sterling fully convertible after the war are brought to light by a discussion during 1944 concerning the opportunity of charging once again dollars for oil supplied to South America (it had been decided to charge in sterling in 1943 reversing an earlier policy) to maintain dollar balances. Some Treasury officials held the view that sterling should be made acceptable and that it would open a dangerous precedent to charge dollars for oil: Argentina could charge dollars for her meat or Spain likewise for iron ore. Keynes, while stating that sterling in the long run should be made not only acceptable but fully convertible, thought that the way to attain this end "will inevitably be to go somewhat to the opposite extreme in the meanwhile" as to put off making the change "means so much off our own liquid reserves".<sup>34</sup> No action was taken in this case as it was thought to be politically unwise to raise the question with Argentina but the episode is a good example of the contradictory ends which had to be kept in mind by British policy-makers in matters concerning sterling payments.

On the whole, while wartime accumulation of Brazilian sterling balances was important from Britain's point of view this "did not cause many sleepless nights for the guardians of Britain's finances" since as the postwar period will prove "there are always ... the sponge of Brazil's old debts" and some British assets for which the Brazilian Government had "an appetite".<sup>35</sup>

Brazil made a final concession concerning sterling balances before the end of the war as in early 1945 it was decided in London that it was time to bring into line the revaluation clause generally included in payments agreements which was set at 168/6 per fine ounce of gold) with the fixed rate of exchange of 4.03 dollars per pound sterling, which at \$35 per fine ounce of gold was equivalent to a 173/8 per fine ounce of gold guarantee. This made Britain liable to a 2.5% readjustment of sterling balances. It was hoped however, that this readjustment could be

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de janeiro de 1940, undated, Conselho Federal de Comércio Exterior (CFCE), Arquivo Nacional: XIII PR 80 and Dantas to Aranha, 24.8.44, CPDOC/Fundação Getúlio Vargas, (FGV): Oswaldo Aranha Papers, 1938-1944, Diversos V.

<sup>33</sup> Powell to Nosworthy, 5.3.42, PRO: T160/F16522/13.

<sup>34</sup> Keynes's minute, 14.6.44; Rowe Dutton's minutes, 15 and 21.6.44, PRO: T160/F18151/08/2.

<sup>35</sup> Sayers, op. cit., pp. 447 and 460. Fodor, Origin of Argentina's Sterling Balances, is the best source on the story of Argentinian balances

done without cost to Britain given its "technical" nature. Brazil was to act a "a bell-wether to lead the South American flock into the fold".<sup>34</sup> After showing reluctance and seeming to want a quid pro quo, showing truly "gentlemanly behaviour", agreed to the British request of simple substitution of the sterling parity price but stressed that this should be taken as an example of Brazil's spirit of compromise, hoping that this would not go unrecognized.<sup>37</sup>

## 2. From the End of the War to the 1947 Sterling Crisis

Between V-Day in Europe and the end of 1946 Brazil accumulated substantial amounts of new sterling balances. Outstanding balances increased from 36 million pounds by mid-1945 to 48 million pounds by mid-1946, and 68 million by March 1947 (see Table 2). This resulted partly from the continuous disequilibrium in the Anglo-Brazilian balance of payments and partly from sizeable third country transfers in particular from Argentine as Brazil had accumulated large blocked peso balances in Buenos Aires as a result of the 1940-41 agreements. The Brazilian surprising lack of preoccupation with the reduced liquidity of these balances continued unabated until the beginning of 1947 when it became evident that the British would be unwilling to see their thawing to proceed at a very fast rate.

The visit of Neves da Fontoura, the Brazilian Foreign Minister, to London in September 1946 had accomplished very little. Britain indeed "managed to steer clear of [commitments related] to the use of the sterling balances for the purchase in Great Britain of capital equipment required for ... the Brazilian transport system and industry".<sup>38</sup> Meanwhile the Brazilian balance

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<sup>34</sup> Mather Jackson's minute, 22.1.45, PRO: FO371/AS464/118/6.

<sup>37</sup> Tel. 4 REMAC, Rio to London, 29.14.45, PRO: FO371/AS607/118/6; tel. 11 REMAC, Rio to London, 18.3.45 and Mather Jackson's minute, PRO: FO371/AS1626/118/6. In 1943 when consulted by Phillimore about whether the revaluation guarantee applied to: (a) Treasury bills and (b) non-Bank of England Brazilian Special Accounts, the Bank of England answered that while the answer was yes for (a), as far as (b) was concerned they "should have to consider favourably if Brazilians raised the question... but they may not raise and we should prefer you did not do so". Phillimore's proposed "concessions" were consequently illusory at the time but these issues would prove to be of vital importance as will be seen in section III. Tels. P216, Phillimore to BOE and B220, BOE to Phillimore, 18.5 and 24.5.42, PRO: FO371/A1963/473/6.

<sup>38</sup> Eggers to Rowe-Dutton, 26.9.46, OF. 16/14/1, PRO: T160/236/598; Exchange of letters Bevin-Fontoura, 21.9.45, PRO: T160/235/598. It is typical that Neves da Fontoura should feel sufficiently confident to cable to President Dutra that he felt sure that Brazilian balances would be available to purchase transport [in Britain], Belgium, Sweden and the Netherlands, MRE, Tel., London to Rio, 18.9.46



of payments position since the end of the war had deteriorated quite dramatically. Due to difficulties related to the supply of imports during the war - which amply outweighed the slight reduction in the capacity to import - and in spite of the considerable depletion of foreign exchange reserves in uses such as public debt redemption, Brazil's reserves in 1945 amounted to nearly 170 million pounds, increasing in 1946 to 180 million pounds: 90 million in gold and 90 million in foreign exchange of which however only 20 million were freely convertible. Given the government's decision to conserve intact its gold reserves and the persistent (if 1950 is excluded) imbalance of payments with the convertible currency countries, it was impossible to maintain the liberal foreign exchange policy adopted in 1946 and by mid-1947 Brazil had to revert to strict foreign exchange controls<sup>39</sup>. The exchange rate was held at an overvalued level roughly equivalent in nominal terms to its pre-war dollar parity and an import control system was introduced based on "essentiality" and the availability of domestic substitutes.

The adoption of this foreign exchange regime is partly explained by the fear that a devaluation would have inflationary consequences and partly its probable impact depressing international coffee prices. In fact, the very fast increase in coffee prices after 1949 and the consequent increase in export proceeds made politically possible the adoption of such foreign exchange policy until 1952.<sup>40</sup>

After Fontoura's visit the British line on the future of Brazilian balances began to take shape. It was thought from the beginning that existing Brazilian balances should be entirely blocked as against dollars and blocked against sterling except for certain specified uses such as public foreign debt redemption. Releases for the purchase of capital goods in Britain were initially proposed to be of 10 million pounds over four years. Currently generated sterling would be freely convertible and blocked balances would earn the "magnificent" rate of 1/2% yearly.<sup>41</sup>

In spite of worries among senior British officials<sup>42</sup> about the Brazilian reaction to a British proposal to release only

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<sup>39</sup> Whereas the Brazilian terms of trade improved modestly between 1945 and 1946, remained stable until 1949 and then significantly improved with the rise in coffee prices, the volume of imports increased much faster than the volume of exports.

<sup>40</sup> See Malan, Bonelli, Abreu and Pereira, Política Econômica Externa, Ch. III.

<sup>41</sup> Eggers to Rowe-Dutton, 26.9.46, Of. 16/14/1 and Niemeyer to Waley, 24.10.46, PRO:T236/598; Draft Heads of Agreement prepared by Bank of England, PRO:AS618/24/6.

<sup>42</sup> Sir David Waley was quite explicit: "Can we get away with as small a sum as 10 million pounds?", minute to Rowe-Dutton, 26.10.46, PRO:T236/598.

10 million pounds over of four years of the more than 60 million outstanding balances and of the recommendation that if an otherwise satisfactory agreement was reached, Brazil should get a 10 million pounds release, Dalton, the Chancellor of the Exchequer, decided to limit the offer to 6 million years.<sup>43</sup>

As the British were aware that even the decision to limit releases to 10 million pounds would come as a shock to the Brazilians it was decided to make clear rather early, before any Brazilian purchasing mission reached Britain, that Brazilian hopes to obtain sizeable releases were unfounded. Brazil reacted very unfavourably to the British "proposal" asking releases to be raised to 12 million pounds and that reequipment of public utilities and their profit and remittances should be allowed to be debited against blocked balances.<sup>44</sup>

Foreign office views were that as British relations with Brazil - "our fighting ally ... the US pet and spearhead in [Latin America]"<sup>45</sup> - would deteriorate if too little was offered it would be important to raise the proposal to 10 million pounds. The Treasury and the Bank of England backed Dalton's proposal: "I hope you are going to remain firm against the tears of the Brazilians. The point is not whether we love or should love them more than the Argentinians or the Indians, but what we can afford, both in itself or as precedent. We need to be quite frank and brutal on this".<sup>46</sup>

This shift of policy was a considerable change in relation to the regime in force until then, i.e., previously all Brazilian balances were in principle freely spendable in the UK, while the new agreement - a corollary of the Anglo-American agreement - limited this possibility to certain specified uses and created the category of freely convertible balances out of current trade. Brazil's reaction was to suspend dealing in pounds sterling, an action denounced by the British as a breach of article 2 of the 1940 Anglo-Brazilian Arguments Agreement as six month's notice was stipulated. The British Ambassador was instructed to protest in

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<sup>43</sup> This was based on the fact that releases of Indian and Egyptian balances would not go beyond 10% of outstanding balances. Argentinian releases however had been nearer to 20%, Waley to Trend, 24.1.47, PRO:T236/599. Dalton's words: "We must be tough and difficult with our creditors. What is the use of exporting capital goods to Brazil, merely in order to reduce a paper debt? I would certainly not go about 10 million pounds and doubtfully beyond 6 million pounds", 26.1.47, PRO:T236/599.

<sup>44</sup> Minute of meeting, Waley's room, 5.2.47, PRO:AS668/24/6, and tel. 78, Rio to London, Confidential, 12.2.47, PRO:AS1062/24/6.

<sup>45</sup> Perowne's minute, 28.2.47, PRO:AS1407/24/6. In the immediate postwar period the Foreign Office was particularly keen about the reaction of Latin American countries to British policy as their total share of United Nations vote was of about 40%.

<sup>46</sup> Niemeyer to Waley, 21.2.47, PRO:T236/595.

Rio that Britain while "perfectly willing to negotiate forthwith about sterling [was] not prepared to do so under blackmail, nor can [Britain] submit to a unilateral breach of the Payments Agreement". It is now clear that in the absence of a rescission of the Brazilian suspension the UK would protect their interests by measures which would go to freezing the Bank of Brazil balances and allowing only payments under special permission of the British authorities.<sup>47</sup> The Brazilian Minister of Foreign Affairs refused to accept that Brazil was bound to purchase sterling without limit and reminded the British Government that Brazil had made quite important concessions in the past - as the readjustment of sterling's gold parity in 1945 - and was now being badly treated by Britain. <sup>48</sup> The Bank of Brazil resumed the purchase of sterling in mid-April 47 based first on a preliminary understanding between the Treasury and Mr. Vieira Machado, Bank of Brazil's envoy, then on a provisional agreement between the Bank of Brazil and the Bank of England. The British agreed to consider expendable all sterling accruing to the Brazilian account after 1.4.47, then to allow a reduction of sterling balances from 65 million to 61.5 million pounds to take account of financial and commercial sterling requirements incurred while negotiations proceeded.<sup>49</sup>

The position was further aggravated, in the far from disinterested words of Sir Otto Niemeyer, by the "wholly unexpected [British] suggestion" that unless the Brazilian unilaterally wrote down part of the substanding sterling balances in recognition of the fact that the burden of the war had fallen much more heavily on Britain than on other allies the 6 million pounds release could not be improved upon. This had "fairly put the cat among the pigeons" and met with Brazil's strong refusal to consider the proposal.<sup>50</sup>

In spite of the views of many British officials in the Bank of England and in the Treasury who stressed the fact that Britain was not "on very sure ground in asking [Brazil to cancel part of the balances]" as "Brazil was, after all, an active belligerent and the balances [were] the result not of military expenditure, but of essential purchases for which [Britain] did not pay excessive prices during the war" and that since Brazil had taken sterling readily since the end of 1946, in contrast with other South American countries, as they were under the impression after the Bevin-Fontoura exchange of notes that they could use

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<sup>47</sup> Tel. 134, London to Rio, Secret, 8.3.47, PRO:AS1469/24/6.

<sup>48</sup> Fernandes to Gainer, 18.3.47, G/DE/35/550. (60), PRO:F0371/61199.

<sup>49</sup> Tel. 171, London to Rio, 12.4.47, PRO:AS2246/24/6 and tel. 202, London to Rio, 1.5.47, PRO:AS2536/24/6.

<sup>50</sup> Niemeyer to Waley, 12.4.47, PRO:T236/600; Waley to Machado, 11.4.47 and Aragão to Waley, 17.4.47, Ministério da Fazenda, Relatório, 1949, pp. 289-90.

sterling for purchases in Britain, perhaps the British offer should be improved.<sup>51</sup> The pressure under the inspiration of Dalton on the Brazilians to cancel part of the balances was maintained and culminated with the Chancellor's famous speech of 6 May 1947, when addressing the Brazilian Chamber of Commerce he stated that British creditors should scale down their claims as a contribution towards the common objective of winning the war.<sup>52</sup>

The very considerable British pressure notwithstanding -- which can be at least partly explained by the need to present a well behaved example of creditor before the start of the much more important negotiations with India and Egypt<sup>53</sup> -- Brazil refused to consider the British proposal based on the argument of Brazil's participation in the war had not been less important than that of other allies.<sup>54</sup>

This was the specific manifestation of a major policy problem. The write off of sterling balances was the subject of sharp controversy after the war. During the U.S. loan negotiations in 1945 the Americans "with the myopia of the rich ... could not see why as they had wiped out all lend lease debts to their allies countries like India or Egypt, could not do the same in the case of sterling balances"<sup>55</sup>. The British, based on a combination of

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<sup>51</sup> Niemeyer to Waley, 12.4.47 and Eggers' minute, 19.4.46, PRO:T236/600.

<sup>52</sup> Ministério da Fazenda, Relatório, pp. 289-90 and Dalton to Aragão, 7.5.47. Dalton's words were rather extreme: "This vast [British] accumulation of debts represents an unreal, unjust and unupportable burden. ... Sooner or later this must be substantially scaled down. Britain is strong, but one sign or her strenght must be a refusal to take on fantastic commitments which are beyond her strenght and beyond all limits of good sense and fair play.", Livingstone, 'The Problem of the Blocked Sterling Balances' (1962). These views can be contrasted with the British standard reaction to Brazil's inability or unwillingness to pay full contractual service on her foreign debt perhaps best illustrated by The Economist both in 1938 "the London market ... does not forgive high-handed default" - and in 1943 when the permanent settlement was considered to involve excessively low payments if compared to Brazil's "capacity to pay", The Economist , 12.2.38, 12.3.38 and 25.12.43, The more extreme views -- like those of Sir David Waley, a senior Treasury official -- were blunter: "of course, I agree that the Brazilian are dirty dogs, but ... I do not think it would help the bondholders to tell them so", Waley to Balfour, 2.8.38, PRO:A6040/4176/6.

<sup>53</sup> Eggers to Murray, 6.5.47, PRO:AS2707/24/6.

<sup>54</sup> Aragão to Rowe-Dutton, 30.4.47, PRO:T236/601.

<sup>55</sup> Strange, Sterling and British Diplomacy, p. 273. Sir Richard Clark comment was that "it was remarkable that the Americans were pressing us [to be tough], for if we had proposed such things ourselves we would have been submerged with cries of "British Imperialism", Clarke, Anglo-American Economic Collaboration , p. 56.

arguments - claiming it was not for the banker to default (Bank of England), that sterling balances could provide Britain with markets for her exports in the likely event of a massive postwar recession (Board of Trade) and that Britain should not run the risk of politically provoking the main sterling holders (Foreign Office) - showed no enthusiasm concerning the American line and managed to turn Keynes' initial proposal to release, write off and fund at no interest for gradual release over 50 years all sterling balances in the rough proportions of 1: 4: 8, into a general commitment mentioning "an early settlement covering the sterling balances".<sup>54</sup>

Gardner's well known harsh condemnation of the British initial reluctance to see sterling balances written off as wished by the Americans is difficult to accept. Why should the purchase in Egypt or India of goods and services for the defence of these countries be considered as items of "accumulating indebtedness particularly hard to justify?"<sup>57</sup> As if the defence of India and Egypt has nothing to do with the overall Allied strategy and had been undertaken basically for the sake of these countries.<sup>58</sup> It is of course true, as alleged by Gardner, that wartime inflation made purchases quite expensive in these markets, but it is clear that inflation also caused distress to local consumers especially so when the supply of imports - controlled in London - was so severely limited. In the case of India particularly it is not easy to see as completely independent events the accumulation of Indian sterling balances and the great Bengal famine of 1943 with its 3 million victims.<sup>59</sup>

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<sup>54</sup> Moggridge, 'From War to Peace - The Sterling Balances', p. 1035.

<sup>57</sup> Gardner, Sterling-Dollar Diplomacy, p. 205. Keynes' well known telegram on the Bank of England's arguments reads: "We are negotiating in Washington repeat Washington. Fig leaves that pass muster with old ladies in Threadneedle Street wither in a harsher climate".

<sup>58</sup> Keynes' himself was consistently, from quite early in the war, in favour of a hard line on sterling balances. When S.D. Waley, a senior Treasury Official, wrote to him in 1943 saying that "the ideal of completely blocking all overseas sterling balances [sent] a good many shudders down [his] spine", he answered: "I had that shudder a long time ago and have got over it!", Moggridge (ed.), Collected Writings of John Maynard Keynes, Volume XXV [JMK] (1980), p. 307. On Indian and Egyptian balances: "India is already profiteering out of the war unduly", JMK vol. XXIII, p. 336 or "we are still treating the Egyptians as impoverished connections who are entitled to call on their rich uncle for whatever costs anything", JMK vol. XXIII, p. 318.

<sup>59</sup> Hutchinson, Economics and Economic Policy in Britain (1968), p. 52. See also Sen, 'Starvation and Exchange Entitlements'

In spite of the reluctance to press for a general write off of sterling balances this possibility always had important supporters including in academic circles. The use of American and Canadian credits to pay off - to a very reduced extent - sterling balances was considered to be a major source for British "troubles": "it really was not right to act the Lady Bountiful with other people's money".<sup>40</sup> In the rare moments when it became clear that to decide the rate at which Britain could repay her debt to blocked sterling holders in fact had important implications on the rival standard of living claims of Britain against those of her debtors, <sup>41</sup> those in favour of a very slow thawing of the balances would even write about the menace of a "veritable Economic Munich", "the insecurity faced by rations of our own people" or even that there was "no categorical imperative to take action on a larger scale for another two, three or five years" to raise "primitive peoples" -- who held sterling -- to a "higher degree of civilization".<sup>42</sup> Other views were less extreme as they explicitly recognized that standard of living disparities should somehow be taken into account but still implied that the adjustment cost involved in the preservation of British "general stability" should be born by the creditors.<sup>43</sup> Very few authors drew the necessary conclusions once British relative maltreatment by the Americans on Lend Lease and the American loan was accepted: that if there was unfairness involved in the distribution of the war financial burden this was more likely to be in relation to the contribution of the United States than that of sterling balance holders.<sup>44</sup>

Because of uncertainty concerning so many major global policy questions no formal agreement was signed between Britain and Brazil to replace the 1940 agreement. A series of letters, exchanged between the Brazilian Ambassador in London, the Chancellor of the Exchequer, the Treasury, the Bank of Brazil and the Bank of England, incorporated the new arrangements which were to apply to Anglo-Brazilian payments.<sup>45</sup>

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<sup>40</sup> Harrod, Are These Hardships Necessary? (1947)

<sup>41</sup> PEP (Political and Economic Planning), Britain and the World Trade (1947), p. 192.

<sup>42</sup> Harrod, op. cit., pp. 53, 56 and 178. More than 20 years after the events Sir Roy had mellowed: "Britain was obviously not in a position to insist on a scaling down [of sterling balances], if creditors did not wish it. It is arguable that she could have insisted on a funding, despite the unwillingness of creditors. It would obviously have been a perfectly reasonable thing to do, since outright repayment was physically impossible, and it was unsound to maintain sight liabilities of so large an amount in existence", Harrod, Money (1970), p. 125.

<sup>43</sup> See, for instance, Robbins, 'The Sterling Problem', p. 25.

<sup>44</sup> Balogh, 'The International Aspect', p. 483.

<sup>45</sup> Aragão to Dalton, 9.5.47; Dalton to Aragão, 20.5.47; Aragão to Dalton, 27.5.47; Machado to Chief Cashier of the Bank of England, 29.4.47; Rowe-Dutton to Machado, 27.5.47; Machado to Rowe-Dutton, 27.5.47; Machado to Cobbold, 31.5.37, PRO:T236/201.

Pre-31.3.47 sterling balances were established at 61.5 million pounds and would earn 1/2% a year. Currently accumulated balances as from 1.4.47 were considered to be freely expendable and in due course to become convertible. Six million pounds would be released in four annual equal releases. Accumulated blocked balances could be spent on debt redemption, to pay compensation to British utilities taken over in Brazil and on the purchase of buildings for the Brazilian Embassy and Chancery buildings in London. The 1940 Payments Agreement was considered to have been superseded as from 31 May 1947.

The reduction of sterling balances depended until 1949 essentially on payments related to the take over of British investments in public utilities and railways (see Table 3). These were, with some exceptions of which the more important was the São Paulo Railway, rather rundown concerns which had faced for quite a long time difficulties on the readjustment of their rates and so did not maintain their profitability in sterling, adapting to this situation by cutting down their investment to the bone. The consequence was a sharp deterioration in the quality of services provided and further aggravation of the difficulties between the companies and the government. Whereas the British quite lamented to have to part with the São Paulo Railway - in the words of Niemeyer "much our best asset in Brazil ... and far from dead"<sup>46</sup> - there was much rejoicing in London with the agreed prices in the case of the Leopoldina Railway and the Great Western as the offers were very advantageous to the companies.<sup>47</sup>

The Brazilians were rather sore with the treatment they had received during the negotiations in the first half of 1947. This soreness - for which there seemed to be some basis in fact <sup>48</sup> - was of course aggravated when the suspension of sterling convertibility cancelled many of the advantages entailed by the arrangements of May 1947 as current sterling balances while preserving their "expendability" could not be turned into dollars. These difficulties were further aggravated by British suggestions that Brazil had converted into dollars almost all her sterling current surplus <sup>49</sup>. It has been alleged that Brazil, facing a dire scarcity of dollars did not abide "by either the spirit or the letter of [her] agreements" and had converted 5 million pounds in the first semester of 1947 and 7.5 million in July-August <sup>50</sup>.

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<sup>46</sup> Niemeyer to Rowe-Dutton, 21.8.45, PRO:T236/596.

<sup>47</sup> Appendix B to minute to Minister of State for Economic Affairs (Brazil Trade Negotiations), 1950, PRO:AB1151/262.

<sup>48</sup> See, for an important British acknowledgment of the existence of fair grounds for Brazilian soreness, Bevin's comments: "the Treasury and the Board of Trade had been less than fair with Brazil", Foreign Office minute, 10.2.48, PRO:AS1055/51/6.

<sup>49</sup> Tel. 407, London to Rio, 18.8.47, T236/610. But the British civil servants thought the arrangements with Machado "rather favourable", Eggers to Evelyn 4.9.47, T236/610.

<sup>50</sup> Gardner, *op.cit.*, p.317.

Table 3

Variation of Outstanding Sterling Balances, Millions of Pounds,  
1947-1952

Quarter		Source of variation*
1947.2	- 8.0	First general release (1.5 million) San Paolo Rwy electrification (2.0) Bank of Brazil commercial credits (0.7) Sterling foreign debt payments (0.8)
1947.3	- 2.0	
1947.4	- 3.9	
1948.1	- 3.3	Purchase Empresa de Armazéns Frigoríficos, Cia. Indústria Brasileiras de Papel and Southern Brazil Lumber and Colonization Co. (2.0)
1948.2	- 1.2	
1948.3	-10.4	Second general release (1.5) San Paolo Rwy purchase (7.6)
1948.4	- 0.6	
1949.1	- 1.7	Coffee loan redemption (1.4)
1949.2	- 6.3	Third general release (1.5) Special releases (3.5)
1949.3	+ 0.5	Ex gratia payment ?
1949.4	+ 9.8	Payment due to sterling devaluation
1950.1	0.0	
1950.2	-19.6	Sterling debt redemption
1950.3	- 4.2	
1950.4	- 0.9	
1951.1	0.0	
1951.2	- 0.1	
1951.3	0.0	
1951.4	-10.3	Leopoldina Railway
1952.1	- 3.2	
1952.2	- 0.1	
1952.3	- 0.5	
1952.4	- 0.1	

Source: Table 2, Bank of England and PRO: FO 371.

\*The following uses cannot be dated precisely: purchase of Great Western Rwy (3.7 million pounds), purchase of State of Bahia Rwy (0.6), Brazilian Embassy building in London (0.3), additional Leopoldina payments (2.3), additional San Paolo Rwy payments (1.0) and sterling debt redemption (10.6). This leaves 6.5 million pounds unaccounted for.

Brazilian conversions of sterling into dollars were strictly according to the May 1947 informal agreements or referred to unblocked sterling generated in current transactions. They were of course legal and rational <sup>21</sup>. To believe that Brazilian

<sup>21</sup> Cairncross, Years of Recovery (1985), p.129.



conversions were against even the spirit of the 1947 understanding does not fit with the facts <sup>72</sup>. Moreover, the run down of sterling balances was a positively a minor factor undermining the attempt to make sterling convertible in comparison with capital movements or "leads and lags" in commercial credit <sup>73</sup>.

### 3. Thawing Problems, 1947-1952

The rather informal arrangements implied by the exchange of letters in 1947 were incorporated in a new Anglo-Brazilian Trade and Payments Agreement signed in Rio in May 1948.<sup>74</sup> This agreement negotiated in Rio by the Wise mission dealt with problems related to current payments, accumulated sterling balances and trade and was complemented by a number of secret letters.<sup>75</sup> The agreement to last for four years incorporated many of the points already settled in 1947. A revaluation guarantee was agreed, applying to current balances of the Bank of Brazil - as opposed to blocked balances which were already partly guaranteed. This guarantee was valid for 12 months and any balances outstanding at the end of this period would continue to be covered by the guarantee. Blocked sterling balances held by the Bank of Brazil in the Bank of England on the 31 March 1947 which were still held in the A accounts continued to enjoy a guarantee against devaluation. By agreeing to this apparently harmless formula the Brazilian negotiators waved the right to legally claim compensation for the effects of devaluation on the bulk of the Brazilian sterling balances. In fact the 1940 Agreement had only guaranteed Bank of Brazil balances in the Bank of England. In spite of the fact that as acknowledged by Sir Otto Niemeyer, since the Bank of Brazil could freely transfer funds between his Bank of England and his other accounts the "distinction between guaranteed... and unguaranteed balances... may be thought rather a

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<sup>72</sup> There are no grounds to support the claim that "holders of sterling were expected to behave as gentlemen; unfortunately they were not gentlemanly enough in 1947", Prof. Pressnell comments, Thirlwall (ed.), Keynes and International Monetary Relations (1976), p. 96.

<sup>73</sup> See Cairncross, op.cit., pp.80 and 156; Cobbold to Eady, 13.10.47 in Clarke, ed. by Cairncross, Anglo-American Economic Collaboration (1982), pp. 181-4 and Balogh, Dollar Crisis (1949), p. XX, in a typical peroration criticizing the "liberal economists unaccustomed to peer beyond the narrow confines of their strange imaginary world", who "direct their attacks on the release of the wartime accumulation of blocked sterling balances and attributed the exchange crisis to its extravagance" and failed to blame the export of capital and military expenditure as by far more important reasons for the balance of payments difficulties faced by Britain.

<sup>74</sup> Trade Series no. 33 .

<sup>75</sup> Butler to Fernandes, letters no. 1,2,3,4,5, 21.5.48 and Wise to Machado, 21.5.48 (2 letters), PRO: FO371/AS3537/341/6.

fine one", it was British policy that guarantees should not go beyond what was guaranteed in existing agreements. The British were quite conscious at least since early 1947 that a strict interpretation of the guarantee clause would mean that only 17 million pounds out of the more than 65 million pounds of Brazilian balances were in fact guaranteed and played a very careful hand in order to make explicit in the 1948 Agreement this reduction in the British de facto commitment.<sup>74</sup> An additional release of up to 4 million pounds was agreed, releases being allowed at the rate of 20% of amounts paid in the take over of British-owned utilities or railway companies. The amount of blocked balances reserved for debt redemption was limited to 35 million pounds to allow for the takeover of British firms.

In 1949 the Brazilian authorities sent again Machado to London to press for additional releases of 10 million pounds. It was agreed to anticipate releases and undertake new releases of 6.55 million pounds in the event the major railway claims were agreed and settled.<sup>77</sup>

When towards the middle of 1949 it became clear that sterling was under pressure - apparently after leaks in the British press about devaluation <sup>76</sup> - the Brazilian authorities became suddenly aware that their current sterling balances of 5.4 million pounds were unprotected by a guarantee against an eventual sterling devaluation vis a vis the dollar. The Brazilians had allowed the twelve month guarantee agreed in 1948 to lapse on 20 May 1949 as there were no current balances at the time. The non-renewal meant that accumulations of sterling since then were totally unguaranteed. The problem was raised in early September 1949, the Brazilian claim being that the revision of the trade list which had been negotiated in early 1949 implied the renewal of the twelve month guarantee.<sup>79</sup>

London had considered the problem in May and, while deciding that they wanted to get rid of such a guarantee, left the matter of approaching or not the Brazilian authorities to the discretion of the Ambassador in Brazil who decided not to broach

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<sup>74</sup> Niemeyer to Waley, 27.3.47, PRO: T236/605. It should be noticed, however, that in 1943, as already mentioned in section II, the Bank of England had instructed their representative in Brazil that if pressed to do so by the Brazilians they would explicitly extend devaluation guarantees to both Treasury Bills held by the Bank of Brazil and all non-Bank of England Brazilian accounts.

<sup>77</sup> Flett to Machado, 28.4.49, PRO: FO371/AS2300/14610/6; Machado to Flett, 9.6.49, PRO: FO371/AS3078/14610/6.

<sup>78</sup> The Economist, 28.8.49. There was also an American leak specifically to the Brazilians, Cairncross and Eichengreen, Sterling in Decline, p.130.

<sup>79</sup> Tel. no. 3 REMAC, Rio to London, Confidential, 5.4.49, PRO: FO371/AS4445/1114/6.

the problem with the Brazilians.<sup>¶¶</sup> The guarantee applying to the Brazilian blocked - as opposed to current - balances remained unaffected but of the total balances of 31.5 million pounds, 8.4 million were deposited in commercial banks and 6 million were held in Treasury bills and in principle unguaranteed as already explained.<sup>¶¹</sup>

The British at first refused to accept the renewal of the guarantee on current balances: "this is neither more nor less an insolent piece of blackmail on the part of the Brazilians ... intended to provide them with some buckshee sterling". The Brazilians went very sore and, after complaining once again that Argentina and Portugal had obtained a guarantee, started to talk about a denunciation of the payments part of the Wise 1948 Agreement.<sup>¶²</sup>

The devaluation of sterling in September 1949 of course confirmed the Brazilian worst fears: the "oversight" concerning current balances implied a loss of 2.3 million pounds while the one on blocked balances was to cost 3.5 million pounds in foregone written up balances. Brazilian authorities would insist with the claims for compensation on current balances and exert all their efforts to cover up the losses entailed by the devaluation on blocked balances.

The core of the British refusal to agree with the Brazilian claim was the Brazilians had signed a bargain and were trying to blackmail Britain since the terms were not suiting them. Other countries such as Italy and Switzerland with larger unguaranteed balances had accepted much better the news of a sterling devaluation. Brazil could not claim a treatment equivalent to the one accorded to Argentina as nothing would be paid to Argentina and there was a structural imbalance in Anglo-Argentinian trade as opposed to Anglo-Brazilian trade.<sup>¶³</sup> Moreover, the British argued that the Bank of Brazil owed the change from their debit position on current account in May to credit position in September to releases of unguaranteed sterling agreed with Machado. Brazil "in equity should not expect a

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<sup>¶¶</sup> PRO: T236/2042 Powell to Sommerville Smith, 12.4.49, PRO: T236/2042; tels. CAMER 4 and 5, London to Rio, 19.4 and 6.5.49, PRO:FO371/AS2152/1114/6. The matter seemed to be unimportant as excess forward sales had made negative the net Brazilian current sterling position but there was a lack of appreciation of the seasonal pattern in the Anglo-Brazilian yearly balance of payments given the importance of a limited number of agricultural products in the British import programme. Tel 4 CAMER, London to Rio, 20.4.49, PRO: FO371/AS152/1114/6.

<sup>¶¹</sup> Tel. 370, London to Rio, 23.9.49, PRO: FO371/AS4639/1114/6.

<sup>¶²</sup> Tel. 4 Remac, Rio to London, 12.9.49, PRO: FO371/AS4544/1114/6.

<sup>¶³</sup> Tel. 359, 18.9.49, Top Secret, London to Rio, PRO: FO371/AS4628/1114/6.

reevaluation profit on sterling payments she has already undertaken to make and which will not vary because of the devaluation of sterling", otherwise "Brazil will receive a purely fortuitous profit".<sup>64</sup>

H.M. Ambassador and the Commercial Minister in Rio pressed continuously for some sort of concession to Brazil opposing the Treasury hardliners who would not go further than to offer face-saving formulae to the Brazilians which would give them no money. Their policy was based on the idea that a denunciation of the trade agreement would hurt more the Brazilians than the British. This proved not to be the case as stressed by the Board of Trade since Britain imported more "essentials" from Brazil than exported to that market.<sup>65</sup> Britain was in fact both refusing to write up anything on Brazil's current sterling balances and to renew the reevaluation guarantee which had lapsed in May.<sup>64</sup> After much pressure by the Board of Trade and the Foreign Office, based on the assessment of likely damage to British interests, on the fact that the subject of the guarantee's expiry had not been raised in due time with the Brazilians and on the evaluation of the cost to Britain in terms of delays of compensation payments and of the trade agreement and of the damage to Anglo-Brazilian political relations, a concession was made.<sup>67</sup>

The Treasury resisted to the end making it impossible for the Overseas Negotiations Committee to put forward an unanimous recommendation.<sup>66</sup> The Brazilian authorities had intimated - after considerable wrangling - that they would be prepared to agree to a deduction of 4 million pounds of the total current sterling balances as this corresponded to extra releases negotiated by Machado (2.5 million tied to the purchase of railways and 1.5 million advanced from 27.5.50). The write up would be on 1,407,000 pounds corresponding to 617,460 pounds. It was finally agreed at a

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<sup>64</sup> Tel 370, 23.9., Top Secret, London to Rio, PRO: FO371/AS4639/1114/6.

<sup>65</sup> King's minute, 21.9.49, PRO: FO371/AS4779/1114/6; tel. 315, Rio to London, 19.6.49, PRO: FO371/AS4544/1114/6; Stacy to Flatt, 26.9.49, PRO: FO371/AS4952/1114/6.

<sup>66</sup> In a somewhat melancholy mood a British official noted: "I fear we did not foresee that the Brazilians' anger at their own incompetence would be so great as to convince them of our bad faith", Cecil's minute, 28.10.49, PRO: FO371/AS5365/1114/6.

<sup>67</sup> Tel 365, Rio to London, 26.10.49, PRO: FO371/AS5380/1114/6. A Board of Trade Note, Overseas Negotiations Committee (ON), (49) 373, Secret, PRO: CAB134/567, 9.11.49, was quite explicit about the disadvantages of trading with Brazil only in essentials: "there would be a serious danger that the rot would spread [as] pressure to cut out less essentials is endemic in Latin America and will remain so now that the post-war spending boom is over".

<sup>68</sup> Economic Policy Committee (EPC) (49) 140, 22.11.49, PRO: CAB134/223.

ministerial level in London to make an ex gratia payment of 0.6 million pounds to Brazil, closing the incident and saving the face of the Brazilian authorities.\*<sup>9</sup>

Instead of obtaining a total write up to 16 million pounds - which would be automatic if the revaluation clauses both on current and blocked sterling balances had not been allowed to lapse in 1949 and 1947 respectively - the Brazilian authorities managed to obtain 10.6 million pounds. The Brazilian official record of these negotiations published by the Ministry of Finance completely falsifies what in fact occurred: indeed it is implied that the write up on blocked balances of 10 million pounds was on 10.5 million and not on 23.1 million as was the case (it seems that \$6 million in Treasury bills were after all written up besides the 17.1 million provided for in 1947) and it is nowhere stated that the Brazilian blocked balances were still of around 31.5 million pounds. Similarly the negotiations on the revaluation of current balances are described very superficially, the total amounts involved never being disclosed.\*<sup>10</sup>

Early in 1950, based on reports by the Brazilian Embassy that there was a growing danger that Britain would repudiate 50% of sterling balances the Brazilian authorities decided to call for redemption at par certain Brazilian sterling loans amounting to 19.8 million pounds \*<sup>11</sup> out of total balances of 40.9 million. The remaining balances were earmarked for payments related to Leopoldina Railway, Great Western Railway, State of Bahia South Western Railways including stocks and orders placed in Britain and for releases at 35% of railway compensation payments as already mentioned.\*<sup>12</sup>

It would, of course, not be advantageous, in principle, to the Brazilian Government to accept that blocked balances should be used to redeem public foreign debt if there was any alternative use for them as it would be certainly impossible for Brazil to raise substantial amounts of new capital either in Britain and the U.S. at the low rates of interest which were being paid in relation to the sterling public debt. The Government consequently faced rather severe criticisms for approving such redemption scheme as it was thought that sterling balances should be used to pay imports rather than redeeming debt. Moreover, as loans were redeemed at par there were additional costs of about 3.5 million pounds if compared with ruling market prices (12.4.50).

The main argument used by the government in favour of redeeming the public foreign debt - besides avoiding the risk of an imagined British unilateral write off of sterling balances -

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 \*<sup>9</sup> Aide mémoire, 21.11.49, PRO: FO371/AS5881/1114/6.

\*<sup>10</sup> Ministério da Fazenda, Relatório, pp. 304, 333-6.

\*<sup>11</sup> Tel. 23, London to Rio, DE/Dpo/651.5 (60), MRE; Ministério da Fazenda, Relatório, p. 336.

\*<sup>12</sup> Ministério da Fazenda, Relatório, pp. 339-40 and tel. 122, Rio to London, 6.5.50, PRO: FO371/AB1151/81.

was the fact the 3.1% rate of interest payable on the public foreign debt was considerably above the interest rate of 0.5% which was being paid by the British on outstanding balances. Since the British had never raised any objection to Brazil's use of sterling balances to redeem the public debt the government should also have answered why it took such a long time to reach a decision which according to their arguments was so obvious. Clearly the government's case relied mainly on the alleged menace of a write off of sterling balances; a rumour for which no corroboration can be found in the official papers and in relation to which the British obviously remained reticent <sup>¶3</sup>. Without the write off menace it would possibly pay to wait longer and try to extract further releases from the British.

Some of the railway compensation payments took a long time to be made and had not yet been made before the expiry of the 1948 Payments Agreement in 31.3.51; after minor difficulties the Agreement was renewed for one year; then in 1952 for another year, losing significance with the disappearance of blocked sterling balances. In fact, even current sterling balances disappeared as Brazil started to accumulate sizeable deficits financed by the accumulation of arrears in her trade with Britain as a result of the Korean war import scare.

#### 4. Conclusions

If compared with some of the larger holders of sterling balances such as Argentina, Brazil held her smaller balances for a longer period with correspondingly larger opportunity costs and losses entailed to the lack of complete coverage related to sterling devaluation in 1949. <sup>¶4</sup> The opportunity cost of holding such balances in comparison with the alternative of paying British-held public foreign debt was of roughly 1% yearly in 1941-43 and 3% yearly in 1944-51; roughly the difference between interest rates paid on the debt and received on sterling balances. The cost of holding sterling balances following the criterion was of 9.4 million pounds (1950 prices) in 1941-50 of which 3.6 million until 1945 and 5.8 million between 1945 and 1950. <sup>¶5</sup> As in 1949 Britain paid about 10.9 million pounds (at 1950 prices) into

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<sup>¶3</sup> Seymour to Flett, 21.4.50, PRO: T238/198: "Brazilian Government has got the idea that HMG will scale down sterling balances by half. Where they got this rumour is unknown. We have taken no special step to disabuse them."

<sup>¶4</sup> Brazilian balances remained outstanding for such a long period from 1948-9 partly because of the morosity of Brazilian "finalizing" procedures concerning the takeover of British-owned concerns in Brazil.

<sup>¶5</sup> Yearly losses capitalized at 3% yearly to 1950. It should be noticed that if an a priori more realistic interest rate - such as the yield on consols - had been used instead of the average interest rate on the Brazilian debt the result would not be materially affected.

the Brazilian account because of the devaluation of sterling it would seem that the cost of holding balances was roughly compensated by such payments.

However, if instead of computing opportunity costs based on interest rate differentials resort is made to a calculation based on the value of foregone imports, this assessment is radically modified. At 1950 prices the cost of not being able to use sterling blocked in London to purchase goods in Britain was of about 38 million pounds, considerably above the compensation of 10.9 million pounds (1950 prices) paid into the Brazilian account due to the devaluation of sterling in 1949.

Against these estimates of the cost of holding idle sterling balances should of course be set the economic benefits of exporting goods to Britain. It is rather difficult to answer adequately the question whether it would be possible for Brazil to place exports which went to Britain in alternative markets if the payments arrangements between Britain and Brazil were not in operation and if so what would have been the economic losses entailed by this trade diversion. During the war it is almost unthinkable that Brazil would have political space to avoid signing a payments agreement with Britain even were it clear that costs outweighed benefits: it would, however, be possible to reduce exports to Britain in certain cases; specially so if it is reminded that a sizeable share of "British" imports were in fact South African imports (See Table 3). After the war Brazil could certainly have played a stronger hand with Britain specially so in 1946 when Brazil accumulated further 25 million pounds in sterling balances by allowing a sizeable deficit to be generated in the bilateral balance of payments.

How could Brazil have avoided the accumulation of blocked balances without incurring in costs related to a decreased level of economic activity? With the benefit of hindsight it is perhaps possible to answer this question: by adopting a policy of accumulating stocks of commodities which were thought to be likely to become scarce in the post-war period instead of selling such commodities to be stockpiled by the British as was the case with cotton since 1943 following Keynes's advice. If Brazil had stockpiled cotton between 1942 and 1948 instead of selling it abroad mainly in exchange for inconvertible sterling the net financial result would have been of no less than 70 million pounds<sup>94</sup>, amply outweighing the costs of holding sterling balances.

Standing aside of such dangerous counterfactual reconstruction -- which would require a reproducible Keynes -- what is important to bear in mind is that even being eventually able to

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<sup>94</sup> Assuming an interest rate of 6% a year and a warehousing cost of 5 pounds/ton/year, Ofício 355, Garibaldi Dantas to Minister of Finance, São Paulo, 10.10.45, SC 44.09.04, Sousa Costa Papers, CPDOC/FGV.

recover all her much deflated blocked balances, Brazil suffered quite a considerable loss by holding these balances earning practically no interest for such a long period. Even if Mr. Dalton's more extreme line was not adopted there is no doubt that Brazil in fact scaled down rather considerably her real claims against Britain in spite of having already collaborated - with cash and blood - for "the common objective of winning the war". This can perhaps be contrasted with the experience of foreign creditors which lent money to Brazil between 1824 and 1931: in spite of all funding loans, partial defaults and reduction of contractual principal and interest rates, the average rate of return on all debt was more than double that of the "riskless" alternative investment.



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