Italy's Trade with the Sterling Area, 1945-1951 (*)

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1. In the years following World War II Italy's balance of payments has been continuously unfavourable, although since 1948 considerable progress has been made towards equilibrium. As shown in Table I, the percentage of credit items to debit items was 56.6 in 1946 but fell to 48.7 in 1947, when exports were checked by the spurt of inflation in Italy, rose to 78.3 in 1948, to 81.9 in 1949 and reached 92.7 in 1950. The net movement, however, conceal uneven trends, at times, opposite tendencies. As in all Western European countries, the most difficult sector was the dollar balance. The dollar deficit was $476.8m. in 1948, 450.9m. in 1949 and 253.1m. in 1950 — a deficit exceeding the global one (1).

The dollar trade balance presents a picture completely the reverse of the dollar balance. By the end of 1946, the commercial and financial transactions between Italy and the Sterling Area since the war had resulted in a credit in favour of Italy of £28.9m. This figure had remained practically the same at the end of 1947 (£28.1m.), but underwent a remarkable recovery in 1948 (£54.7m.), increasing again to £59.6m. at the end of December 1950 and to £72.68m. in the first months of its existence and our sterling credits consequently tended to decline. They fell from £79.68 on June 30, 1950 to £72.78m. at the end of December 1951, and to £59.61 in March 1951. Italy then became a creditor nation in E.P.U. and at the end of August 1951 our sterling balances in London had increased again to £72.78m. (See Chart I).

Thus, in the post-war period, Italy has played the unusual role of financier of the Sterling Area, a development which has naturally given rise to discussion and controversy. The problem has recently (in the autumn of 1951) again come to the forefront and our growing E.P.U. credit balance, due largely to the surplus in our transactions with the United Kingdom, placed before the Italian Government the necessity of taking delicate re-equilibrating measures. It may, therefore, be of

ITALY'S STEERING BALANCES IN LONDON

Chart I
interest to review rapidly the principal phases of the trade between Italy and the Sterling Area in the post-war period.

From the end of hostilities to the agreements of April 1947, Italy joins the Transferable Accounts countries.

2. At the end of hostilities, a combination of various factors brought about a rapid recovery in Italian exports to Great Britain (2) which offered a market ready to receive and capable of absorbing a relevant part of the output of some typical Italian commodities, particularly citrus and other fruits and vegetables, that had always contributed much to Italian exports and which had lost their main outlet, Germany. Scarcity of dollars and of shipping contributed to this expansion in imports from Italy. Detailed statistics for the period immediately following the war are not available but the pre-war position was regained by the United Kingdom in its re-opened export trade was recorded in the Report of the Bank of Italy for 1945 (p. 149). "Our exports appear to have reached approximately 900,000 lire in 1944 and 1,700,000 lire in 1945, consisting mainly of farm products, especially citrus, and semi-manufactured goods. The principal destination was the United Kingdom which took at least 70 percent of our exports."

The Italian Government encouraged these exports to the United Kingdom, because they helped the revival of the agriculture of South Italy and enabled our financial authorities to obtain sterling at the favourable rate of 403 lire to the £ (the black market rate for sterling in 1945 fluctuated around 900). (1)

3. Transactions with the United Kingdom and the Sterling Area were settled from the outset under a free currency system and at no time by clearing arrangements. Up to January 1946, the exchange rate was 403 lire to the £. The proceeds from exports were paid by the Italian exporters to the Italian Exchange Office. The lire/dollar rate being then 1,200 lire per $1, the official rate of $ 1 to the £ was fully respected. The rate of 403, having regard to the relative price levels in the two countries, undoubtedly overvalued the lire but the circumstances of the early post-war period — scarcity of goods, a sellers' market, price dispersion — enabled Italian exporters to obtain remunerative prices despite the deterrent exchange rate. The undervaluation of sterling, however, resulted in some illicit retention of the proceeds from exports (3), with a consequent buildup up of private sterling balances in London — a hedge i.e. against the inflationary danger then becoming evident in Italy.

Early in 1946 the Italian monetary authorities introduced two measures which resulted in a substantial devaluation of the lire. These measures were due not so much to the advance of inflation within the country, for prices held fairly firm in Italy throughout the first quarter of 1946 and black market exchange rates and stock exchange quotations showed some weakening, but rather to the re-emergence of international competition and the growing importance of the price factor in international trade.

The first measure, applied on 4 January, established a premium of 125 percent on the official exchange rate for foreign currency obtained from exports. The dollar consequently appreciated to 357 and sterling to 907 lire. The second measure, introduced in March, was much more important because it established the so-called 50 percent free accounts (See Table II and note). The creation of a «free market» for part of the sterling receipts resulted in a sterling/dollar cross-rate that was different from the official parity. In fact the cross-rate on the «free market» at once moved

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(1) By agreements made between Italy and the United Kingdom in September 1945, Italian Accounts were opened and the Trading with the Exxony Act, in an application to Italy, was repealed. These agreements, which marked the re-opening of commercial and financial relations between the two countries, provided that the proceeds from commercial and financial transactions made by residents in Great Britain or in other markets of the Sterling Area to the Italian exporters could be deposited, subject to the permission of the Italian Exchange Control, in Italian Accounts of which they would be free to dispose upon fifty-four payments to resident in the United Kingdom and other parts of the Sterling Area or to transfer to other accounts.

(2) Through the device of investing goods at prices below those actually received.

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(4) When liaisons crossed the official exchange rate between the Italian lire and the sterling was fixed at 593 lire per sterling (and the exchange rate of the lire per dollar was fixed at 115 lire per dollar). All the above rates were understood to be bid rates, and were recorded in the Italian Foreign Exchange Office (Ufficio Italiano dei Cambi - U.I.C.). Therefore the official rate was equal to U.I.C. buying rate.

(5) A decree, effective 4/1/1946, established a premium of 25 percent on the official rate for foreign exchange obtained by exporters. The U.I.C. buying rate for sterling was fixed at 593 lire per pound sterling (as it was four lire per U.S. dollar).

(6) For sterling, the U.S. dollar, Swiss franc, Portuguese escudo, Egyptian pound and a deus, effective March 12, 1946, limited the maximum foreign exchange rates for sterling to U.I.C. 1/222, that is to 593 lire per pound sterling, for the purchase of sterling, and for the selling of sterling, 600 lire per pound sterling. Therefore, at that time, 1 sterling exchange in Italy in April 1946. 1) the official rate of 593 lire almost at par (precisely 594.5 lire per pound); 2) the U.I.C. buying rate of 593 lire per pound sterling, and for the purchase of sterling, and for the selling of sterling, 600 lire per pound sterling.

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(7) From Table II, note 2.

(8) From Table II, note 2.
below 4.03 (4). Naturally, the existence of a free rate was not viewed favourably by the British authorities since it brought to light a serious imbalance in sterling with respect to the dollar which London strove to the last to prevent. This British opposition to a free rate is a point to be borne in mind, because, as indicated below, it exercised afterwards an appreciable influence on the course of trade between Italy and the Sterling Area.

2. — Reliable figures on trade with the Sterling Area as a whole are not available even for 1946 but it is known that trade with the United Kingdom showed a surplus in favour of Italy of nearly 6,000,000 lire (5). In any case, at the end of 1946, Italy was a creditor of the United Kingdom, for all transactions with the Sterling Area, to the extent of about 2,820,000 lire (6). Utilization of this credit was very difficult owing to the scarcity of needed goods on the British market while the allocation system left only the slightest possibility of purchasing in other countries in the Area (7). On the other hand, this problem was not to be relieved by the coming restoration of convertibility of sterling because convertibility was to apply only to sterling derived from current transactions.

Early in 1947 an Italian mission visited London to discuss the problem with the British authorities and to attempt to secure the unification of sterling and dollar rates, which was a matter of considerable importance to the Italian Exchange Office, but the dollar rate rose relatively more than that of the pound and the other sterling currencies, after first touching 2.97, declined substantially more in the following months. Meanwhile, the sterling-dollar cross-rate on the black market was lower, keeping continuously below 2.8 (See Table 10).

(4) Both the dollar and sterling rates on the free market are considerably above the rates on the Italian Exchange Office, but the dollar rate rose relatively more than that of the pound and the other sterling currencies, after first touching 2.97, declining substantially more in the following months. Meanwhile, the sterling-dollar cross-rate on the black market was lower, keeping continuously below 2.8 (See Table 10).

(5) According to British sources, British imports from Italy in 1946 amounted to £43,000,000. Imports and vegetables accounted for £1,319,000, while British exports to Italy were only £6,854,000, with a deficit of £14,465,000. Italian sources (Central Statistical Office) give Italian imports from U.K. at £4,895,000, lire and exports from Italy to the U.K. at £6,085,000. At the rate of 4.03 lire to the £1, these figures show only minor differences.

(6) The figure of 2.820,000 lire includes some financial items not included in Chart 1.

3. — The suspension of convertibility put a problem of our sterling balances and our trade with the Sterling Area on a bilateral basis. It will be relevant however, before dealing with this development, to refer to the exchange structure in Italy.

The end of 1946 witnessed a violent surge in the inflationary tide which continued with increased momentum in the early months of 1947 until it was checked by the so-called Inaudi policy (8). The index of wholesale prices, which in October 1946 still stood at 3,776 (1938 = 100), reached its highest point in September 1947, touching 6,022. The industrial price index rose from 87 in October 1946 to 1,116 in May 1947 (1938 = 100). From May the Stock Exchange underwent a setback, anticipating the general price recession which set in after September 1947. The foreign exchange market showed a similar trend to the Stock Exchange (9). The free market, sterl, after having touched 2,000 in September-October 1946 fell to 1,522 (6) in December 1946. Early in 1947 it began rising again, reaching its highest level in May (2,315). Black market rates rose almost uninterruptedly from May 1946 (9.93) to May 1947 (2,315) (See Chart 2).

After this inflationary spurt, the Italian Exchange Office buying rate (2.85 to the dollar and 907 to the pound) appeared completely unreal. Accordingly, on 1 August 1947, the official dollar rate was raised to 3.50 and the official pound rate correspondingly to 1,411 lire. The sterling/dollar cross-rate of 4.03 was thereby maintained.

Meanwhile, on the free market the anticipation of sterling convertibility had increased the value of sterling with respect to the dollar, bringing the cross-rate between the two currencies near the official one. In June it eased to 2.96 but in July doubts on the success of the British attempt caused a weakening to 3.77 (10). Naturally, with the suspension of convertibility, the dollar was liked less. And all interest or justification on the part of Italy in supporting the sterling "free rate" had disappeared. Convertibility into dollars of both our balances and our current earnings having become impossible, we were confronted once more with the problem of applying appropriate measures to bring our trade and payments with the Sterling Area into balance. This problem was a delicate one because our imports consisted of essential commodities, while our exports, particularly those to the U.K., consisted to the extent of 90 percent of manufactured and semi-manufactured articles, and for the rest of fruits and vegetables, handcrafts, marble, etc., that is, of "non-essential" products.

6. — The exchange system introduced in Italy in November 1947, based on fluctuating exchange rates, was intended to further the recovery of equilibrium. Under the new system, the lire rate for the U.S. dollar, the British pound and the Swiss franc had to be completely determined by free market forces. Therefore, the official lire-dollar rate was no longer pegged to the lire/dollar parity. The cross-rate of 4.03, which had continued in force until then, at least for 90 percent of the sterling acquired by the Italian Exchange Office, was entirely abolished (See Table 1, col. 5 and 7).

The introduction of a fluctuating exchange rate could not but arouse objections and reservations from the British authorities. In January 1948, when the sterling/dollar cross-rate on the Italian market fell to 2.84, the London financial authorities canvassed the necessity of...
raising the sterling rate to its official parity in order that Italy might continue to be included among the Transferable Account countries. The British request was not accepted and Italy joined the group of «bilateral countries», which meant that the authority of the Bank of England would be required for practically every transaction with the sterling area countries. The Report of the Bank of Italy for 1947 commented on this subject as follows (11):

«The fact that the Bank of England requested that the Italian lire be treated as a «bilateral currency» is a step in the right direction, but it is not yet certain that the result will be to reduce the trade deficit.»

As the Report of the Bank of Italy stresses that coal had to be the balancing commodity in the trade between Italy and the Sterling Area, it may be useful to glance at the present position. As Table III shows, in 1953 Italy's trade balance was unfavourable both with respect to the United Kingdom (140m. lire) and with respect to the Sterling Area as a whole (1490m. lire). Since 1945, on the other hand, the balance with the United Kingdom has always been favourable. From 1945 to 1948, coal was virtually absent from British exports to Italy whereas in 1953 coal imports were 2.2 million tons, valued at 355,117,000 lire, or 59 percent of all our imports from the United Kingdom. Without the coal imports, it would have been possible in 1953 also to have a surplus in our trade balance with the United Kingdom, which would have largely offset our deficit with the Sterling Area as a whole. In the post-war period, however, the trade balance with the United Kingdom has been reversed while our trade with other countries of the Area has taken a very irregular course which has accentuated, rather than offset, our creditor position vis-à-vis the United Kingdom.

7. — The fluctuating exchange rate introduced in November 1947 did help materially in paving the way to a more balanced position in the trade relations between Italy and the Sterling Area. It achieved this in spite of the advent of a factor with a completely opposite influence, though of tremendous benefit to our economy, namely, the beginning of Marshall Aid, which naturally limited our purchases in the Sterling Area.

It is roughly estimated that Italy's trade balance with the Sterling Area in 1954 closed with a deficit of 10,000m. lire, made up of a surplus of 25,800m. lire with the United Kingdom and a deficit of 13,800m. lire with the other countries in the Area. At first sight, these figures might suggest that Italy had to face a deficit problem rather than a surplus problem, but this would be incorrect for two reasons. First, it will be remembered that 1954 was a «black year» for Italian exports owing to the growth of inflation in a period of partially pegged exchange rates. By comparing the deficit in the trade balance with the more serious general trade deficit it was easy to argue that a return to a more stable business situation in Italy would have brought about a surplus in our favour in trade with the Sterling Area (2a). Secondly, in 1954 total sterling payments were very different from the


(10) The percentage of the credit items to the debit items in the Italian trade balance was 36.5 for the general trade balance and about 84 for the sterling balance.
trade balance. The former closed with a surplus in favour of Italy of £1,406, but, since an almost equal sum was disbursed in pay- ments of an exceptional character, our credit in London at the end of the year was practically the same as at the total at the end of 1946 (13).

In 1948, as was to be expected, there was a material improvement in our trade balance with all monetary areas. The percentage of exports to imports rose to 69. In absolute figures, the net improvement was 339,100m. lire. The sterling trade balance showed a surplus in 1948 of 17,600m. lire; the net improvement over 1947 was thus 27,600m. lire. Our credits in London, on the other hand, showed a decline to be attributed to a great extent to a substantial reparation of capital. This return of capital to Italy was a result of the stabilization policies, which succeeded in arresting deflation in September 1947, and was greatly encouraged by the facilities then granted for the return of capital. Imports dropped to £2,800m. lire.

Towards the end of 1948, however, the re-establishment of the official sterling/dollar parity was accepted by the authorities from our imports from the Sterling Area and gave a new impetus to our exports.

The return of sterling to the official cross-rate with the dollar. Italy again a Transferrable Account country (November 26, 1948). The devaluation of sterling (September 1949).

8. As is known, on 16 October 1948 the 16 participating countries signed in Paris the first agreement on inter-European pay- ments, which for the purpose of facilitating reciprocal trade, established the so-called "cross-rate". In the discussions which took place at that time regarding the distribution of Marshall Aid, it appeared that Italy insisted that the United Kingdom should concede drawing rights up to £250m. This request was based on the expectation that transactions between Italy and Sterling Area would shortly return to their traditional pattern, which is a debit in Italy (15). The figure of £250m. represented the expected deficit for the period of the agreement (16 October 1948 - 30 June 1949). For their part, the British requested that the lire/sterling rate should be brought line with the official sterling/dollar parity; this would have permitted Italy to repay the Transferrable Account countries and therefore to use sterling freely within the scheduled territories. Probably, in support of the British request there were motives of a political character which permitted no alternative.

Eventually, an agreement was signed in Rome on 26 November providing as follows:

The Italian Exchange Office was to quote the pound on the basis of the dollar quotation on the Italian market and of the dollar rate fixed in London by the Bank of England (16). Therefore, the pound was to be removed from the 5% percent free accounts. Italy was again to be included in the Transferrable Account countries. The United Kingdom was to facilitate Italian purchases in the Sterling Area to the fullest possible extent.

The concession of drawing rights and the revamping of sterling, unfortunately, proved to be contradictory measures. The revamping of sterling in time of fire removed all possibility of making use of the £250m. for which drawing rights were granted. It soon became evident that the granting of drawing rights by Italy to the United Kingdom would have been more appropriate since, had this been the case, the increase in our credits in London would have had a favourable effect for Italy; it made more difficult the task of reducing our dollar deficit. With the aim of eliminating or at least reducing this deficit, the participating countries directed their purchases as much as possible from the dollar area to other monetary areas. But for Italy the check which the rate of 2,317 placed on purchases in the Sterling Area naturally resulted in greater purchasing in the dollar area (18).

This explains the criticism made of the agreement entered into in May 1949 between Italy and Great Britain in the framework of the second agreement for European payments (1949-1950). The demand for measures that would correct the marked disequilibrium in our commercial exchanges with the Sterling Area became more and more insistent whereas the agreement of May 1949 provided none. The expectation of a volume of trade between Italy and the Sterling Area (76m. of imports and £74m. of exports) seemed very unrealistic.

9. In September 1949 the devaluation of sterling was interrupted in this state of affairs. The lire-pound rate fell at first to 1,772 from 2,317 and subsequently, following the dollar rate, to 1,748-1,749 (19). Thus, the devaluation of the pound with respect to the lire, after the initial period of adjustment, was about 24 percent. For Italy, the devaluation of the pound was very damaging owing to the size of the existing sterling balances in London. To this was added the preoccupation whether the devaluation itself and the adjustment chosen for the Italian lira would cause a serious reduction in

(13) In 1947, i.e. £ 83m. was paid for war surplus stores, as provided for in the agreements of April 1947. £ 33m. was paid to France for the cooperation accorded with France, and £ 3m. was paid to countries in the dollar area (see Report of the Bank of Italy for 1947, p. 138).

(14) It is very probable that the stability of our sterling credits, notwithstanding the decline in the trade balance and the credit easing, is due to the reluctance of Italian capital firms to finance inflations.

(15) France's imports were allowed in specific areas (the imports under the act to ask for an allocation of foreign currency and to open credits in Italy to the foreign importer). These credits were granted in the form of credit balances held abroad. See Centro Italiano, Exchange Rate Structures and Price Level in Italy: 1947-49, in this Review, No. 1, July 1949, p. 198 ff.

(16) The United Kingdom entered the agreement as the Sterling Area.

(17) The rate of the dollar in Italy in July 1949, before the agreement was about 275, at the rate for the pound rose to about 2,317. Inevitable result with sterling at 2,317 lire — would have had at least the counterpart of $1 in the United States (17).

(18) The underlining of the lira had another unfavourable effect for Italy; it made more difficult the task of reducing our dollar deficit. With the aim of eliminating or at least reducing this deficit, the participating countries directed their purchases as much as possible from the dollar area to other monetary areas. But for Italy the check which the rate of 2,317 placed on purchases in the Sterling Area naturally resulted in greater purchasing in the dollar area (18).


(20) Except for changes of a technological character, the lira-pound exchange rate was not revised after the September devaluation. There was, however, a change of some importance in the lira-dollar exchange rate. The rate for the 90 percent which was to be exchanged to the Italian Exchange Office was no longer fixed according to the average rate recorded on the free market during the preceding week but according to the average of the previous day. The lira fell from 695 to 635 lire and subsequently fell to 625 lire.

Hence, if the pretax devaluation of the lira was P percent after becoming effective after some fluctuations by P percent on the average.
our exports—particularly to the Sterling Area and to create a new obstacle to trade with the dollar area.

These considerations were not groundless. Trade with the Sterling Area, which, as we have seen, showed a surplus in our favour in 1949 of £45,400,000, fell, resulting from imports of 152,000,000 lire and exports of 157,300,000 lire, although a surplus in 1950 but of much smaller proportions, 81,100,000 lire, resulting from imports of 205,000,000 lire and exports of 217,000,000 lire. But the maintenance of this small favourable surplus was made possible only by the compensating effect of the process of trade liberalization which helped materially our exports to Great Britain. It is significant in this respect that in 1949 the Italian surplus with the United Kingdom had increased over 1949 (55,700,000 lire against 23,700,000 lire) while the surplus with the Sterling Area was changed into a deficit (from 14,700,000 lire to 23,500,000 lire) (20).

The post-Korean situation. Transactions between Italy and the Sterling Area under E.P.U.

11. In the second half of 1950 two new factors came into play, modifying the structure and trend of transactions between Italy and the Sterling Area. These were the setting up of E.P.U. and the Korean outbreak.

Table IV shows the course of the Italian and British monthly balances in E.P.U. for the period July 1950 to November 1951, and the positions of both countries with respect to other members of the Union (21).

(a) In 1950, with the aim of increasing imports from the Sterling Area, Law No. 258 was passed dated 28 April authorizing the Treasury to obtain securities from the Exchange Office up to L 5,000 for the financing of purchases of machinery, equipment and implements in the Sterling Area by Italian industrial and agricultural firms.

(b) Italy was assigned a quota in the E.P.U. of £ 32,000. (all credits, £ 10,000,000 sterling) composed of £ 11,250,000 (35,000,000 lire) in credits and £ 1,250,000 (9,000,000 lire) in gold or dollars. As is known, the British quota is £ 7,700,000.

The maximum financing margin granted by Italy to the several purchasing countries before the setting up of the E.P.U. varied from 15.000 lire to 30,000 lire in sterling sterling, according to the margin of the Sterling area, with respect to which reciprocal credits were formally extended. On the 26 June 1950, 250,000,000 lire in sterling balances were transferred to sterling balances in sterling balances arriving from multilateral cleargages corresponding to the balances created by the debit and credit positions in which the Sterling Area is subject.

(Italy's Trade with the Sterling Area, 1949-1951)
in 1951 to cover our requirements by imports from Germany, Poland and the United Kingdom and we were obliged to import once again from the United States.

The analysis of the problems which this situation presents to the Italian government and the governments of other interested countries lies beyond the limits of this survey, as do the possible developments of the present situation, which, in any case, are difficult to foresee owing to rapid changes from a creditor to a debtor position and vice versa (26). For their part, the Italian authorities have taken some number of steps to increase imports (29), while, on the other hand, measures that might discourage exports have been avoided since these might have a serious impact on the internal economic situation, characterised by idle industrial capacity and mass unemployment.

(26) The principal steps are:

(29) Scrips resolutions: cottons debits have been reduced by 25 percent and consequently the average of redenominated scrips has declined from 18.4 to 16.2 percent.

(30) Credit facilities for importers: the Italian Exchange Office still grants credits at a total of $2,000,000, with interest at 2.5 percent, to those wishing to purchase on foreign markets. These credits are for a period of six months.

(31) State purchasing: appropriations for government purchases of foodstuffs and raw materials have been increased from 200,000,000 to 350,000,000 lire.

(32) Liberalisation for invisible debit items (trade allowances of foreign exchange, travel, etc.).