Ref: O.& F.396.01 **1201**
396.10
AMAL (Cables, etc.)

APPENDIX II (A)

Canadian Mutual Aid

In contrast to the "billion dollar gift" which was a contribution of money to the U.K.alone, the help which Canada provided under the Mutual Aid Act of 14th May 1943 was intended to take the form of goods and services and to be granted to other United Nations as well as to the U.K. That change came about partly owing to the influence of American Lend/Lease but more especially for internal political reasons. Both inside and outside the Dominion Parliament there had been criticism of the resale for cash to third countries of goods bought by the U.K.out of the billion dollars; and of the propriety of subsidising the U.K.alone when other nations were also engaged in the struggle. Not unexpectedly the French Canadian bloc, which had consistently been lukewarm, if not hostile, towards any form of gift, was loudest in its complaints; though in fact complaints about resales to third countries were first raised by the Australian authorities.

Although the effect of these criticisms was to produce a scheme more closely related to Lend/Lease in its scope and outward appearance, the main purpose and function of Mutual Aid remained the same as that of its predecessor, viz.to cover the current Canadian dollar deficit of the sterling area. The extent to which Aid would be given, e.g.to Russia and China, was expected to be large.

The preparation of the Mutual Aid Act did not mean that other exceptional methods of maintaining the U.K.'s Canadian dollar balances were dropped; nor did the Act necessarily exclude them in the future. The premature exhaustion of the billion dollar gift several months before Mutual Aid could become effective led to various expedients being adopted to cover our deficit in the interim period, the most important being certain capital transfers to liquidate U.K.interests in Canadian munition plants and to repay various items of working capital. Both these sources were non-recurring. In addition we sold to Canada a quantity of U.S.dollars and the Canadians in their turn took over the full burden of R.C.A.F maintenance overseas. Broadly speaking the alternative methods

P.T.O.

fortuitous circumstances of external trade. At first the Canadians suggested that individual quotas could best be determined by canalising trade and payments between each territory concerned and Canada. This proposal was successfully resisted, but Canadian insistence on direct negotiation with other parts of the Empire and on direct delivery - as far as practicable - of Mutual Aid goods to them prevailed. In dividing Aid, however, the Canadians tended to move away from the strict balance of payments concept and to take into account general political considerations and the uncertain factor of "merit" according to war sacrifices (see below).

In so far as goods were directly provided under Mutual Aid it was - as in Lend/Lease - necessary that they should be procured and received by Governments. Our original hope was that the Canadians would apply the idea of gift in kind only to a few major imports in the munitions category. They declared, however, that this would be politically impossible and claimed that, in theory at least, Mutual Aid (and therefore Government procurement) should be applicable to any Canadian exports they might choose. The proportion of U.K.imports at the time obtained through Government channels exceeded the probable U.K.allocation of Mutual Aid and no great alteration in methods of procurement was in practice necessary. As regards other Empire countries, we wished to settle Mutual Aid quotas by a simple cash transfer in sterling either direct from the U.K.or via Canada; but the Dominion Government, while not rejecting cash settlements out of hand, emphasised that they must be kept to a minimum and used only where an alternative procedure was impracticable.

While the fixing and distributing of Mutual Aid quotas to individual Empire countries was a complicated matter, and one that might have to be the subject of careful statistical calculation, the total need of Mutual Aid by the sterling area as a whole could be assessed at any time by reference to the area's Canadian balances. As soon as these balances dropped below a reasonable working minimum it was clear that Mutual Aid should begin to operate.

We therefore arrived - after much discussion - at the position of having to agree on some procedure which would (a) still open to the U.K.of obtaining abnormal supplies of Canadian dollars were to sell U.S.dollars, gold or sterling; but there were difficulties or objections to all these courses, and in particular the sale of sterling had to be regarded as a purely temporary expedient. So long as the Mutual Aid appropriation lasted, however, none of these methods were necessary on purely balance of payments grounds, but they might have been necessary to bridge the inevitable gap before any new appropriation was voted.

That the Mutual Aid Act would have to be renewed for at least one further period seemed most probable; and it was therefore particularly important to agree at once on a workable and elastic mechanism which would create no awkward precedents for the future. In arriving at the large measure of agreement described further below we had to fight against a number of complicated and rather fanciful ideas put forward without a clear appreciation of what they involved. The original Canadian proposals would have caused a wholesale disruption of existing channels of payment, the creation of separate Canadian dollar pools for different countries of the sterling area, and much additional Governmental supervision. Our aim throughout was to maintain the sterling area conception, to preserve existing payments machinery as far as possible and to avoid policing and other vexatious complications.

Subject to the overriding consideration of covering the sterling area's deficit, the declared intention of the Canadians was to apportion Mutual Aid between different parts of the sterling area according to "need", i.e., according to the state of their current balance of payments with Canada. In practice non-British sterling countries had not so far been considered and are not discussed in this note; but determination of the amount properly due to each Empire country was difficult. It would, of course, have been preferable to see all but an insignificant proportion of Mutual Aid accrue to the U.K.on the grounds of relatively greater sacrifice in the war effort; but clearly this latter argument could not be pressed. The balance of payments method of allocation was disliked however, for more specific reasons, e.g., difficulty of calculation and inequality of budget relief to recipients according to

fortuitous

a maximum and minimum limit of $20 and $10 million respectively. If it dropped below the minimum, automatic transfers in multiples of $5 million from the Suspense Account were made, and similarly there were transfers in the reverse direction if it exceeded the maximum. In addition an overall minimum was provided for the U.K. Suspense Account plus Bank of England account of $15 million, the idea being that although under certain circumstances the sterling area's total dollars might fall below this figure, the Mutual Aid Board would not be entitled to make payments out of the Suspense Account if these would bring the total below $15 million.

After June 1943, the Canadian Government gradually took over responsibility for procurement and payment of supplies formerly obtained by the Canadian representatives of the Ministry of Food, Supply, etc. No serious upset to existing trade channels seemed likely to be caused beyond those already introduced by our own Controls, and difficult items such as aluminium and certain other raw materials were excluded from Mutual Aid. For wheat it was necessary to adopt a special procedure, but one which, in spite of the closing of the Winnipeg futures market, was calculated not to hamper a return to normal conditions later on.*

The general principle was that for all supplies procured on behalf of the U.K. (and later of other parts of the Empire) the Dominion Government acted through the Mutual Aid Board. According to the Canadian dollar position of the sterling area, and in the light of any available statistical estimates of its future trend, the Mutual Aid Board drew on the Mutual Aid Fund or on the Suspense Account. In so far as the money was obtained from the Mutual Aid fund, it represented straight transfer for which no payment was asked by the Canadians. Where, however, the money was drawn from the Suspense Account, i.e., out of the E.E.A.'s Canadian dollar resources, it was necessary to collect sterling payment from the consignees in the U.K.

*See several documents in O.& F.396.01, Vol.3.

allow the Canadians to decide at short notice, according to the overall Canadian dollar resources of the sterling area, whether particular procurements by the U.K.(and ultimately by other Empire countries) should be paid for out of Mutual Aid or out of our Canadian dollar balances, (b) ensure that, so long as Mutual Aid was being currently granted, there would be practical limits on our Canadian dollar balances, (c) provide for adjusting payments between the U.K. and other Empire countries for any excess or deficiency on Mutual Aid quotas which could not be adjusted by other methods and (d) enable the Canadian Government to take over from U.K.Government Departments (ultimately also from other Empire Governments) the actual procurement of supplies and make payment to the Canadian supplier, whether the goods were to be a charge on the Mutual Aid fund or on sterling area cash.

The system which was evolved, and eventually took the form of an agreement signed by H.M.G.and the Canadian Government, provided for the setting up of a "U.K.Suspense Account" in Canadian dollars to which were credited all R.C.A.F.and C.E.F.maintenance payments by the Canadian Government. Formerly the Canadians effected such payments simply by laying down sterling in London and paying this over to the Air Ministry and War Office when due, the dollar equivalent being merged in the entirety of E.E.A.assets. The Suspense Account, although designated "U.K.", was available to other parts of the sterling area since it constituted one part of the area's pool of Canadian dollars, the other main part being the Bank of England's Canadian dollar account which, subject to the limitations set out below, continued to function. (For their own administrative convenience the Canadians actually opened a "U.K.Suspense Account" in July, 1943, crediting it with maintenance payments and debiting it for certain cash supplies procured for the U.K. It was not, however, regarded as other than a purely Canadian affair, and no settlement of the sterling counterpart could be made until the Agreement came into force).

The Suspense Account, now an E.E.A.asset, was in fact operated by the Mutual Aid Board on H.M.G.'s authority. As a further measure of supervision of the sterling area's Canadian dollar balances it was agreed that the Bank of England's account should be kept within

a maximum

To operate Canadian Mutual Aid it was necessary to keep four financial channels open:-

1. The Bank of England Account, a cash account at the Bank of Canada, remained the regular channel for transfers to Canada by the Bank of England and the source of all U.K.payments in Canada except those made to the Canadian Government for war supplies. It was fed by the proceeds of the net requirements of sterling by the Banking system and Government of Canada (e.g., pay and allowances of Canadian armed forces overseas). It supplied dollars to credit the administrative expenses of U.K. and other sterling area missions in Canada, contributions to air training, etc., and made up deficiencies of sterling area banks in the current Canadian dollar transactions. Any balance over an agreed maximum of $20 million was transferred to the U.K.Suspense Account (see below); while insufficiency to meet current demands on it was made up from the Suspense Account.

2. The United Kingdom Suspense Account, also a cash account, was operated by the Mutual Aid Board on behalf of H.M.G. It received all payments by the Canadian to the U.K.Government which did not have to be made in sterling, and which were almost exclusively for equipment and maintenance of Canadian Forces overseas, and also proceeds of the purchase by Canada of U.K.capital assets and working capital. Its debits were for two purposes: a first charge to replenish, when necessary, the Bank of England Account; and after this to the U.K.Cash Receipts Account.

3. The United Kingdom Cash Receipts Account, in spite of its title, was not a cash but a book account of the Mutual Aid Board, held in the Consolidated Revenue Fund, and an entirely Canadian affair. Credits were by transfer from the Suspense Account, and transferred ownership at that point from the U.K.to Canada. The Mutual Aid Board used it as the source of all payments (through the appropriate Canadian Departments) for supplies neither charged to Mutual Aid Appropriation nor financed through the usual commercial channels. It was in effect a supplement to

Mutual Aid Appropriation. There was, however, no provision for transfer from the Cash Receipts account to the Suspense account (which had to transfer dollars to meet a shortage on the Bank of England account); so that if the income of the latter, after drawing to the full on the Suspense account, were still insufficient to cover its outgoings, an absolute shortage of dollars would be faced.

4. Canadian Mutual Aid Appropriation. This was not, of course, an account, but the means of authorising credits in the Consolidated Revenue Fund in favour of Canadian Departments responsible for procuring supplies for the United Nations.

It is not necessary to describe here the technical detail of the banking arrangements which had to be made to ensure the day-to-day working of the scheme, beyond saying that credits and debits to the Suspense Account were advised daily to the Bank of England who -

(a) paid the sterling equivalent of credits (other than transfers from the Bank of England account) to the Departments concerned, i.e., the Air Ministry or War Office:

(b) obtained reimbursement in sterling for debits (other than transfers to the Bank of England account) from H.M.Treasury, who made their own settlement with the various Supply Departments.

The numerous and varied payments to and receipts from Canada other than those described above continued to go through the Bank of England Canadian dollar account.

Over the whole period of Canadian Mutual Aid (i.e., an accounting period of three years from 1st April 1943 to 31st March 1946, but effectively from September 1943 to September 1945) disbursements for the U.K. amounted to \$2,112 million out of a total to all United Nations of \$2,471 million (The Mutual Aid Board also expended \$1,407 million in Cash on behalf of the U.K. for purchases in Canada). This total of over \$3,800

3.500?

million for the U.K. included supplies for the Colonies, except British West Indies, aid for which was administered separately by the C.M.A.B.

In view of the close trade relations she had long enjoyed with the British West Indies, who expected the supply of essential foodstuffs from Canada to continue, Canada decided that flour would be the most appropriate form of Mutual Aid to these colonies, and flour costing $5½ million was accordingly shipped, the bulk of it in 1944/45.

India, Australia and New Zealand received Mutual Aid under agreements negotiated between their Governments and the Canadian Government:

India	$18.8 million
Australia	91.4 "
New Zealand	15.3 "

Total aid to the British Empire was thus $2,243 million or 90% of Canadian Mutual Aid to all countries (10% to the U.S.S.R., China and France).

By categories the total was distributed thus:-

	Can.$ million
Aircraft and parts	272
Automotive Equipment and Mechanical Transport	390
Guns and Ammunition	389
Tanks and other fighting vehicles	102
Merchant Vessels (contructions, repairs, servicing)	321
Naval Vessels and Equipment	87
Grain and Flour	212
Other Agricultural (and Fisheries) products	253
Freight	30
Other	187
	$2,243 million

Ref.F.E.307
W.87

APPENDIX II(B)

"Interrupted Communications": "Empire Sterling"

By May 1940 the possibility that the U.K. might be invaded did not seem altogether remote. It was thought that if the invasion should be so successful as to overrun the South of England up to an including the Port of Liverpool the Government might have to be evacuated to Canada. On 23rd May, a week before the evacuation of Dunkirk began, the Treasury raised the question of ensuring that the Purchasing Commissions in the U.S.A. and Canada should not run short of funds on account of any interruption in communications.

By 4th June it had been agreed with the Federal Reserve Bank of New York and the Bank of Canada to cancel all signatories operating on the Bank of England's accounts with them upon their receiving a notification to that effect from the British Ambassador in Washington. They were then to accept instructions from the Ambassador or the Bank of England's representative in Ottawa, who could also delegate their powers. At the same time the Ambassador was supplied with letters addressed to these banks and to the Central Banks of Australia, South Africa, India, France, Argentina, Switzerland, Java and Sweden. The letters were to be used by the Ambassador at his discretion should need arise: in fact, they were of course never despatched by him.

As regards assets with Commercial Banks, it was thought that only balances held in the U.S.A. were of sufficient importance to warrant emergency arrangements, and it was proposed that these should be transferred into the name of H.M.G., with a view to removing the danger of attachment. The accounts with the Federal Reserve Bank were also to be transferred into the name of H.M.Government.

On 4th July the Ambassador was advised that the emergency letters for Paris, Stockholm and Zurich should not be sent in the absence of further instructions. By the middle of September it had been decided not to transfer the assets of Commercial Banks in the U.S.A. There were a number of serious difficulties in doing so, particularly in connection with credits: the Commercial Banks would almost certainly object to granting credits to a belligerent government.

Later, the letter intended for the South African Reserve Bank was entrusted to the U.K.High Commissioner there, who was to forward it on receiving telegraphic advice from Washington; and in the Spring of 1942 the Reserve Bank of New Zealand was added to the list of Banks to be advised.

The Bank of Canada, in May 1940, had been equally alive to the desirability of making emergency preparations, and when they received the Bank of England's telegram concerning the accounts they took the opportunity to open up wider questions. Mr.Towers cabled that since in the event of a complete suspension of communications the official sterling market would not be functioning, other Empire Central Banks and Colonial Banks would have to decide on what currency to base their quotations and what point to use as a central clearing centre. While the U.S.dollar would be the logical currency from a financial point of view, for psychological reasons it would be highly desirable to maintain an Empire financial structure so far as was possible. Mr.Towers wondered whether the Canadian Dollar could be used for this purpose. Empire Banks.... "would not commit themselves to maintain rates unchanged, and would make adjustments if our rate in terms of U.S.dollars should change. In fact, therefore, they would be basing their rates on the U.S.dollar but using the Canadian dollar as a screen. To make this arrangement work a gold fund for U.S.settlements would be necessary: probably a relatively small amount would suffice for an emergency situation which could not last for very long. Whether or not other Empire points made arrangements of this kind, I think it would be necessary for the British West Indies to do so".

The Bank of England replied that a gold fund would be set up, and that American and Canadian restricted securities would be shipped to Canada. The securities would remain in their existing ownership, but the Treasury would act as custodian. Experts of various kinds would accompany the securities, but discussion of the ideas put forward by Mr.Towers would require the visit to Ottawa of an Executive Director. Sir Otto Niemeyer accordingly left for Canada in July. In part his mission was to inform the Bank of Canada of the position in the U.K. and to give some reassurances designed to counterbalance the defeatism current at the time in Washington.

Sir Otto found that a secret committee, consisting mainly of officials from the Bank of Canada, had been appointed by the Government to consider the effect upon Canada of a complete interruption of communications with the U.K. This committee never reported (as the emergency passed), but had elaborated for consideration a number of projects on the declaration of a state of emergency: the fixing, for balance sheet purposes, of rules for the valuation of pre-emergency securities at pre-emergency prices; the establishment of an Emergency Finance Corporation, with a capital of $200 million provided by the Government, to finance industries - in particular agriculture, and possibly to guarantee advances by the Banks to such industries, and to finance a Purchasing Body which would buy and store approved Canadian products. An Anglo-Canadian Settlement Fund was also suggested, to collect and hold payments due to the U.K. and to register claims against the U.K

Neither Canadians nor English could quite bring themselves to regard the conquest of the British Isles as a serious possibility. But viewed from Canada it seemed to be a duty to explore possibilities on that hypothesis.

On 29th July Sir Otto Niemeyer cabled the following suggestions from Mr.Towers and himself for the creation of "Empire sterling" (paragraph 1 was introductory only):-

"..........

2. On zero Dominions would lose main export markets and also use of sterling balances if any. Though there would be

some set-offs in home charges and their own gold production they, and particularly Australia and New Zealand, would clearly have to restrict imports other than armaments drastically.

3. Apart from important political aspects it would help their export possibilities if they could stand together and deal as a single currency.

4. Can we not for this purpose conceive the maintenance provisionally of a special "Empire sterling" worked on the general machinery now applicable to the Sterling Area exchange control, though from a new centre, in which the Dominions would settle their balances inter se (as well as those with any foreign countries which could be induced to accept "Empire sterling" for use in the Sterling Area") and in which the Empire as a whole would trade, so far as was inevitable, with foreign countries?

5. It is probable that the area could only trade with the United States in dollars, and the new currency would have to provide dollars (as existing sterling does). The extent to which it could do this would clearly be limited by its assets, and whether its means would be sufficient would depend on how successful action to restrict imports, especially dollar imports under 2, had been. But as 2 would be inevitable anyway, it might be that a sufficient backing for absolute essentials would be available.

6. Each Dominion could peg on "Empire sterling" at the point it chose (as is the case now with sterling) and "Empire sterling" would have to maintain at least a nominal rate with the dollar - query 4.02 as now.

Each Dominion would have to give its own currency for "Empire sterling" and vice versa - maybe up to some agreed maximum.

7. The "backing" might come from

(a) A sum to be set aside from United Kingdom assets in gold. (Obviously, as in the circumstances envisaged gold and securities would be the only assets available to H.M.G. in the United Kingdom in exile for war purposes, such amounts would have to be very strictly limited.)

(b) Proceeds of such Empire current gold as now goes to swell United Kingdom assets.

(c) Possibly some contributions from existing Dominion monetary gold stocks (e.g., India).

8. The smaller dependencies would probably have to be grouped under the local currencies of their larger neighbours - if only to simplify the machinery of the clearings.

9. An important consideration - particularly for a provisional makeshift - would be to change as little as possible in the current machinery now known and practised in detail.

10. Unless British Commercial banks function here I do not see how all trade could be cleared through "Empire sterling". General trade owing to volume of transactions would have to go direct from Dominion to Dominion in local currencies we clearing only inter-Dominion or international balances ....."

The bank (2.8.40) did not think foreign countries would accept Empire sterling unless it were fully and freely convertible. Sufficient backing would not be available. The existing position of the Dutch guilder and the Dutch Colonial Empire offered a parallel case on a smaller scale.

The argument was now taken up in letters. On 6th August Sir Otto Niemeyer wrote to the Deputy Governor. His earlier cable had tried to compress a complicated idea into "a sketch in barest outline". The references are mostly to the Bank's telegram of 2nd August:

....

'Fully and freely convertible'. ... is there now any effective currency in the world, except the U.S.$ which is "fully and freely convertible"? ..... Yet that fact does not prevent people from trading in not fully convertible currencies: indeed there would be precious little trade if it did. Why then should it prevent them dealing in Empire sterling? The Empire no doubt could not supply all the things the existing sterling can supply, but it could supply some of them, e.g., South America would still need Tea and Jute, and Japan, if not belligerent, would need wool and maybe cotton: and a currency usable in an Empire area would still have some value in a world whose trading was ex hypothesi very greatly reduced.

Dutch parallel. I am not quite sure of the bearing of this analogy. The Dutch Colonial Empire is the counterpart of our Crown Colonies, and in no way resembles in position the British Dominions with their separate policies. And is it not a fact that for practical purposes the Dutch Colonial Empire has a single currency - the N.E.I.Guilder - Surinam and the other exceptions hardly counting?

Delay in Dominion readjustment. That obviously would be a point to be watched and the criticism would be just, if the Dominions, by adhering to Empire sterling, got an unlimited call on gold or dollars. But they would not. The amount available as backing would not in any case permit this, and each Dominion would in fact have to be told that it could not count on getting more than X, X being fixed at a very low figure.

This is, I think, in essence what you have been trying to do through exchange control with sterling. In the new circumstances, the limitation would have to be infinitely more drastic: and indeed I am not sure that the result would not be to bring home to the Dominions the need for the restriction of purchases even more rapidly than if there was no such proposal and they were left to their own slow and unwilling realisation of the position.

(On Gold) ..... the Empire would have to sell its gold somewhere. U.K.being out, it could only sell to America: but it might be induced to sell some to a central pool instead of direct to America (as in fact it does now).

Existing stocks are of course a long shot. But in the circumstances of the hypothesis, is India to continue to sit on £60 million and, say, Egypt on £8-£10?

..... The displacement of the centre would of course mean a vast change in everyday administration. ...... what I had mainly in mind was the general machinery of the various exchange controls and their principles of action.

..... To pack in wooden boxes many millions of gold, etc., under your direct physical control and dump them somewhere else is no doubt a laborious job. But it is surely just not in the picture with trying to set on foot among a number of geographically and politically separated countries currency arrangements which they are to adopt overnight just as the bottom has fallen out of their world? Moreover, if you regard this trans-shipment as the "necessary basis", is it not somewhat inconsequent to refuse to contemplate the use of some of these assets for the purpose for which they are the basis?

....

Now let me put to you again the fundamental issue as I see it. It is mainly political.

Zero would produce enormous reactions both within the Empire and in the world outside. The tendency would be to break up and for some parts to be grabbed by other people, e.g., Japan or even U.S.A; and once grabbed how and when retrieved? Is it not of the first importance in such a position for the parts to stand together, for their common defence and ultimate common resurrection? Should we not do all we can to promote this, even at the risk of technical flaws, even if it costs us a little money? And at the lowest, would it not pay us to do so? [I omit any moral responsibility we may have for sterling balances]. From the Dominions' point of view, would not such unity be worth something to their safety? On this ground, should not the economically strong come in a bit to help the weak (N.Z., e.g.), even it it meant pooling some of their resources, e.g., some gold? ......

Is it not the Dominions' only alternative to individual dependence on the help and protection of the U.S., whose ideas, e.g., about Canada and the West Indies, would probably not be entirely the same as ours?

If there is anything in this vision, have we not got to try and make - if only in limits - some kind of currency link between the parts, to play in the much diminished sphere for the time being in action - and remember, with Europe and U.K. out, how limited it would be and how little the Empire would need foreign countries' exports other than U.S.A. - the role now played by sterling?

Apart from politics, there must be economic advantage in some pooling of balances: and the Empire as a whole would do better if each local currency had not to negotiate separately with outsiders, and if between Dominions triangular clearings could be worked through a centre. Dutch East Indies, for instance, might not be willing to sell Oil for Australian pounds, but might take a currency she could use to buy Rice, Textiles, etc., from India. ...."

On 28th August the Deputy Governor replied:

"..... Since you wrote, you will have had my cable No.13 of the 8th August, which was intended to give an idea of how our minds have been working in recent weeks on the "Empire sterling" question. ..... What we intended to suggest was not, of course, that sterling was now "fully and freely convertible" or that, in given circumstances, you could not conduct an adequate trade with a sterling only partially convertible but rather that the attitude of the outside world to sterling might be quite different in the catastrophic circumstances which we are talking of. Whereas in our present undefeated state, with free, or relatively free, communications and a fair measure of convertibility many countries are ready to accept sterling (though it is to be noted that even now the Japanese, for example, are making difficulties about it, things would be quite different in a world in which the United Kingdom had gone into eclipse as a centre for trading and

and financial transactions. Unless the thing called sterling in new circumstances was fully and freely convertible, I do not believe that you would get foreign countries to accept it. What they would do, I believe, is to insist either that the new sterling meant gold or that it meant dollars. If there were any doubt about either they would not accept the new sterling and would ask for gold or dollars direct from those parts of the Empire with which they still traded. In other words, the continued acceptability of sterling internationally is the measure of our continued success in resisting our enemies; but, in the circumstances we are talking about, the main centre of resistance would have ceased to function, and with it, we believe, the acceptability of sterling would also have disappeared. ......

As regards the Dutch parallel: we were not thinking of the function now performed by the N.E.I.guilder (which, indeed, might be that performed by the rupee or other separate Empire currencies in a dislocated Empire) but of the function which is not performed by the Netherlands guilder. The eclipse of the Netherlands themselves has forced the Netherlands guilder for all practical purposes out of existence - and that in spite of a substantial Dutch holding of gold which, in theory, could have been used to continue a quotation for the Netherlands guilder. Of course, the parallel is not exact, and as you point out, for all practical purposes the Netherlands East Indies <u>are</u> the Dutch Empire outside Europe. Still, the position of the Netherlands guilder itself seems to me to be different more in degree than in kind from that which would face sterling in the event of catastrophe in these islands.

..... I wish I could feel that what we have been trying to do through exchange control is to bring about readjustment of the Empire economy to war conditions. It is true that we have been complaining whenever we could about extravagance in the use of foreign exchange (as we have seen too often) in the outlying parts of the Empire; but I fear that our Exchange Control in itself has been but an imperfect instrument in bringing the Dominion and

Colonial economies into line with war needs. Indeed, the figures of imports into Australia, South Africa, India, etc. - in fact, into all the Empire except New Zealand - have never ceased to cause us alarm since war broke out. I fear that nothing but constant political pressure - and possibly a slow but growing realisation of the gravity of the adjustments necessary to victory - will bring about the lowering in the standard of living required all over the Empire. On this point it is only now that there seems to be any awakening to the urgency and importance of this problem. It has too easily been assumed that it was quite all right for the Empire to import so long as it imported from the United Kingdom. The fact is that every unnecessary import - even if it comes from us - is a call on our machines, our labour and, to a certain extent, on raw materials which we ourselves have to bring here. Oddly enough, as I mentioned above, the only Dominion - maybe the only part of the Empire - which has reduced its standard on a scale comparable to the emergency - is New Zealand, and that is not mainly because they are more patriotic than anybody else but is largely a matter of accident: they were on their beam ends at least a year before war broke out and have got used to measures of restriction and control which the others had never contemplated and have to all appearances been most reluctant to adopt.

...... you take me to task a little about the importance I attach to the mere movement of gold and other assets. Of course, I was not suggesting that this was a substitute for planning and organisation in the unhappy event that we have been discussing. All I wished to imply was that none of the plans that had been discussed would be possible unless there were substantial United Kingdom assets of the sort mentioned available in North America and that at least we had made it possible to consider plans later by carrying out the lengthiest and physically most troublesome part of the preparation. I do not see why it is inconsequent to refuse to pledge in adv nce the use of some of these assets in a project which it seems to us at this distance would be difficult to fulfil, and doubtful of value in proportion to the wastage of assets involved. Of course, we shipped the gold, etc., for quite another purpose: it is only if the new purpose seemed attainable and advantageous that we could use any of the gold in support of it.

I realise the force of the political issues you outline ..... They are of enormous importance and if anything we could do, by parting with some portion of our remaining external assets in the given circumstances, could hold the monetary fabric together, then it might well be worth doing. But, when one considers how fundamental a role in the economy of the outlying parts of the Empire has always been played by the mere consuming and producing power of the British Isles, and thinks of the situation in which that consuming and producing power was removed (even temporarily), then it seems to me that no resources we are likely to be able to spare could prevent a complete revision of the standard of living in the outlying parts of the Empire. This would mean too a reorientation of their economies in those directions which would establish the best complementary relationship for them with other parts of the world. I should like to think with you that the economically strong would come in to help the weak. I have no doubt that such an idea would appeal to Smuts - though probably less to Menzies - but I do not believe it would appeal to Smuts' compatriots: nor do I think it would appeal at all to Congress in India; or to Quebec and the Prairie Provinces, unless Canada could become the real focus of Imperial relationships.

Well, you will say, this is all very negative and very dispiriting. I suppose it is bound to be so and, indeed, the hypothesis of defeat is so thoroughly dispiriting that we refuse to treat it as a practical possibility. And, after all, there is something more than self-hypnotism or wishful thinking in this, since from a purely practical point of view we cannot create now in our minds any clear image of the attitude of the outside world to the remains of the Empire in the event of German success in Europe. I think that we can have some idea of the gravity of the adjustments that would be necessary for the rest of the Empire, and that is what the Bank of Canada has been examining through the Committee which you mention in your letter of the 16th July. Doubtless there might be something to be said for other parts of the Empire making the same enquiry, though it would seem from this distance as though North America tended to be noticeably more "windy" than the other Dominions and Colonies. In short, we are refusing to be hustled along this dangerous path, under the propulsion of fears we do not share, in a direction we regard as dubious and towards a goal we do not see any possibility of attaining ....."

The other Dominions were not consulted, and as by mid-September the Battle of Britain had been won, the subject of how to satisfy the external creditors if the U.K. were successfully invaded was pursued no further.

APPENDIX II(C)

Hyde Park Agreement

This Agreement was, on the face of it, both reasonable and simple to work: the existence of American Lend-Lease clearly pointed to some arrangement of the kind. In so far as it was intended to remove anomalies in U.K./Canadian contracts it was largely frustrated by accounting complexities.

On 20th April 1941 there was signed by the President of the U.S.A. and the Prime Minister of Canada an Agreement which was largely concerned with American purchases from Canada but which also provided that the U.K. should in future obtain, under the Lend-Lease Act, for transfer to Canada, defence supplies from the U.S.A. which entered into the production of munitions, etc. for the U.K., and for which Canada had hitherto paid in U.S.dollars. Some of these supplies were identifiable throughout Canadian processes; others lost their identity altogether.

The April Agreement was followed by an arrangement signed on 14th May by the Canadian Deputy Finance Minister and Sir F.Phillips and approved by Mr.Morgenthau, which laid down working principles for carrying out the British part of the Agreement.

Goods in the first category would be obtained under Lend-Lease by the U.K. and transferred to Canada direct; goods in the second would continue to be purchased from the U.S.A. by Canada, for which she would pay cash. Canada would be compensated by receiving goods to an equivalent value (which she would normally buy from the U.S.A. for her own use) and also obtained by the U.K. under Lend-Lease.

A first determination of the amount transferable for the period ending 30th June 1941 fixed $120 million for the identifiable supplies and $100 million as a rough estimate for unidentifiables. Calculations were soon revised and by August it looked as though the proportions would be more like $50 million to $170 million. In any case the U.K. would have to obtain and transfer to Canada goods under Lend-Lease to the value of $220 million.

It was soon thought inadvisable to expose urgent orders to the delays incurred in requisitioning, and it was decided that Canada should continue to make substantial cash purchases in the U.S.A. But whether these U.S.components were bought by Canada or obtained via the U.K. on Lend-Lease their Canadian dollar equivalent, charged in the Canadian price, had to be restored to the U.K. And here there seems to have been some misunderstanding from the outset as to whether, when Lend-Lease components had been shipped, Canada should charge gross and credit the U.K. in Canada, or invoice the finished products to the U.K. on a net basis*.

At all events the large proportion of unidentifiables and the very large number of hands through which requests had to pass led to delayed settlements. Nearly nine months after the Phillips/Clark Agreement was signed the Financial Adviser to H.M. High Commissioner, Sir Gordon (then Mr.) Munro, was writing to Professor Robertson of the Treasury ...... "To sum up, while the Hyde Park Agreement has worked well as regards purchases by the United States from Canada, it has been almost completely ineffective in so far as the Phillips/Clark arrangements are concerned, partly because of American delays at the requisitioning end in Washington and partly because of the serious accounting arrears in Ottawa". (L.2.2.42). Six months later Mr.Thompson-McCausland (note of meeting at Bank of Canada 19. 8.42) said that "..... So far we in London had been unable to trace any significant transactions under the Agreement or, indeed, to obtain any clear idea of whether transactions were occurring at all".

At the time of this meeting it was at least ascertained that identifiables had been coming in for incorporation in U.K. contracts. Invoicing had been on a net basis (cf. above) and there was no risk, therefore, of charging the U.K.twice. On unidentifiables little information was forthcoming; it was

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*The system of charging and accounting in connection with these transactions was known as the "Canship" system and codified according to whether Lend-Lease goods were shipped to Canada (Canship) or the components paid for (Canpay). The proposed recovery of dollars by the U.K. was coded as "Canex".

believed that insignificant credits (perhaps $2 million) were then due to the U.K. There appeared to be a list of over $120 million outstanding transactions, but their nature was obscure and the realised total was likely to be much less. The arrangement seemed to be unpopular with both the D.M.S. and the Americans, and in default of special represenations was likely to die out.

The position then becomes somewhat obscure; but news of a few credits to the Bank of England was cabled from time to time (about $20 million up to March 1944). With the coming of Canadian Mutual Aid a new situation developed. Canada was accumulating U.S.dollars at a rate which led to suggestions of a dollar ceiling (cf. a similar situation in the U.K.) and in the circumstances preferred to pay cash for U.S.components in her U.K.munitions contracts. This meant that the U.K. would lose the Lend-Lease benefit which the supplies had enjoyed for more than two years. Their cost would be transferred to Canadian Mutual Aid and the Mutual Aid appropriations would run out sooner.

Settlement between Canada and the U.S.would now necessitate intricate and burdensome computations, which work would fall on the Canadians. There was also the danger that Canada's payment in cash for certain aircraft components might predispose the U.S.Authorities to discontinue Lend-Lease facilities which the U.K.had enjoyed under the Air Training Agreement.

The U.K., in fact, stood to lose Lend-Lease benefit on balance: for while she would now have to forgo the Lend-Lease element in her Canadian contracts (and be charged their full cost, including what the Canadians paid the U.S.A. for components), she would only have, as an offset in her U.S.Lend-Lease, the reduction the Americans would make in their Lend-Lease appropriations booked to the U.K. (on account of such Canadian goods as they might embody).

This and other reactions of the changed policy were under consideration, and representations to the Canadians were made by the High Commissioner's Office from November 1943 onwards. A cable from Mr.Munro (4.12.43) reassured H.M.G. that for the time being the aircraft components would continue to be delivered on Lend-Lease; and a later one (31.12.43) that requisitions under the "Canship" system "will not be suddenly discontinued but merely dwindle away".

On 2nd March 1944 a cable from the same source brought news that Canada's proposed U.S.dollar ceiling (a figure recently suggested had been $350 million) was to be lifted altogether as from 1st January 1944. It also gave a figure for "Canex" deliveries already made to Canada of $39 million. Of this about $20 million had been paid to the U.K., which under the new arrangement would have to be refunded to Canada.

On 30th June the High Commissioner cabled that the Canadian Government proposed to ask the U.K. for settlement in gold or U.S.dollars for the U.S.A.content of Canadian munitions shipped to the Sterling Area for the current year, and estimated at $250 million in a full year. Payments might be made monthly under an agreed formula.

On this H.M.Government cabled (13.7.44) to the British Delegation attending the Bretton Woods Conference, and to Sir Wilfrid Eady at Ottawa, reviewing the position, expressing astonishment at the figure of $250 million≠ (more than ten times as high as they had envisaged) and ending ......" having terminated (without consultation with us) arrangements which have satisfactorily dealt with the problem, on the proper basis of general Mutual Aid principles, it is surely unreasonable for them now to suggest that we should assume the consequent United States dollar liability".

Meanwhile proposals for a Financial Settlement (see Main Text) had been completed and were put before Mr.Illsley (Canadian Finance Minister) on 14th August. Among several matters to be adjusted was the $250 million for U.S.components. The Canadians now agreed that their claim should relate only to supplies furnished under Mutual Aid, not to munitions financed or to be financed by the U.K. by other means during the rest of the current fiscal year. This reduced the amount claimed to 80 million in U.S. dollars (Can.$88 million), which formed part of the Agreement of 14th August and may be said to have closed this unsatisfactory account.

≠ which was in fact substantiated ($246 million) by detail given in incoming cable 7.8.44.

APPENDIX II(D)

Empire Air Training Scheme

The Bank were not much concerned with the direct finance of the Empire Air Training Scheme (E.A.T.S.), the available financial records of which incidentally are elusive and incomplete. Comparatively modest cash payments by Australia and New Zealand must have come out of the sterling area dollar pool, but the U.K. contribution, so far as it was made, was in aeroplanes, equipment, etc. An accumulated further liability of about £100 million was cancelled under the 1946 Agreement between the U.K. and Canadian Governments. Advanced training in the U.K. of Canadian personnel was no doubt a kind of reciprocal aid, but Canada made considerable payments for maintenance and reserve stores. For the greater part the scheme must be regarded as Canadian Mutual Aid (and some American Lend-Lease) on a very large scale, at a total cost to Canada of at least $2 billion.

In the middle of October 1939 a Mission sent by the Air Ministry, under the Chairmanship of Lord Riverdale, arrived in Ottawa. Its primary object was to arrange for the training in Canada of pilots and ground staff from Empire countries, including always a proportion from the U.K.; but it was also deeply interested in aircraft production in both Canada and the U.S.A. This was to be of importance later, when contracts for aircraft and components in connection with the Scheme, placed in North America, followed on initial supplies from the U.K.

In the first discussions it was decided that to maintain a number of separate purchasing agencies for the requirements of the Mission would be unworkable, and that all purchases must be made through the two B.P.C. organisations already set up in Canada and the U.S.

On 17th December 1939 an Agreement was signed in Ottawa by the U.K., Canada, Australia and New Zealand, and was to last until 31st March 1943.

It was first estimated that expenditure up to March 1943 would include capital undertakings of $400 million and maintenance costs of a little over $500 million. Since substantial contributions by participating countries could not well be made wholly in dollars, it was advocated that the U.K. should supply capital equipment and replacement aircraft to the value of $221.5 million, and that the remaining $687 million should be borne by Canada, Australia and New Zealand, Canada probably bearing half.*

The U.K. agreed to their contribution (equipment valued at £50.5 million) but, in view of the uncertainty of the final cost of the Scheme, suggested that their share should be limited to 25% of whatever the total cost should be. There was also for consideration expenditure which the U.K. would incur in furnishing equipment to Australia and New Zealand for elementary training there. An early guess at the amount of dollars the U.K. would lose was $50 million for the first year; but in fact payments to Canada by Australia and New Zealand were quite small in the first year and only a little over $30 million in the first two years.

Instructions and training began in the Spring of 1940, and the first student "graduated" in the following November. The Scheme provided for the training of 544 pilots, 340 observers and 580 wireless operators every 4 weeks, which involved the maintenance of 58 separate training units (including flying, observer, navigation and wireless schools).

In 1942 a Combined Committee, consisting of representatives of the U.S.A., Canada and U.K., was appointed, to sit in Washington with advisory functions. At the same time the four partners to the 1939 Agreement reviewed progress and made plans for the future, and the old Agreement was replaced by a new one, signed on 5th June 1942. The new Agreement, overlapping the old one by 9 months, extended from 1st July 1942 to 31st March 1945 - a date prophetically near to the end of the war in Europe.

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*$824 million (Canada $600 million) according to Canada Year Book, 1942.

At this time total operating costs of the Plan up to 31st March 1943 were put at just under $1,000 million, of which about half had actually been expended by 31st March 1941.* To the end of March 1945 the total cost was estimated at about $1,500 million; but by the end of 1943 the cost to Canada alone was over $1,600 million.**

There are many gaps in the Bank's record of the finance of the Scheme; and the Canada Year Book gives only broad detail. Cash contributions by Australia and New Zealand up to 31st March 1943 were fixed at $51 million and $31.6 million respectively. By the end of June 1943 New Zealand had discharged her liability in full and Australia had paid $47 million. Australia and New Zealand subsequently persuaded Canada to finance their contributions from Mutual Aid, but it was at the time (early 1944) considered premature to raise this issue with regard to the U.K. The U.K.accumulated a liability under the old Agreement of $200 million up to June 1942. For the further liability up to 1945, mostly discharged in aircraft, equipment, etc., an estimate of $720 million was thought to be an outside figure as late as April 1944.***

Towards the end of 1943 the Canadians began to be apprehensive lest their decision to pay in cash for U.S.aircraft components, among other supplies hitherto obtained on Lend-Lease, and its implications for the U.K. might in turn endanger payment of the U.K. liability under the Air Training Agreement. In the Canadian view ...... "everything possible must be done to maintain the U.K.contribution ..... on its present basis" (cable from Munro 4.12.1943).

In the following Summer, when estimates of the U.K. deficit with Canada for the current fiscal year were under discussion, the Air Training Agreement liability down to June 1942 ($200 million) was already two years in arrear. The U.K. had reasonable claims on Canada for reserve stores, a proportion of

* The original 58 training units were now to be extended to 77.

** Canada Year Book 1943/44.

***Particulars in this paragraph from Statistics Office File 1604*.

were deemed to be held against requirements of the Canadian Overseas Forces.* It was suggested that against these the $200 million, among other liabilities to Canada (e.g., the Mutual Aid and Lend-Lease elements in the reserve stores themselves) might be regarded as a useful offset (cable 21.7.1944 to Sir W.Eady).

This suggestion brought from the High Commissioner a request for particulars of arrangements under which the U.K. had accepted financial responsibility for part of the reserve stores held in Canada against the Air Training Scheme. Under the June 1942 Agreement the U.K. had agreed to bear half the total cost less certain payments by Australia and New Zealand, with, however, no explicit reference to reserves.

The Canadians did not consider their claim very strong, and in the general Financial Agreement (14th August 1944), the U.K. liability received no mention. On the other hand, there was to be a provisional payment of $75 million, which was likely to be increased, for advanced training in the U.K. of Canadian personnel who had been in an R.C.A.F.squadron since 1st April 1943. A payment of $100 million was made in September.

In fact, with the concurrence, or at all events without the disapproval, of the Canadians the finance ofthe whole scheme tended to be static. A cable 21.3.45, to the High Commissioner, speaking of further possible contributions by Canada, says ...... "no allowance for this was included in the estimates submitted last Autumn, since it was felt that this was best dealt with along with the Air Training liabilities already outstanding"... and the reply (30.3.45) ...... "air training finance. It was agreed that this should be left in suspense for the present." - a pretty clear indication that with the war ending in Europe, all parties had in mind the sweeping settlements of war claims, of all kinds and on all of them, which before long were to appeal to their mutual tolerance and sense of fairness.

*Tentative estimates were $350 million for the R.C.A.F. and a doubtful $50 million for the Canadian Army. The amount included for both in the Agreement of 14th August was $300 million.

At the end of January 1946 final agreement was reached with the Canadian authorities on the amount of the U.K. liability for 1942-1945 on the Air Training Scheme. The figure was $225 million. There had been no settlement of the $200 million outstanding for the period down to June 1942, it will be remembered. Article 7 of the Financial Agreement of March 1946 says:

> "The Government of Canada agrees to cancel the amount owing by the Government of the United Kingdom to the Government of Canada with respect to the British Commonwealth Air Training Plan, which amount the two Governments agree is $425,000,000."

During the 5 years of the Plan's operation 360 schools were established, 7,000 hangars built and 131,553 air crew "graduates" trained, of which nearly 55% were Canadian.

Canada	72,835
U.K.	42,100
Australia	9,606
New Zealand	7,002

The peak year was 1943, in which 7,000,000 hours were flown.*

*For a good summary see Canada Year Book 1946.