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An Example of Countertrade: The Anglo-Italian Clearing*

World trade and payments are predominantly multilateral; but the last ten years have seen the growth of barter agreements which aim at some form of clearing.[1] According to some estimates, up to a fifth of world trade is now carried out in this form.[2] This practice stems from imbalances in international accounts due to export difficulties, heavy foreign debt, or excess capacity which may thus be put to use. In a different context and to a different extent, these very same problems led the principal European countries to forms of bilateral exchange some fifty years ago.

Restrictions on trade, arrangements to pay off financial arrears, and the choice between current trade and financial claims all affect employment, output, and the political trustworthiness of the governments concerned. It is therefore interesting to examine the origins and the organization of barter when it becomes the general regulatory trading system, as it did in the 1930s. This article studies the relationships between Italy and Great Britain from 1932 to 1940–an extremely complex and unstable time, in which the rapid ebb and flow of contractual power made any attempt to control trade difficult.[3]

1. *Clearing agreements*

Clearing is a way of settling bilateral trade without any movement of reserves. It was introduced in the autumn of 1931 in the wake of increased payment restrictions in the Danube region. The countries in this area were in debt to western European

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creditors, and very much dependent on each other. The accumulation of unpaid trade debts disturbed trade among the debtor countries, as well as their relations with western Europe.

Clearing was proposed in November 1931 by the representatives of the Austrian government at the Prague Conference sponsored by the Bank for International Settlements.[4] In the following months and throughout 1932 several agreements were reached between countries in southeastern Europe operating exchange controls, and between those same countries and western creditors. Creditor countries witnessed an accumulation of frozen commercial credits, while their investors suffered from moratoria on transfers decreed by debtor countries.[5] In these cases clearing often aimed to recover the credit through a surplus in the merchandise account.

In many cases, the debtor had a favorable commodity balance with the creditor, but was unable to pay the credit. Indeed, even in the face of a trade surplus, the central bank could lack foreign currency, because exports were financed with long-term credit or because export earnings were left in the foreign country as a hedge against devaluation. In addition, the earnings on sales abroad were occasionally used to acquire debt certificates in order to take advantage of temporarily revalued exchange rates.

The procedure by which the clearing agreements were imposed was fairly simple: payments were blocked in order to induce the countries with exchange controls to negotiate the agreement. Payments were then centralized in special institutions or in the central banks which collected the sums paid by the importers in the national currency, and paid the exporters out of these amounts upon verification that the foreign purchasers had paid to their own center the amount due. The exchange rate was either the official rate or a negotiated rate. Generally speaking, the sums paid into various accounts did not bear interest.

Clearing-and-payment agreements considered the payment of arrears and of financial claims as well as trade. Obviously, the more the creditor country's balance of trade is passive, the more it can force the situation and recover any old outstanding credits.

The clearing-and-payment agreement differs from the clearing one in that the creditor country places at the disposal of its exporters only a part of the currency paid in by its importers; the remainder is assigned to the amortization of old trade or financial debts. To this end the outstanding balance is placed at the disposal of the central bank of the debtor country. Some countries also negotiated pure payment agreements; these involve the normal method of payment in foreign exchange.[6]

From 1932 onwards, clearing agreements spread rapidly throughout continental Europe; in 1937, they covered some 35% to 50% of those countries' merchandise trade.[7] Latin American countries (Brazil, Chile, and partly Argentina) also negotiated clearing agreements with European countries but rarely adopted this system among themselves.

Tables 1 and 2 show the distribution and importance of clearing agreements during the 1930s. Their rapid development may be largely attributed to Germany and Italy, two countries that maintained strict import controls. Indeed, the success of a clearing agreement depends on a certain balance between the imports and the exports of the contracting parties. This balance is not automatic. It could be brought about through the accumulation of frozen debts but this is ineffective when demand is depressed and pressure to sell is intense. Several nations, such as Germany and Italy, thus introduced quantitative controls over the movement of goods. Other nations, such as France and Belgium, witnessed instead a rapid growth in frozen credits, and turned quickly from clearing to payment agreements.

Table 1
Clearing and Payment Agreements of the Major European Countries

	In Force in June 1936			In Force in January 1939		
	Clearing	Clearing and Payment	Payment	Clearing	Clearing and Payment	Payment
	(1)	(2)	(3)	(4)	(5)	(6)
Belgium	1	9	3	1	7	5
Bulgaria	4	9	—	7	10	—
Czechoslovakia	7	3	0	4	5	1
Denmark	1	—	—	2	1	1
France	3	7	0	1	4	7
Germany	15	13	4	21	7	7
Great Britain	2	2	3	1	3	5
Italy	12	4	1	19	4	2
Holland	1	5	1	1	5	2
Poland	2	—	—	7	1	1
Rumania	3	14	0	4	10	2
Spain	3	6	0	2	8	0
Switzerland	—	9	1	2	8	2
Yugoslavia	4	7	0	5	6	3
Total	58	88	13	78	79	35

Source: M. Gordon, *Barriers to World Trade: A Study of Recent Commercial Policy* (New York, 1941), pp. 130-31.

The United States did not engage in clearing, but adhered unconditionally to a multilateral system of payment based on private enterprise and on equal treatment of the contracting parties. In addition, the United States had a strong and structurally favorable balance of trade with many European and Latin American countries, and could not "impose" credit payments on them.[8] The American government could have attempted to defend private creditors, as many European governments did in the same period; yet because of its recent formation, America's financial market probably lacked the internal cohesion needed to adopt a negotiating policy on private credits and properly represent the creditors' interests.

Great Britain adopted a more pragmatic attitude than the United States.[9] Until 1932, the treaties signed during the great crisis with Rumania, Turkey, and Yugoslavia restricting the movement of goods did not discriminate among countries and kept alive the idea of multilateral trade. However, after 1932, Great Britain sought actively to derive the maximum advantage from the situation of the individual contracting parties. It was openly declared, in agreements with Denmark, Estonia, Finland, Lithuania, and Poland, that "the aim of the agreement is to balance trade relations bilaterally by increasing British exports."[10] When minimum trade quotas were used Britain attempted to negotiate special concessions for coal in almost every agreement,[11] discriminating as much as possible against other countries, in an effort to relieve the difficulties of her coal-producing areas.[12] In any case, the negotiation of numerous payment and clearing agreements established by itself a network of bilateral preferential relationships tying sterling receipts from British imports to precise objectives. Indeed, Alfred Hirshman's study of trade flows calculates that Britain relied more on bilateralism than many other European countries, including Germany.[13]

Table 2

Shares of Trade Carried Out Through Clearing Arrangements in 1937 (percent)

	Imports (1)	Exports (2)
Belgium	3.9	3.7
Bulgaria	87.6	70.2
Czechoslovakia	28.7	30.3
Denmark	25.0	19.3
France	2.2	2.4
Germany	52.6	57.1
Great Britain	2.1	2.1
Italy	45.6	40.7
Holland	23.4	17.4
Poland	20.7	23.0
Rumania	74.9	66.7
Spain	32.0	59.4
Switzerland	36.0	28.4
Yugoslavia	61.0	49.0

Source: Adapted from Gordon, *Barriers*, p. 133, taken from *World Trade*, 11 (Feb. 1939).

2. *Towards a bilateral policy: the first Anglo-Italian talks*

In Great Britain the devaluation of the pound was accompanied by a drastic increase in protection: the Abnormal Importation Act was passed in November 1931 and the Import Duties Act the following April.[14] The first aimed to discourage speculative buying of goods while definitive measures were still at the discussion stage, and gave the Board of Trade the right to impose ad valorem duties of up to 100%. The second act proposed three kinds of tariffs: a general one of 10% ad valorem; taxes and exemptions for certain goods; and retaliatory tariffs. The same legislation created a special committee to suggest changes in rates, and in fact the first tariff increases were implemented immediately. Overall, protection was about 20.0% ad valorem for manufactured products; it reached 33.5% for several goods required for national security, but remained below 20.0% for foodstuffs and raw materials.[15]

Other important developments followed the 1932 tariff. The Ottawa Agreement (1932) established the principle of preferential tariffs for the British Empire. Complex bilateral discussions were initiated with all the principal countries both within and outside the Empire, with the aim in every single case of exploiting Britain's strengths through the use of discriminatory clauses. In 1934 the law empowered the government to introduce a clearing system unilaterally. This great novelty, for a free-trade country, meant that the British were entitled to prohibit direct payments to any given country; this was certainly threatened in the negotiations with Italy and Germany.[16]

The literature has emphasized that Italy's trade policy during the first years of the crisis was much less decisive than Britain's.[17] Following the devaluation of the pound in September 1931, Italy extended the possibility of import prohibitions to all goods, imposed a 15% ad valorem surcharge on imports (10% on coal), and introduced a series of retaliatory regulations against countries with currency restrictions.[18]

In the spring of 1934 a licensing system was introduced, initially for only three goods (copper, oil-seeds, and raw wool); within a year it had been extended to almost all imports. At first, for organizational reasons, the Ministry of Finance authorized the Customs to allow imports equal to a share (varying from 10 to 35%) of the 1934 imports documented by customs certificates. A licensing system based on prior authorization by the Ministry of Finance was introduced in 1935 and extended to a constantly increasing number of goods because of its greater flexibility.[19]

Currency restrictions began on the same uncertain path. At first these were left to the "moral suasion" of the bankers' association.[20] Not until December 1934 was a government currency monopoly established, in the form of the Istituto Nazionale per i Cambi con l'Estero (known as Istcambi), through which all currency purchases and sales had to pass.[21]

These regulations were administered from early 1935 by a new body, the Commerce Board; it was transformed a few months later into an undersecretaryship and two years later into a ministry. It was assisted by a special committee which first administered the import quotas, and later determined them; by numerous private bodies (such as the Cotton Institute and the Italian Association of Coffee Importers) that exercised specific legal powers under the Board's supervision; and by committees representing specific industries (oil seeds, cellulose and paper and

Table 3

Coal Purchases by the Italian State Railways

	Total (thousand tons)	Percentage Share			
		U.K.	Germany[a]	Poland	Others
	(1)	(2)	(3)	(4)	(5)
1930	3,333	29.2	70.8	—	—
1931	2,177	32.1	67.9	—	—
1932	240	54.2	45.8	—	—
1933	922	5.1	89.1	—	5.8
1934	3,386	0.6	84.4	10.8	4.2

[a] Includes reparations in 1930 and 1931.

Source: Memorandum by the Mines Department, Annex B, March 26, 1934, in the Public Record Office, London, Board of Trade Files (briefly, BT) 11/310; Memorandum enclosed in E. Drummond to J. Simon, March 12, 1935, in the Public Record Office, London, Foreign Office Files (briefly, FO) R 1956/2/22.

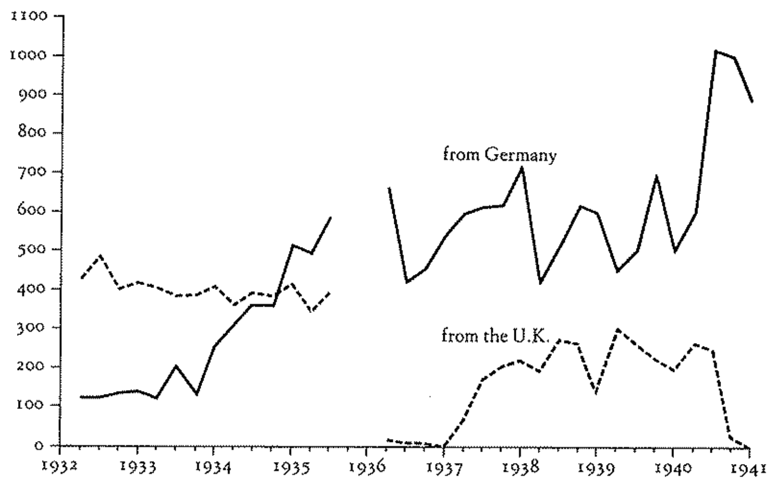
later wood, leather and hides, poultry and eggs, movies, and so on).[22]

Freed from the gold standard, the British were relieved of any remaining obligation to respect freedom of trade and exchange. Their tariffs reinforced similar tendencies abroad and opened the way to new devaluations and retaliatory tariffs. A few months after the passing of the Import Duties Act the British government sought new links with Italy. The Italian garment industry had been severely hit, and Britain feared that Italy would retaliate by not buying coal from Wales.[23] Actually, the Italian government put up with the British restrictions without protest for over a year, until German and Polish delegations offered favorable bilateral contracts to supply coal to the railways.[24] The government entered directly, and probably for the first time, into the negotiations, favoring the German and Polish offers:[25] Italy could buy from Germany through clearing and without spending foreign currency by drawing on Italy's frozen credit balance,[26] while Poland offered to take two ships from the Monfalcone yards.[27] All this obviously limited the market for British coal, which was of better quality but more expensive.[28]

The loss of the Italian market was evident by the second half of 1933 (see Figure 1 and Table 3), and it would get worse. The

Figure 1

Italian Coal Imports (thousand tons per quarter)



Source: Istituto centrale di statistica, *Statistica del commercio speciale di importazione e di esportazione*.

trading links between the two countries, as they had evolved in recent years, certainly did not put Great Britain in a strong position. It is true that overall Italy was only a marginal buyer and supplier for Great Britain;[29] but Italy was the second biggest customer for coal, buying 10% to 12% of the total exported at a time when total sales had dropped at least 30%.[30]

The 1920s had produced a reversal of the trade balance in manufactured products, and it was now in Italy's favor.[31] Italy exported goods that competed directly with British products (natural and artificial silk, clothing, and automobiles; see Table 4), and fewer foodstuffs and raw materials than in the first years of this century. Low-value-added products, such as coal, continued instead to dominate British exports.

In 1932, Britain's devaluation and tariff increases may have strengthened her position; but the advantage proved to be ephemeral. The structure of trade was against Great Britain, and the aggressive policies of the other main coal suppliers quickly undermined her strength.

Indeed, the preparatory documents for the negotiations with the Italian representatives reveal that the British viewed with concern any measure likely to extend their imports of Italian goods (hats, gloves, buttons, and artificial silk). They estimated that a slight reduction in their tariffs on these goods (25%, on average) would have cost some 2,000 jobs. On the other hand, if

Table 4

Composition of Anglo-Italian Trade (percentage shares of aggregate values, British data)

	British Exports to Italy			British Imports from Italy					
	Raw Materials	Manufactures		Foodstuffs and Tobacco	Raw Materials	Manufactures			
		Total	Machinery[a]			Total	Silk[b]	Vehicles[c]	Apparel[d]
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1910-13	49.6	45.4	9.0	30.3	19.1	49.6	10.5	10.0	1.8
1921-25	49.1	46.3	11.1	26.9	16.3	54.9	12.0	6.8	8.8
1926-30	44.8	49.5	13.3	27.7	16.9	55.1	13.3	4.1	12.4
1931-35	53.2	40.1	10.2	30.7	13.3	43.3	10.2	0.5	12.1
1937-40	64.0	29.9	9.3	42.5	17.4	39.2	4.0	1.6	4.7

[a] Includes ferrous metals.
[b] Includes artificial silk from 1926.
[c] Carts and carriages to 1913.
[d] Hats, bonnets, and gloves.

Source: H. M. Customs and Excise, *Annual Statement of the Overseas Trade of the United Kingdom.*

the Italian railways returned to their traditional policy of buying in Great Britain, a contract for one million tons of coal (half their total requirement) would have meant 4,000 more jobs for Welsh miners.[32]

In the spring of 1934, Board of Trade officials and the Italian commercial attaché in London, Giovanni Battista Ceccato, began exploring the possibility of a large shipment of coal for the railways (not immediately needed since inventories were high).[33] In exchange, there were to be substantial reductions in the tariffs on the main Italian exports to the United Kingdom.[34] The talks dragged on without success. The Italians found it cheaper to buy coal from Germany, and the British, fearing lively opposition in Parliament, were unwilling to reduce tariffs on competitive manufactured goods. Britain's agreement with Germany had been criticized in the House of Commons, though it secured several contracts for British coal.[35] In negotiations with Sweden, another industrially advanced nation, Britain encountered fewer problems because Swedish exports were not competitive with British products (55% of Sweden's exports were raw materials, and half of her exported manufactured goods were paper and wood pulp).

The Ministerial Decrees of February 16 and June 25, 1935, imposed restrictions on almost all goods imported into Italy, including coal, and worsened the position of British exporters. The quota was at first quite low: it was calculated as 35% of the imports in 1934, which were themselves two-thirds of the 1927-30 average, and thus equaled only 23% of average imports in the late 1920s. Because it was based on value, moreover, the real quota was further reduced by the intervening price increases.[36] The aim was obviously to direct trade to countries with clearing agreements: their exports were allowed in up to 100% of their 1934 value, and exempted from the licensing system.[37]

These initial quotas were subsequently loosened; but as a member of the gold bloc Italy was concerned to limit specie outflows and therefore penalized countries such as Britain (with which Italy had a deficit of 100 million lire in 1934 and whose import quota was fixed at 80% of the 1934 values) and France (with a deficit of 85 million lire and an 85% quota). On the other hand, imports from countries with which Italy ran a surplus or a limited deficit, such as Albania, Austria, Holland, and Switzerland, could reach 100% of their 1934 level.[38] Such a rigid import policy does not seem justified neither in view of the long-term balance of visible trade with Great Britain (which had been a surplus for a number of years) nor of the overall balance of payments (which determines the level of reserves, and places the problem of equilibrium in a more general context, since all commercial and financial items have to be considered).

3. *What is the deficit, and whose is it?*

The discussion of the balance of trade lends an almost surreal quality to Ango-Italian relationships: each country tried to show that it bought more than it sold and thus needed to boost its own sales. The British in particular directed their energies toward requesting that the coal quota be raised to 100%, perhaps leaving quotas on other goods at 80%.

The discussion concerned both visible and invisible items. From early in the century British trade statistics had recorded a balance of visible trade continuously in Britain's favor. Towards the mid-1920s the situation had changed, with occasional small deficits from 1925 to 1935. Overall, the 1920s and '30s witnessed a systematic increase in British imports, especially of natural and artificial silk and clothing (Table 4). The net balance remained in any case within acceptable limits, and hardly ever exceeded 10% of the value of exports or imports (Table 5).

To the Italian commercial attachés, who used their own country's statistics, the state of the commodity account appeared far greyer. Indeed, the Italian figures show a continuous deficit in the account from early in the century to the war (which agrees with the British figures), but then continue (unlike the British statistics) to show a deficit through the 1920s and '30s.

However, the import and export data on which the Italian office in London based its arguments were not in fact comparable, as the import values were gross, and the export values net, of insurance and freight. If the two countries' figures are both calculated f.o.b., the differences between them tend to disappear (Table 5).[39] The Italian deficit is then much reduced, and limited to two or three years.

On the other hand, the quantity figures in the two countries' statistics agree relatively closely (Table 6).[40] The differences therefore can be largely attributed to the values. The import figures are notoriously more reliable than those for exports.[41] A hypothetical balance of visible trade comparing Italian imports with British imports, both f.o.b., would show Italy in fairly constant surplus from 1931 to 1934 (Table 5), in line with the claims of the British delegation, and would certainly not justify Italy's

rigid negotiating position. A special commission was appointed to clear up this problem but it soon abandoned its task.[42] In fact, it appears that Italy was less interested in reconstructing a "true" goods account than in forcefully restating her own chronic deficit. The strenghts of Italy's argument were that the introduction of quotas had already put Italy in a powerful position;[43] that Italy certainly ran a deficit with the British Empire, and pre-

Table 5
Merchandise Trade between Italy and the United Kingdom (excluding transit trade)

	Italian Statistics (million lire)					British Statistics[a] (thousand pounds)			
	Imports		Exports	Balance	Equivalent Balance[b]	Imports		Exports	Balance
	C.i.f. (1)	F.o.b. (2)	(3)	(4)	(5)	C.i.f. (6)	F.o.b. (7)	(8)	(9)
1910-13	539	431	239	−192	−7,529	7,443	6,699	13,590	6,891
1921	1,680	1,411	795	−616	−6,353	8,890	8,001	16,937	8,936
1922	2,022	1,698	1,117	−581	−6,197	11,276	10,148	18,667	8,519
1923	2,204	1,851	1,211	−640	−6,427	14,294	12,865	19,408	6,543
1924	2,169	2,085	1,493	−592	−5,420	18,227	16,404	17,670	1,266
1925	2,728	2,291	1,852	−439	−3,618	19,289	17,360	18,835	1,475
1926	1,881	1,561	1,755	194	1,543	15,733	14,160	10,499	−3,661
1927	1,826	1,497	1,528	31	323	16,775	15,098	13,487	−1,661
1928	1,794	1,435	1,404	−31	−335	15,796	14,190	14,353	163
1929	2,040	1,710	1,461	−249	−3,168	16,800	15,120	15,999	879
1930	1,677	1,384	1,190	−194	−2,090	15,004	13,504	13,834	330
1931	1,099	889	1,201	312	3,714	15,147	13,632	9,916	−3,716
1932	743	593	736	143	2,092	10,762	9,686	8,638	−1,048
1933	727	588	689	101	1,585	9,138	8,265	9,050	785
1934	707	567	529	−38	−645	8,421	7,579	9,313	1,734
1935	568	471	431	−40	−673	7,901	7,111	6,799	−312
1936	52	43	156	113	1,601	2,231	2,008	533	−1,475
1937	561	471	641	170	1,809	7,739	6,965	4,942	−2,023
1938	728	611	587	−24	−248	7,122	6,410	5,719	−691
1939	568	477	518	41	481	6,529	5,876	4,799	−1,077
1940	419	352	276	76	−1,000	5,047	4,542	2,956	−1,586

[a] These occasionally include trade with Italy's possessions in the Aegean.
[b] Thousand pounds.

Source: Cols. 1 and 3 are from Ministero delle finanze, *Movimento commerciale del Regno d'Italia* and Istituto centrale di statistica, *Commercio di importazione e di esportazione*. Cols. 6 and 8 are from Board of Trade, *Statistical Abstract for the United Kingdom* and H. M. Customs and Excise, *Annual Statement*. Cols. 2 and 7 are obtained by deducting estimates of freight charges from cols. 1 and 6. Freight charges for Italian coal imports are estimated directly, using L. Isserlis, "Tramp Shipping Cargoes and Freights," *Journal of the Royal Statistical Society*, 101 (1938), pp. 53-146; freight charges for other Italian imports and for all British imports are estimated as 10% of the goods' c.i.f. values (see Note Prepared by the Statistical Department of the Board of Trade, March 28, 1935, BT 11/310). Cols. 4 and 9 are the difference between exports (cols. 3 and 8, respectively) and the corresponding estimates of imports, f.o.b. (cols. 2 and 7, respectively). Col. 5 is the lire balance in col. 4 times the exchange rate, from Banca d'Italia, *Adunanza generale ordinaria degli azionisti*.

ferred to reduce imports from Great Britain rather from India or Egypt; that Britain's claim that Italy ran a surplus was open to infinite objections, and if due to invisible items was in any case risky and uncontrollable.

As can be imagined, this uncertainty regarding visible trade was accompanied by even more discordant opinions regarding the "true balance" on invisibles.[44] The British estimate seems fairly accurate for the earnings from residents and tourists.[45] The Italian estimates were the more correct for capital income.[46] Overall the outcome was a balance in favor of Italy of more than one million pounds. The committee did not reach any startling conclusions here either, since the Italians insisted that visible trade was the only basis for establishing quotas.[47]

Although Italy's current account had long been in surplus, this did not mean that there was an accumulation of sterling. Apart from the deficit with the British Empire, Italian exporters readily offered long extensions for payment in order to leave money abroad and speculate on a fall in the exchange rate. For the same reason, British merchants who possessed Italian shares and bonds tended to sell them.[48] Hence, from late 1934 to early 1935, the British sold less in Italy because of the imposition of quotas; but at the same time what they did sell was not paid for because the Italian exports to Britain were not used only to pay for British goods sent to Italy, as would have been the case under a clearing agreement.[49]

Table 6

Merchandise Trade between Italy and the United Kingdom: Individual Goods

	Italian Exports to the United Kingdom								British Exports to Italy	
	Lemons (thousand quintals)		Leather Gloves (hundred pairs)		Marble (tons, excluding art work)		Sulphur (tons)		Coal and Coke (tons)	
	Italian Figure	British Figure	Italian Figure	British Figure	Italian Figure	British Figure	Italian Figure	British Figure	Italian Figure	British Figure
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1923-25	363	425	64,522	50,694	53,000	47,361	67,333	69,312	6,368	7,035
1926-30	502	503	54,670	57,932	42,848	42,531	47,186	46,441	6,173	6,164
1931-35	602	601	59,942	63,054	42,440	44,073	26,492	26,703	4,847	4,724
1936-39	294	283	19,570	20,635	32,227	32,298	27,456	24,841	1,789	1,825

Source: See Table 5, cols. 1, 3, 6, and 8,

4. *Payment agreements and the "voluntary" clearing*

The decree of February 16, 1935, which established the quotas, had particularly hurt coal exporters (see Figure 1). The Italian government admitted goods carried on ships that had already left port on February 19, but from then on trade was practically closed.[50] To meet this situation the British govern-

Table 7

Britain's Balance of Payments with Italy in 1934: Current Account (thousand pounds)

	Italian Estimates		British Estimates	
	Credits (1)	Debits (2)	Credits (3)	Debits (4)
Exports, c.i.f.	11,815			
less: freights	2,186			
Exports, f.o.b.	9,629		9,331	
Imports, c.i.f.				8,536
less: freights				854
Imports, f.o.b.		9,007		7,682
Silver, bullion, specie	50	30	50	30
Second-hand ships	225		225	
Subtotal, visibles	9,904	9,037	9,606	7,712
Tourists	250	1,250	200	2,200
British colony in Italy	100	250		900
Insurance	975			
Freights and bunkering	2,250	600	1,450	950
Interest and dividends	800		300	200
Bank commissions	120			
Brokerage	280			
Royalties	500			
Subtotal, invisibles	5,275	2,100	1,950	4,250
Balance on current account	+ 4,042		−406	

Source: Calculated from scattered estimates in notes dated Nov. 11, 1934 and March 11, 1935, BT 11/311; Sub-Committee on Invisibles, April 8, 1934, and Sub-Committee on Visibles, April 5, 1935, BT 11/351; Note Prepared by the Statistical Department of the Board of Trade, March 28, 1935, BT 11/310; "Italy Coal Freights," March 29, 1935, BT 11/349; "Balance of Payments between Italy and the United Kingdom," March 12, 1938, Annex A, BT 11/351, on tourists' expenditure, estimated as 55% of that in the 1920s; and the diplomatic correspondence relating to the inquiries on the expenditures of British residents in Italy, BT 11/356. See also Telegram to Mr. Ingram from Acting Secretary of State, April 11, 1935, BT 11/351, which agrees with the Italian estimate of interest and dividends.

ment authorized its embassy to conclude a temporary agreement by which British imports were allowed up to 80% of their 1934 value (on an annual basis) on presentation of a customs certificate. The Italian government undertook to collect from Italian exporters the sterling received, and to use it to pay for imports and for freights on British ships.[51] The Italian importer paid off his debt by depositing the equivalent sum in lire, so that the risk of a currency devaluation was borne by the British creditor.[52]

This agreement was reached with difficulty. It had the personal support of Mussolini,[53] who exposed all the weakness of the British position.[54] Britain's ambassador, Sir Eric Drummond, noted that the British position was all the more fragile since the Empire also clearly ran a visible-trade surplus with Italy, and the Italians persisted in considering the British Empire along with the United Kingdom.[55]

Although the provisional agreement of March 1935 allowed trade to resume, it was unsatisfactory for several reasons: the quota was in fact based on the Italian merchandise balance (imports c.i.f., exports f.o.b.) of 1934 without considering invisibles;[56] the quota did not guarantee that the Italian authorities would collect the money from the Italian exporters;[57] and British exporters were left with a considerable exchange-rate risk.[58]

A month later the provisional agreement was replaced by a "voluntary" or "unilateral" clearing system. A Lire Account was established with the Istituto Nazionale dei Cambi con l'Estero in Italy, and a Sterling Account with the Bank of England. The Italians were compelled to pay into the Lire Account, while the British were not compelled to deposit sterling in the Bank of England. The exchange risk was on the Italian importer until the British exporter received sterling (when his turn came up, in chronological order).[59] Freight charges incurred before March 18, 1935, were settled outside the clearing framework.[60] In fact, such a voluntary system is hardly a clearing arrangement. The Board of Trade repeatedly encouraged its own exporters to use the Sterling Account, but without success.[61]

As the following months would show, the agreement was unworkable. The Italian exporters paid only a small part of their credits into the Lire Account, preferring to defer payment in order to keep the money as long as possible in London in anticipation of a devaluation.[62] On the other hand, the Board of Trade estimated that half of the British importers ignored the Sterling Account and paid directly with checks in lire, which were bought on the black market at a discount on the exchange

rate.[63] Despite the controls, the commodity account continued to be unfavorable to Italy, with a negative balance of more than a million pounds sterling in the first six months of 1935 (one and a half times the balance of the same period of 1935).[64] The account held at Istcambi showed a cumulative deficit of 500,000 pounds in June and of 1,500,000 pounds in September: in three months outstanding debts had grown to equal two months' imports (see Tables 5 and 8), with delays in payment of about 120 days.[65]

The Foreign Office commented, "we knew at the time that it would be a lame duck but the Treasury view was that it was better than no duck at all."[66] From the outset the Foreign Office had been keen on accepting the Italian offer of bilateral clearing, while trying to reopen discussion on quotas and licenses. The Treasury and the Board of Trade, however, were decidedly opposed to it on the grounds that clearing would drastically reduce prospects for British exports; but here they underestimated the faulty operation of controls on financial movements.[67]

Table 8

Situation of the Bank of England's Account at the Istituto Nazionale Cambi (cumulative values, in pounds)

	As of June 16, 1935 (1)	As of Sept. 18, 1935 (2)	As of Dec. 24, 1935 (3)	As of June 10, 1936 (4)
Declared credits of Italian exporters	1,351,383	2,690,382	4,932,787	5,153,887
Paid credits of Italian exporters	644,274	1,974,788	3,547,270	4,093,042
Outstanding	707,109	742,594	1,383,517	1,060,845
Total amount of declarations by Italian importers	1,840,043	4,197,970	6,216,122	6,421,372
Checks issued to Italian importers	643,207	1,940,841	3,495,525	4,027,964
Outstanding	1,196,836	2,257,129	2,720,597	2,393,408
Applications for checks from Italian importers not yet granted through lack of sterling	1,035,891	1,028,064	1,463,932	1,300,337
Difference[a]	169,944	1,229,063	1,256,644	1,093,070

[a] The small discrepancy is attributable to bank commission and exchange rate movements.

Source: "National Institute for Foreign Exchange Situation on . . .," FO R 3981/2/22, R 6434/2/22, R 7825/2/22; "Weekly Statement of Account Furnished by the National Foreign Exchange Institute at Rome. Situation," June 16, 1936, BT 11/536.

This agreement also envisaged the possibility of private barter outside the clearing system and without incurring the quantitative limits set on Italian imports. This was little more than window dressing. Private barter began a few months before the declaration of sanctions, but never amounted to much.[68] It was a kind of arrangement that, through its very nature, required complex organization. The summaries of compensation requests held in the archives of the Board of Trade show that their total value reached only a few tens of thousands of pounds.[69]

Sanctions against Italy were decreed by the League of Nations on November 18, 1935. The aim was to create a great imbalance in Italy's international position, rapidly exhausting her gold reserves and thus undermining her ability to sustain a war.[70]

In practice, none of the League's aims were met quickly enough to lead to the desired result. There already existed in Italy a control mechanism that allowed strict limits on imports and even a threat of retaliation against the countries imposing sanctions.

During this time, clearing ceased to operate. In November a controller of Anglo-Italian debts was nominated, and all debts dating from before November 18, 1935 had to be paid into the Sterling Account at the Bank of England.[71] The total amount held in this account was paid to British creditors for goods sold previously and for freight services. The Board of Trade estimated credits from before March 3, 1935 at half a million pounds, and those under the agreement of April 1935 at 2 million pounds or more. Adding financial credits and credits with third countries, the overall total was about 4 million pounds.[72] Of this the controller of the Anglo-Italian debt may have recovered about 15%.[73]

According to the Italian statistics, from December 1, 1935 to July 31, 1936 net exports (excluding the colonies) fell by 500 million lire, but reserves fell by 2,500 million lire because invisible earnings ceased and foreign credit was suspended.[74]

The end of sanctions left Italy with a heavy military (and hence monetary) commitment abroad, reserves reduced to zero and therefore the prospect of a rapid devaluation, and debts estimated at 15 million pounds; of these, two-thirds were outside clearing and thus very difficult for the creditor to recover.[75]

On the other hand, the countries that had imposed sanctions showed their desire to conclude clearing or payment agreements as soon as possible, buying at any price in order to recover their credits. Since the Royal Decree of November 20, 1935, declared the debtor free from his obligation when he had deposited the sums due in lire at Istcambi (where they were frozen), the exchange risk was transferred to the creditor.

Italy's position was strengthened by her high debt, by the possibility of discriminatory measures against the countries that imposed sanctions,[76] and by the risk of devaluing debts by 30% or 40%.[77] The creditor countries had been united during the sanctions in the Coordination Committee of the League of Nations, but now their united front quickly disintegrated.[78] Each country chose to act individually: not to recover past credit, for which joint action might perhaps have been best, but to resume selling before any of the others. They were, in fact, export competitors; and they tried to regain their positions on the Italian market, having been largely displaced by Germany and the United States, who had sold for cash in advance during the sanctions and were therefore not burdened in the 1937 market by any financial arrears.[79]

Belgium thus sold Italy some shipments of coal, threatening otherwise to expel Italian workers from her territory.[80] France tried to foster new trade by disregarding arrears. In Great Britain a similar position was taken by the Board of Trade, who tried to suggest bilateral compensations (lemons against coal).[81] Priority would be given to new trade,[82] while arrears would have been settled over a long period by issuing bond certificates in London on behalf of the Italian government and paying British exporters with the proceeds.[83] A loan might have been attractive, given the very serious nature of Italy's currency situation, and the only possible source was London.[84] Yet neither Felice Guarneri, Minister of Trade and Foreign Exchange, nor Vincenzo Azzolini, Governor of the Bank of Italy, favored this solution.[85] The Bank of England also opposed it, fearing that it might weigh down the home market. A satisfactory solution, however, was not easy to find. Private compensations would have damaged small exporters and favored large ones. A payment agreement with a gradual recovery of credits could have been easily broken (as had happened before); a clearing, with a revalued exchange rate, would have rapidly increased arrears and thus made the situation worse rather than better.[86]

5. *The new clearing and the recovery of debts*

On average the agreements in force between Italy and the other countries dedicated no more than 15% of current income to the payment of old debts.[87] The British, however, demanded that half of the receipts should be held for this purpose.

Because of Britain's inflexibility, the negotiations dragged on, and Great Britain was one of the last countries to resume trade with Italy. The clearing agreement was signed on November 27, 1936. As in the old agreement, two accounts were instituted, the Lire Account in Italy and the Sterling Account in Great Britain; but these were now divided into sub-accounts.[88] The pounds sterling paid by British importers into the Sterling Account were allocated as follows:

1) 18% to the Sterling Arrears Account A, for payment of Italian debts for goods and freights incurred from March 17, 1935 to November 18, 1935 (the period of the previous agreement).
2) 9% to the Sterling Arrears Account B, for payment of the same from the pre-agreement period (before March 17, 1935) and the period of sanctions (November 17, 1935 to July 6, 1936).
3) 3% in the Sterling Arrears Account C, for financial debts and payments.
4) 70% in the Sterling New Account for current trade after July 14, 1936, with priority for the payment of freights.

Hence, 27% of the sterling paid in was to pay up arrears of a commercial nature. Any surplus not used for current trade was to be transferred for the same purpose at quarterly intervals. Once the arrears were paid, any surplus accumulated in any sterling account would be transferred from A to B or from B to A, and subsequently from these to C, and then finally to the Sterling New Account (Article 5). This underlined the commitment to settling the arrears before resuming trade.

Similarly, sub-accounts were opened in Italy to collect the lire paid by Italian debtors and to allocate them to the creditors. The Lire Arrears Account A absorbed any residual funds from the Lire Account and handled claims dating from the preceding agreement; the Lire Arrears Account B handled claims from the pre-agreement and sanctions periods; the Lire Arrears Account C handled financial claims; and the Lire New Account handled current trade. Since there existed an overall Italian deficit, there was no problem regarding the allocation of lire, which were entered into the account to which the transaction referred. Should a surplus appear on the Italian side (as would happen during the last months of 1937), sterling would be left over for the Istituto Nazionale Cambi.

The exchange rate was the official rate of the day as quoted in

Rome, and the exchange risk for late payment was left with the Italian debtor. However, trade arrears, for which the exchange risk was on the creditor (Ministerial Decree of November 20, 1935) were paid at the fixed rate of 64.46 lire to the pound (article 3.2), with a difference of 28-30% compared to the official quotation.

In order to generate sufficient sterling to pay the arrears and current transactions, a commercial agreement was signed on the same day, setting strict restrictions on the main British exports to Italy (by value, on a three-month basis) so as to limit sales and quickly create a surplus for Italy.[89]

In 1937, the resulting trade surplus was almost 200 million lire (2 million pounds).[90] This surplus allowed a quick recovery of ar-

Table 9

The Anglo-Italian Clearing, 1937 to 1940 (thousand pounds)

		Clearing Office Receipts	To Export Cover			Clearing Office Allocations		
Payment Period	U.K. Imports, C.i.f.[a] (1)	Total (2)	Total (3)	Percent (4)	U.K. Exports, f.o.b., plus Freights[a] (5)	Current U.K. Exports Paid (6)	Arrears Paid[b] (7)	To Istcambi Free Account (8)
April 1, 1937 to Sept. 30, 1937	3,770	3,395	2,821[c]	71	2,177	2,427	1,544[d]	0
Oct. 1, 1937 to March 31, 1938	4,167	3,085	2,441		3,374	2,553	647	0
April 1, 1938 to Sept. 30, 1938	3,263	2,645	2,502	94	3,397	2,548	355	80
Oct. 1, 1938 to March 31, 1939	3,859	3,729	3,256	87	3,037	3,241	272	180
April 1, 1939 to Sept. 30, 1939	4,187	3,012	2,620	87	3,080	2,761	306	150
Oct. 1, 1939 to March 31, 1940	2,780	3,490	3,036	87	2,333	2,830	212	110
April 1, 1940 to Sept. 30, 1940	4,707	1,418	928	65	3,259	1,235	124	60
Oct. 1, 1940 to March 31, 1941	1,610	41	0	0	11	0	0	0

[a] Shifted three months forward, to allow for the average lag between the commercial operation and the corresponding clearing operation. See also "Reasons why the Trade Accounts do not Reflect the Clearing Position," Draft, Aug. 2, 1938, BT 11/851.
[b] Includes both trade and financial arrears.
[c] Includes an opening balance of 654 thousand pounds (excluded from the percentage in col. 4).
[d] Includes an opening balance of 698 thousand pounds.

Source: Through September 1938, "Financial Position of the Anglo-Italian Clearing, Enclosure 4," in R. Shackle to R. Nosworthy, Nov. 11, 1938, BT 11/851. Subsequently, calculated from H. M. Customs and Excise, *Annual Statement;* "Anglo-Italian Clearing" and "Accounting Instructions," in the Public Record Office, London, Treasury Files 106/10/201/83/1 and 106/16.

rears (at the exchange rate of 64.46),[91] as can be seen in Figure 2, which illustrates the delays in payment (calculated as the number of days between the date on which the transaction was entered in the clearing accounts and the date of the last check issued to the British exporter). Figures 2 and 3 show a clear transfer from Sterling Account A to B in June 1937, and four months later from B to C and thence to the New Account.[92]

An example taken from Table 9 can clarify the working of the agreement. In calendar 1937 Great Britain imported some 8 million pounds of goods c.i.f. Importers paid 6.5 million pounds in to the Clearing Office, with a lag of about 90 days; 30% of that remained frozen in A, B, and C, while 70% (4.6 million pounds, to which was added the preceding residual of 0.7 million pounds) went to the New Account. British exports were valued at 5.6 million pounds by the merchandise trade statistics, and 5.0 million pounds were charged to the clearing. This amount could be paid entirely with the sterling in the New Account, without any delay. In Italy, importers had paid in to Istcambi some 470 million lire (5.0 million pounds multiplied by 94, which was the exchange rate) while exporters were owed some 611 million lire (6.5 million pounds × 94) which were not available; there was therefore a delay for Italian exporters (see Figure 2).

If the British exports had been 6 million pounds there would have been a delay in payment both for British exporters (less was exported than imported, but the debt had to be recovered) and for Italian exporters. The calculations by Istcambi and the Clearing Office of the number of days' delay in payment do not refer therefore to the same payments. A precise inverse correspondence between the credits and the debits in the New Accounts of the two institutions would appear only when Arrears Accounts A, B, and C were balanced.

The situation in 1937, when Italy had a trade deficit (f.o.b.) and had to repay financial arrears, can be summarized as follows:

Clearing Office (thousand pounds)		Istcambi (thousand lire)	
Paid in by importers:	6,480	Paid in by importers: (4,980 × 94.36)	469,913
to New Sterling Account:	4,536 (+654)		
to Arrears Accounts A + B + C:	1,944		
Owed exporters:	4,980	Owed exporters: (6,480 × 94.36)	611,453
paid:	4,980	paid:	469,913
		residual (delayed):	141,540

After the end of sanctions, Italy sought a relaxation of international tensions and the prompt repayment of arrears through a surplus in the trade account.[93] In fact, the 500 million deficit with the main European industrial powers was eliminated within 1937, and the deficit on all clearing accounts was reduced by 60%.[94] The overall deficit was transferred to more peripheral countries.

The Italian surplus in 1937 had been reached with the aid of various export subsidies which dated from before the devaluation of the lira, on October 5, 1936. That devaluation exceeded 40% with respect to the pound;[95] and over the whole of 1937 the black market valuation of the lira was at least 10% below the official exchange rate.[96] The tendency to an Italian trade surplus was strengthened by quotas on Italian purchases abroad, and by the awareness of British exporters that in any case they would be paid only gradually, as the old debts were paid off.[97] It is difficult to separate the effect of the quotas and the effect of depreciation. The quotas were no doubt laxly applied, because their management was left in Italian hands[98] at a time when the Italians had a very real need to rebuild their stocks after the war with Ethiopia, and the British needed to sell.

Table 10 shows how in some cases (for example, coal) actual imports were almost double the quota; on average, the quota was exceeded by at least one-third. The Italian government was thus furnished with the means to practice a discriminatory policy favoring purchases of raw materials for industry. In 1937 the British share of Italian imports was half of what it had been in 1934; the strict application of licenses would have forced it down to as little as a quarter of its former value.

6. *Only lemons against coal? The end of clearing*

Italy's trade surplus throughout 1937, the rapid repayment of arrears, and the accumulation of sterling by Istcambi induced both sides to conclude a new clearing agreement on March 18, 1938, which favored current trade. The percentage of sterling made available to British exporters rose from 70% to 87% of the sums paid into the Clearing Office by British importers. The quota assigned to pay financial claims grew from 3% to 6.5%; the residual 6.5% was assigned to pay commercial claims from the earlier agreement (Arrears A), and otherwise left at the disposal of the Istituto Nazionale Cambi (Lire Sub-Account E) once the arrears were paid. These funds, which had a corresponding amount of sterling available in the Sterling Sub-Account E, were combined with currency which could be derived from other sources (such as tourists) and used for various payments outside clearing (including coal freights, now excluded from the agreement).

To prevent excess coal purchases from delaying payments for other goods, the New Sterling Account was divided into a Coal Sub-Account and into a Sub-Account D; these were allocated quotas of 41% and 46%, respectively.[99]

Together with the clearing, a commercial agreement was negotiated which increased the Italian import quotas for British products.[100] This agreement followed long discussions on the percentage to be allocated to the two accounts and on the quotas.[101] At first sight this does not seem very sensible. Why assign to the coal account a share linked to the quota, if in fact it is known that the quota will be exceeded and that this may lead to arrears? The separate Coal Account meant, however, that continued purchases of coal without payment would immediately show up as arrears in the Sterling Coal Sub-Account, and the relevant amounts would be known weekly, with every closing balance. It would then be possible to act through the embassy in

Rome and to discourage the buyers (who were few and well known) so as to keep purchases within the currency constraint. This is precisely what happened.[102] It did not matter if the quotas were exceeded, as they were, so long as the goods were paid for on time.

The situation with Sub-Account D was different because here it would not be possible to trace an excess of Italian imports to specific goods until customs data were available. In any case the cause would be unclear since the excess could depend on licenses issued in the past and not used right away. The corresponding quotas were exceeded by more than 100%, enough to exceed the currency availability by more than 100 million lire in a year (see Table 10, excluding coal).

The voluminous correspondence of the embassy shows that prior controls were complex and slow. Licenses were issued every six months; when they were issued there was no way of knowing how many of those issued in the past had yet to be used.[103]

Figure 2 shows this clearly: the delays in the payments to British exporters in Account D (goods other than coal) grew rapidly to 120 days within a few months of the signing of the agreement.

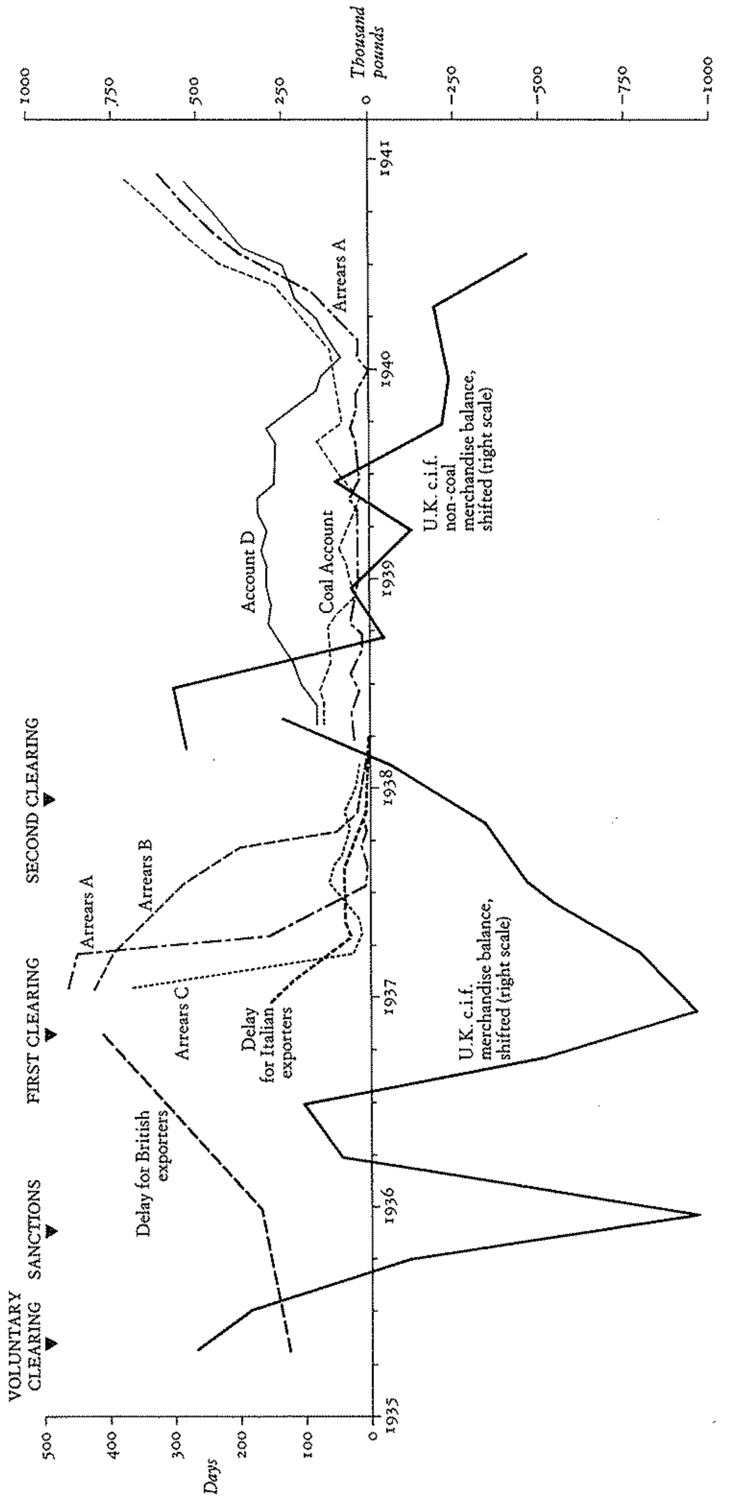
Table 10
British Import Quotas and Actual Imports from Britain (thousand lire)

		Imports from Nov. 16, 1936 to March 31, 1938			Imports from April 1, 1938 to Feb. 28, 1939			Imports from March 1, 1939 to Feb. 28, 1940	
	Quotas Set Nov. 16, 1936 (1)	Actual Value (2)	Index (quota = 100) (3)	Quotas Set March 18, 1938 (4)	Actual Value (5)	Index (quota = 100) (6)	Quotas Set March 14, 1939 (7)	Actual Value (8)	Index (quota = 100) (9)
Newfoundland cod fish	19,937	5,849	29	14,500	8,940	62	14,100	11,903	84
Part A, excluding coal and lead ore	155,265	132,981	86	116,900	112,009	96	94,700	56,720	60
Coal	239,250	411,917	172	229,500	367,207	160	229,500	475,866	207
Lead ore	3,987	7,388	185	4,000	13,035	326	4,000	1,505	38
Part B[a]	11,633	16,186	139	11,888	16,205	136	8,492	8,025	94
Part C	107,580	175,070	162	253,330	226,439	89	78,533	20,308	26
Total	537,652	749,391	139	383,022	727,630	190	429,325	574,327	133
Total (thousand pounds)	5,742	8,003		4,122	7,830		5,038	6,379	

[a] Require past customs certificates.

Source: "Anglo-Italian Clearing Position," no date, Annex E; "Imports into Italy from the United Kingdom," in R. Shackle to R. Nosworthy, Aug. 20, 1938; "Comparison between Quotas and Licenses Issued, Annex 2. Anglo-Italian Clearing," meeting at BOT on Oct. 31, 1938; "Licenses for Additional Imports from the U.K. Issued in the Second Quarter of 1938," no date; and "Annual Quota Expressed as a Percentage of Imports from the U.K. in 1934," no date (all BT 11/851). Istituto centrale di statistica, *Statistica del commercio speciale di importazione e di esportazione.*

Figure 2 Delays in Clearing Payment of British Credit Arrears (situation at the end of the month)



Source: See Table 9. The delays are calculated as the number of days between the date on which the transaction was entered in the clearing accounts and the date of the final check issued to the British exporter. Freights were paid without delay, and are not considered here. See note (in pencil) dated April 6, 1937, signed Campbell, in the Public Record Office, London, Treasury Files 106/10/201/83.

The Coal Sub-Account was administered better, given that on several occasions the intervention of the British embassy in Rome induced the Italian state railways and the Coal Federation to defer major purchases.[104]

Figure 2 also shows how this was due to the appearance of a British trade surplus, albeit a temporary one. The clearing agreement had been negotiated on the presumption of a balanced trade account, or even a possible British deficit of up to 13%, but not an Italian deficit.[105] There were several reasons for this deficit. In the first place it was thought that British firms would themselves limit their exports; this did not occur, especially in the case of the smaller, highly export-oriented companies.[106] Italian exports fell because of the bad harvest, and many industrial products (particularly textiles) grew less competitive. The case of textiles turned on the nature of export incentives and the high official clearing exchange rate. Italian sales abroad had increased in 1937 because exporters could use their foreign credits to buy raw materials abroad even beyond their own needs, with the aim of re-selling them at inflated prices to producers on the home market. They could therefore sell aggressively in foreign markets by allowing large discounts and recovering the profits at home.[107] In 1938, with the fall in home demand, raw materials

Table 11
Clearing Office Sub-Account D and Coal Sub-Account (thousand pounds)

	Goods Other than Coal			Coal		
	Exports (1)	Sub-Account D Cover (2)	Balance (3)	Exports (4)	Sub-Account Cover (5)	Balance (6)
April 1 to June 30, 1938	912	620		788	695	
July 1 to Sept. 30, 1938	1,073	560	−1,138	486	628	+375
Oct. 1 to Dec. 31, 1938	796	813		587	913	
Jan. 1 to March 31, 1939	779	721		760	808	
April 1 to June 30, 1939	629	742	+171	695	824	+272
July 1 to Sept. 30, 1939	642	501		688	561	
Oct. 1 to Dec. 31, 1939	337	595		696	918	
Jan. 1 to March 31, 1940	294	568		862	638	
April 1 to June 30, 1940	696	437	−187	1,240	491	−1,698
July 1 to Sept. 30, 1940	485	0		725	0	

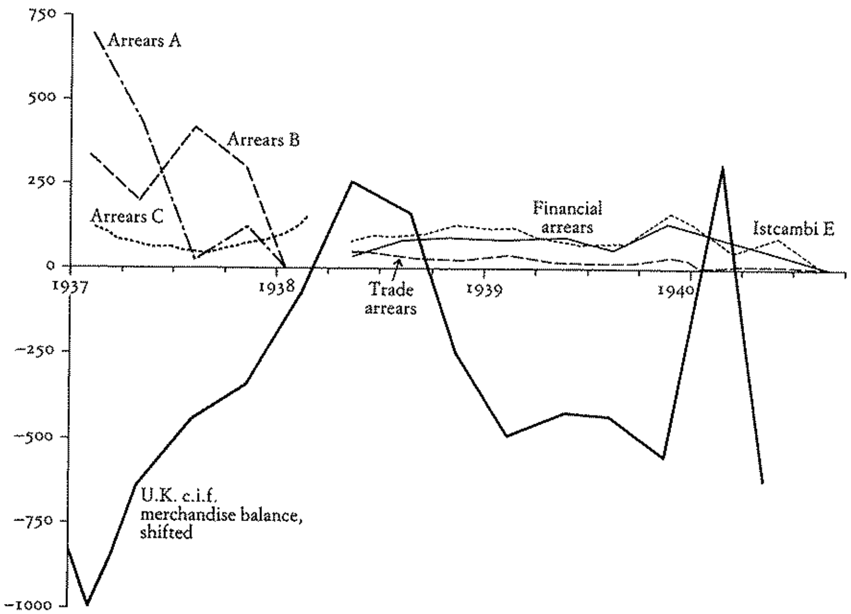
Source: See Table 9; also Report by Mr. Wardley, Dec. 15, 1939, BT 11/963.

were no longer required by anyone, and the possibility of adopting a competitive price policy disappeared.

The effect of the devaluation of the lira had also been short-lived; it was offset almost immediately by a considerable increase in home prices. In terms of purchasing power parity, after only two quarters the lira was again overvalued with respect to the pound.[108] Nor did the quota system guarantee correct management of the merchandise account. The Italians quite happily continued to purchase in excess of the quotas, which the British for their part refused to manage directly since they lacked the necessary administrative machinery.[109] While excess coal purchases appeared immediately in the balance of the Sterling Coal Sub-Account, and were in any case paid for, now other raw materials (lead, copper, cast iron, sulphate, nickel, rubber, and platinum) were purchased in amounts that exceeded the quotas by almost 100%, or 15 million lire per month.[110] Great Britain was itself an importer of these goods, and therefore reaped no benefit in terms of employment and domestic production.

The Coal Sub-Account represented a victory for the powerful

Figure 3
Quarterly Clearing Payments of British Credit Arrears (thousand pounds)



Source: See Table 9.

lobby of coal exporters: they were able to guarantee themselves prompt payment from Italy. The events which led to the worsening of Account D are readily apparent in Figure 2 and Table 11. The British trade surplus of 1938 was limited both in time (seven and one-half months) and in scope, but the fact that payment for coal was obtained almost in its entirety meant that it occurred at the expense of other goods. Figure 2 illustrates the British merchandise balance for Account D (exports minus coal against 41% of imports, both shifted); it shows that Britain's surplus in that account was very high in 1938 (well above the overall merchandise balance), and only slightly offset by a deficit the following year.

Arrears built up in Account D, while sterling flowed into the free account of the debtor country (Istcambi E; see Figure 3). These developments in Account D prompted a revision of the agreement.

One might have asked the Italians to pay for imports in excess of the quotas in free currency (something they would have refused to do).[111] Or one might have asked them to respect the quotas (something they would not have done in any case).[112] Or the British might have imported more by means of massive government purchases; or they might have exported less. Having discarded the first two solutions, the Board of Trade favored the third.[113] As after the sanctions the Board had absolutely no intention of sacrificing current trade to arrears, and proposed a modification to the clearing to recover the arrears extremely slowly. The fourth solution was favored by the Italians, who in the pursuit of autarky were disposed to import less (Italy then had a clearing surplus with Germany).[114] The Foreign Office also favored the fourth solution, explicitly noting the political problem of the credit that would otherwise be extended to the dictatorship, and forced the Board of Trade to settle the arrears in short order by restraining exports.[115] The sales of coal could be maintained as a political weapon, at least in the short term, to avoid losing the entire Italian market to German and Polish supplies.

This new state of affairs led to a tightening of the quotas. In the agreement signed on March 14, 1939, the quotas were returned to their 1936 values (5 million pounds annually).[116] Most significantly, the Italians administered them very strictly: import licenses for the second half of the year were frozen, and bank credit for purchases abroad was reduced.[117] Excluding coal, quotas remained largely unused (as much as 70%), so that funds flowing into Account D exceeded the sums due to exporters, part of the credit was recovered, and delays were reduced (see Figure 2 and Table 11). Coal continued to be bought and paid for, thanks to high exports to the United Kingdom. Italian exports, especially to countries where they would produce net earnings of foreign exchange, were assisted by exchange rate guarantees, various subsidies, and government contracts (in the first half of 1939).[118] At the same time, the position of the Italian creditors grew more serious, as they had to wait to be paid for their exports.[119]

The improvement of the financial situation was accompanied by a drastic reduction in the total trade between the two countries. The British exported little to Italy since quotas were frozen; but with autarky the Italians had lost interest in buying British manufactures. In turn, the Italians sold little to Great Britain because they were paid late; perhaps more importantly, the demand for their foodstuffs, fabrics, and clothing had fallen off, as Britain now purchased from her empire. The two economic systems tended increasingly to move in diverging orbits.[120]

There remained, exceptionally, Britain's desire and commitment to sell considerable quantities of coal to Italy in an attempt to draw the two countries closer together. In late 1939 the War Cabinet embargoed all ships exporting coal from Germany; at the same time it attempted to ward off Italian political opposition by making British coal available and by guaranteeing payment to British exporters, at least for a short time, through the Export Credit Guarantee Department.[121] During the last two or three months of 1939 coal exceeded 75% of total sales to Italy and nearly equaled total Italian exports, even if less than half of them were reserved to pay for it (Table 11).

At the end of 1939, the situation posed new problems. The Coal Account was heading for a large deficit, D remained passive to the tune of one million pounds (Table 11), Istcambi E was in surplus, and Britain feared that the Italians might sell currency on the black market–thus weakening the pound–in order to buy raw materials which had to be paid for in dollars.[122] It was therefore becoming ever more necessary to increase imports from Italy at least over the medium term, in order to reduce the deficit balance of Account D, and above all to receive payment for the coal. As Edward Playfair observed in Rome, by now the two things go hand in hand.[123]

Since it proved next to impossible to induce private buyers to increase their imports from Italy, the British considered public orders.[124] If large enough, these would allow Italy to pay for the coal and its transport. Orders for manufactures, if tied to the purchase of raw materials from the countries of the Empire, would have the additional advantage of reducing the free sterling in Istcambi E.

On the eve of war three kinds of goods could be purchased in Italy: agricultural products, manufactures (specifically arms and engines), and some raw materials such as mercury and sulphur. It was easiest to buy agricultural products, as Germany did. Buying manufactures was instead extremely complex, since orders for industrial products involved the allocation of free currency to buy raw materials; in essence, only the value added (some three-fourths of the value of production) contributed to clearing.

This was nonetheless the path followed by British negotiators at the end of 1939. Every contract signed during this period was agreed upon separately, "outside clearing" and thus in a sense illegally, with the allocation to a special free account of a high percentage of sterling tied to purchases of raw materials from the British Empire.[125] Britain thus received some shipments of engines for the navy, explosives, and a few other goods; but their total value was under 2 million pounds.[126] Britain's share of Italian arms exports remained extremely low, less than 6% in 1939.[127] In this way clearing became meaningless: it no longer regulated current trade, and only small sums were paid into the account.

Buying "highly manufactured" goods had two advantages for Britain: depriving Germany of these goods, and making Italy more firmly neutral by weakening her.[128] The embargo on arms sales decreed by Mussolini early in 1940, Italy's rapprochement with Germany, and the confirmation of the Axis further complicated the issue. If trade was to be carried on with Italy, there now remained only lemons against coal.[129]

Both countries thus abandoned the hope of an active resumption of trade. Policy was allowed to drift, and the stalemate dragged on until Italy entered the war in June 1940.[130]

7. *Conclusion*

The preceding pages illustrate the complex and erratic nature of the commercial ties between two industrial countries in the 1930s. The problems ranged from the discrepancies between the two countries' trade statistics (which complicated the first negotiations) to the more difficult questions concerning the employment and balance-of-payments effects of extremely rigid agreements which changed every six or twelve months.

In the first place, the structure of trade between the two countries in the 1920s was far from the stereotyped image of an industrialized country dealing with a backward neighbor. Indeed, the United Kingdom largely exported one raw material—coal—which few wanted, and imported from Italy not only foodstuffs but also competitive manufactured goods. The devaluation of the pound and the new protective tariffs seriously affected Italian exports. But simple countermeasures were available, and Britain feared that Italy would pursue sales in exchange for coal in third markets, aggravating unemployment in the Welsh mining districts. The first negotiations sought to minimize retaliation against the Import Duties Act by industrialized countries, including Italy, and to safeguard the level of effective demand for British goods on the Continent as much as possible.

Italy, saddled with an artificially high rate of exchange, pursued equilibrium in visible trade; the surplus on invisibles seemed unreliable, and in any case an overall surplus was not undesirable. It was easy enough to reduce imports from Britain and use that surplus to purchase raw materials from other sterling area countries. In fact, Italy's deficit with these countries remained unchanged over 1935, and then rose as their share of Italian imports increased while Great Britain's declined. The Italian position thus appears to have been basically multilateral rather than bilateral.

The 1936 clearing covered merchandise, freights, and the payment of arrears; it was thus much broader than the earlier "voluntary" clearing. It worked smoothly so long as the creditor nation ran a trade deficit, which could go to recovering arrears.

The British were less interested in selling goods in Italy than in recovering the financial arrears, and they pursued the latter objective with a certain pugnacity. Trade was made easier by Italy's desire to improve relations with the countries that had imposed sanctions, by the new low parity of the lira, by Italy's export subsidies, and, very probably, by the high exchange rate applied to the arrears, which induced the British to buy in order to be paid.[131]

The second clearing instead sought only to balance the merchandise account, in the sense of equating Britain's coal exports to 46% of British imports, and Britain's other exports to 41% of British imports. For this operation to succeed there had to be a strong link between currency allocations and trade orders; but such a link is hardly automatic, least of all when overall demand is slack. Control was possible in the case of coal, which was traded in an oligopolistic market, but not in that of other goods,

where British sellers were numerous and eager to sell, and Italian buyers did not wish to abide by the agreements. When the limits were enforced in 1939, Account D also came near to equality.

Perhaps it would have made more sense to favor private barter deals, such as occurred between Great Britain and Rumania. This was the suggestion of *The Economist*, which attributed the uncertain developments of the Anglo-Italian clearing to an "inappropriate" exchange rate.[132]

A lower exchange rate for the lira would have helped Italian exports, which already enjoyed considerable subsidies; but unlike imported Rumanian oil Italian manufactures competed with British goods, especially artificial fabrics. In addition, British coal exports would probably have suffered; once they had to be paid for in free currency, they would have been quickly substituted by imports from Germany.

An exchange rate fixed by law in the absence of an actual market is admittedly arbitrary; but one hardly solves the problem by reducing it to the exchange rate. The important question is that of the consequences, for both countries, of pursuing equilibrium through large variations in the exchange rate.

In any case these obstacles to free trade and the collapse of the international system of exchange rates were not the initial causes of the depression. Measures to protect the domestic economy from other countries' business cycles and to slow the effects of changes in patterns of trade were often unavoidable. Perhaps these measures often canceled each other out; but pursuing equilibrium through changes in prices, incomes, and exchange rates seems equally dubious, even from the narrow perspective of the balance of payments.

[1] International Monetary Fund, *Annual Report on Exchange Arrangements and Exchange Restrictions* (Washington, D.C., 1983).

[2] Kyung Mo Huh, "Countertrade: Trade without Cash," *Finance and Development*, Dec. 1983, p. 5; and the more recent *Financial Times* survey, "Countertrade," Feb. 6, 1985.

[3] I have worked mainly with English records in the Public Record Office, London: the Board of Trade Files (briefly, BT), the Foreign Office Files (briefly, FO), and the Treasury Files (briefly, Tr); these are referred to below using the classification in Great Britain, Foreign Office, *Index to the Correspondence of the Foreign Office for the Year* . . . and *Index to the "Green" or Secret Papers* (Liechtenstein, various years). Relying on English sources may engender a certain bias, though this is tempered by the scope and detail of the information on Italian positions often provided by the British embassy in Rome. In any case, I have also made use of the memoirs of F. Guarneri, *Battaglie economiche tra le due guerre*, 2 vols. (Milan, 1953), of the articles in *Il Sole*, and of the few available Italian

archives—notably Banca d'Italia, Rome, fondo Ufficio Rapporti con l'Estero (briefly, BI RE), and Direttorio, fondo Vincenzo Azzolini and fondo Nicolò Introna (briefly, BI Azzolini and BI Introna). There is no archival collection from the Ministry of Trade and Foreign Exchange.

4 On the Prague Conference, see the Second Commission's report in BI Azzolini, 69. The problem of the clearings is also dealt with in Société des Nations, Session économique et financière, *Enquête sur les accords de clearing* (Geneva, 1935); and in M. Gordon, *Barriers to World Trade: A Study of Recent Commercial Policy* (New York, 1941).

5 Germany was a creditor to other east European countries and, in this way tried to recover credit arrears; she was in debt, however, to the more industrialized western countries. See H. S. Ellis, *Exchange Control in Central Europe* (Cambridge, Mass., 1941), p. 202.

6 International Chamber of Commerce, *Clearing and Payment Agreements* (Basel, 1938). This distinction becomes extremely dubious when one of the countries which stipulates the payment agreement has exchange controls, and in the case of clearings which foresee partial payments in currency.

7 The calculations are from *World Trade*, 11 (Feb. 1939), and are reproduced in Gordon, *Barriers*, p. 133.

8 They negotiated quantitative quotas but tended to apply them in a non-discriminatory manner to other countries. See H. G. White, "Blocked Commercial Balances in American Foreign Policy," *American Economic Review*, 29 (1939), pp. 74-91.

9 This aspect is emphasized in H. J. Tasca, *World Trading Systems: A Study of American and British Commercial Policies* (Paris, 1939).

10 Ibid., pp. 53-64.

11 This excludes Poland, but includes Germany. On the United Kingdom's economic problems, see the excellent book by A. Kahn, *Great Britain and the World Economy* (New York, 1946).

12 This is in contrast to many earlier agreements with clauses stipulating equality of treatment towards British exports.

13 Such a policy, on the part of a country so important to world trade, may in the long run have been counterproductive even for Great Britain. This is the opinion of Tasca, *World Trading Systems*, p. 150. F. W. Paish takes the opposite view in "Memorandum on the Effect of Exchange Control on British Trade" (International Study Conference, International Institute of Intellectual Cooperation, League of Nations, Paris, 1939, typescript), pp. 14-15. A. Hirshman calculated, for five European countries, an "index of bilateralism" which measures the difference between imports and exports with an individual country and total imports and exports, on the basis of the standard deviation. For the United Kingdom he notes a sharp increase in bilateral trade from 1932 onwards, which was greater than or equal to that which occurred in Germany. See A. Hirshman, *Etude statistique sur la tendance du commerce extérieur vers l'équilibre et le bilatéralisme*, cited in J. B. Condliffe, *The Reconstruction of World Trade* (London, 1941), p. 283.

14 F. Capie, *Depression and Protectionism between the Wars* (London, 1983).

15 National Institute of Economic and Social Research, *Trade Regulations and Commercial Policy of the United Kingdom* (Cambridge, 1943), part 2. The Import Duties Advisory Committee (IDAC) recommended that a duty be adopted, and it had to be approved by the Treasury with the advice of the Board of Trade; the Treasury directive then had to be approved by the House of Commons. In reality the IDAC made the decisions; the other steps were formalities (ibid., p. 5).

16 This is thoroughly treated by Condliffe, *The Reconstruction*, chap. 6 and following; and in National Institute of Economic and Social Research, *Trade Regulations*, part 3. It is also interesting to note the reasons behind the law authorizing the government to conclude agreements on clearing (Debt Clearing Office and Import Restrictions Act, 1934): "It is my impression that foreign countries realize that we do not possess the power with which they have armed themselves and think it is, therefore, not our policy to employ these powers, just as they appear to have imagined before the imposition of a tariff that the U.K. was definitely and forever a free trade country" (minute sheet, BT 11/274). The law was introduced after pressure by the Foreign Office. I am grateful to Sir Edward Playfair for pointing out to me that although Britain never imposed any clearing unilaterally, and the 1934 act could only be seen as a temporary device for blocking payments, it served as a threat and greatly increased the bargaining power of Great Britain, which had no exchange control until 1939.

17 G. Toniolo, *L'economia dell'Italia fascista* (Bari, 1982), pp. 178-86; and Minister Felice Guarneri himself, *Battaglie economiche*, vol. 1, pp. 244-49. The decree law of June 10, 1926, placed strict controls in the banks' foreign business and obliged them to report periodically to the Treasury. This lasted until March 12, 1930, when a new decree reestablished complete freedom of currency movements.

18 See United States Tariff Commission, *Italian Commercial Policy and Foreign Trade, 1922-1940*, report no. 142, 2nd series (Washington, 1941); and Banca d'Italia, *L'economia italiana nel sessennio 1931-1936* (Rome, 1938), part 1. Royal decree law no. 1207 of Sept. 29, 1931 gave the Minister of Finance the power to regulate the foreign exchange market by issuing decrees. The surcharge was introduced by royal decree law no. 1187 of Sept. 24, 1931. The only quantitative restrictions on the exchange of goods are included in the trade agreement with France of March 3, 1932.

19 Ministerial decree of Feb. 16, 1935. See also Guarneri, *Battaglie economiche*, vol. 1, pp. 330-50. The system based on past customs certificates was eliminated by royal decree law no. 1891 of Nov. 3, 1935.

20 Towards the end of 1932 a "semi-official" control of international currency movements was entrusted to the Confederazione italiana delle imprese di credito e di assicurazione in order to protect the value of the lira. This seems to have been a weak and inopportune intervention. See United States Tariff Commission, *Italian Commercial Policy*, p. 27.

21 All foreign bonds and Italian bonds issued abroad held by Italians had to be declared to the Bank of Italy (royal decree law no. 804 of May 26, 1934). The ministerial decree of May 26, 1934 subjected all transactions in currency to "the needs of trade." For a negative evaluation of this policy see Guarneri, *Battaglie economiche*, vol. 1, pp. 329-37.

22 For the series of decree laws see ibid., vol. 1, pp. 30-31.

23 "Our fiscal measures have hit some Italian interests pretty hard, notably textiles and gloves. Of course, there is nothing doing until the whole Ottawa business is settled . . . but when the proper moment comes it might be desirable that we should approach the Italians or give them a hint to approach us" (R. Vansittart to W. Runciman, Oct. 8, 1932, FO C 255/255/22, 1933, which includes passages of a preceding letter by R. Graham, Ambassador to Rome). The Board of Trade prepared a study of possible reductions in duties, which concerned about one-third of Italian exports and which specifically excluded textiles and gloves ("Annex. Secret. Analysis of the Principal Imports into the United Kingdom from Italy," Dec. 17, 1932, ibid.).

24 The minute sheet to FO C 1917/255/22, dated March 6, 1933, written by J. V. Penrose, reads: "it thus seems to Sir Ronald Graham that there would be an advantage in letting sleeping dogs lie and it would be dangerous to initiate even limited discussions."

25 R. Turner to E. Crowe, Oct. 27, 1933, FO C 9571/255/22 reports a conversation with B. Nobili, a railway executive, who commented, "the word had come from above that coal was in the future only to be bought by the state railways from markets which were prepared to do something that would benefit Italian exporters."

26 Interest on short-term German debts was supposed to be recovered (Meeting with Ceccato, Italian commercial attaché in London, on April 23, 1934, BT

11/310). This was regulated by a 1932 protocol ("Protocollo per il regolare pagamento dei debiti commerciali tra Italia e Germania," June 15, 1932, BI Introna, 22, Secret). The amount of the surplus on trade with Germany is reported in "Promemoria sui crediti e titoli germanici," no date, BI Azzolini, 69, and in BI RE, file 3, 6712, frame 543 and following.

27 The news was transmitted from the Embassy in Rome to the Foreign Office on Nov. 18, 1933 (E. Drummond to J. Simon, FO C 101218/255/22).

28 R. Turner to E. Crowe, Oct. 27, 1933, FO C 9571/255/22.

29 The Italian share of Great Britain's import and export trade varied between 1% and 3%; the British share of Italian trade equaled 10% (exports) and 15% (imports) in 1910-13, and 8% (exports) and 10% (imports) in the later 1920s; See Istituto centrale di statistica, *Annuario statistico italiano*.

30 France was the biggest buyer, with 16% of exports in 1910-13, followed by Italy with 14%. In the 1920s and early '30s the two countries took 22% and 13%, respectively. H. M. Customs and Excise, *Annual Statement of the Overseas Trade of the United Kingdom.* The unemployment rate in the mining industry was 25-35% of the work force; see Bank of England, *Statistical Summary*.

31 In the four years 1910-13, the balance on manufactured goods averaged 2.5 million pounds per year in favor of the United Kingdom. In 1921-25 it was practically zero, and in 1926-30 it averaged 2 million pounds per year in Italy's favor (data from H. M. Customs and Excise, *Annual Statement*).

32 Minute sheet, May 11, 1934, and Minutes of the Meetings held at BOT on July 27, 1934 and Nov. 17, 1934, BT 11/310.

33 In 1931 the railways bought the minimum quantity set at the Hague convention (700,000 tons); none was bought in 1932 since stocks had reached 5 million tons, and in 1933 and 1934 coal was bought only from Germany. This obviously worried the British, as quotas were based on the 1934 figure (Special Position of Coal, Memorandum by the Mines Department, March 26, 1935, BT 11/310).

34 One notes that in 1933 "textiles and gloves are out of the question" (Board of Trade to the Undersecretary of State, FO C 255/255/22); but in the spring of 1934, gloves were specifically included (minute sheet to "United Kingdom and Italian Negotiations," Nov. 17, 1934, BT 11/310). The loss of employment was estimated at 400 jobs in the gloves industry, 400 jobs in hats, 100 in buttons, and 500 in marble working. At times the issue concerned tariff increases recommended by the IDAC, which the Italians tried to limit. (Note on Modification of United Kingdom Tariff Asked by the Italian Government, May 6, 1934, BT 11/310).

35 The tariff reductions accorded Germany provoked a lively reaction in Parliament–one the government was anxious not to repeat (Memorandum by the President of the Board of Trade on United Kingdom Coal Trade with Italy, no date, BT 11/310).

36 Bank of England, *Statistical Summary*.

37 Guarneri, *Battaglie economiche*, vol. 1, pp. 348-50.

38 Ministerial decrees of Feb. 16, 1935 and March 1, 1935 regulated Italian trade through quotas (percentage ratios established for individual goods and countries) and through licenses (permits issued by the Ministry of Finance). Imports of certain products (gold, coal, mineral oils, and a few others) remained subject to separate regulations.

39 It would seem more correct to record both countries' statistics in f.o.b. terms and to consider insurance and freight among the invisible items. This was also the view of the joint commission; see the two untitled records of Nov. 8, 1934 and Nov. 17, 1934, BT 11/310.

40 One must keep in mind that the two countries used completely different criteria in their statistics (for instance, with respect to the country of origin) and did not even agree in their definitions of the two national territories (see note to Table 5). Besides, for many goods the quantities cannot be compared because of different classification schemes and, often, because of different units of measurement.

41 For example, it is claimed that lemon exporters declared higher values than they actually invoiced, in an attempt to influence the pricing policy of the intermediary (Sub-Committee on Invisibles, BT 11/351); the figures declared by British importers would seem to be correct.

42 The commission included the Sub-Committee on Visibles and the Sub-Committee on Invisibles; references to two of their meetings, on April 5 and 8, 1935, appear in BT 11/351.

43 The British were well aware of their weakness, attributable to the nature of their exports (wool and coal; minute sheet, Nov. 9, 1934, BT 11/310). There was also a weak attempt by the Board of Trade to strengthen Britain's position by raising tariffs, but it was soon abandoned (Memorandum by the President of the Board of Trade on U.K. Coal Trade with Italy, no date, BT 11/310).

44 The number of tourists was estimated, from various sources, by the embassy (Embassy to J. Simon, July 20, 1933, BT 11/351). The Italians objected that not all British passport-holders were tourists from Britain, though the discrepancy would hardly have been significant. An extremely careful census of British residents in Italy is contained in BT 11/349. The agreement with the Italian estimate of interest payments–around 800,000 pounds–is noted in Telegram to Mr. Ingram from the Acting Secretary of State, April 11, 1935, BT 11/351.

45 E. Rowe Dutton to L. Browett, March 26, 1935, BT 11/310. Because the estimate could not be checked, the Italians did not want to consider it in any agreement.

46 Telephone conversation, Embassy with L. Browett, April 5, 1935, BT 11/351, which reports on talks with the governor of the Bank of Italy.

47 Clearing had been repeatedly suggested by the Italian delegation. The Board of Trade opposed it, fearing repercussions on foreign sales, while the Foreign Office was broadly favorable; two Notes by the Board of Trade, March 25, 1935, BT 11/310.

48 Sub-Committee on Visibles, April 5, 1935, and Telephone call from E. Drummond to L. Browett, April 5, 1935, BT 11/351.

49 F.O. to E. Drummond, March 9, 1935, and the reply of March 11, 1935, BT 11/349.

50 Italian Import Restrictions, Memorandum by F. Leith Ross, March 15, 1935, FO R 1857/2/22. Some 300,000 tons of coal, which had been blocked for over a month, were now either stowed or ready to be stowed. British wool exports had been hurt by the decree of April 14, 1934, subjecting imports to licenses which were not issued, so as to increase imports from Uruguay and allow the recovery of Italian credits frozen there (M. Millington Drake, Montevideo, Jan. 28, 1935, BT 11/310). Other British exports were hurt less, in part because many goods were shipped by rail and thus much less easily controlled. The coal industry was so important, and its position so critical, that it immediately posed the political problem of state intervention. Purchases of coal by Italy directly employed about 19,000 miners, half of whom were in South Wales (see the minute sheet of an undated dossier in BT 11/349).

51 The text of the agreement (in BT 11/351) was published as Cmd. 4883.

52 See "Italian Import Restrictions," FO R 1857/2/22, 1935. The Bank of Italy acted on behalf of the Istituto Italiano Cambi.

53 Initially 80% was guaranteed only for coal. E. Drummond to J. Simon, FO R 1621/2/22, and Telegram from Rome [E. Drummond], March 8, 1935, BT 31/310.

54 As was repeated on several occasions by the embassy in Rome; see FO R 1756/2/22, and, earlier, minute sheet, Nov. 9, 1934, BT 11/310.

55 E. Drummond to J. Simon, FO R 1756/2/22: "Each country in the British Empire has an active balance of trade with Italy. It seems clear that the Empire

countries would stand to gain more by negotiating separately . . . [and] it would be bad policy to negotiate considering the Empire as a unit since the adverse balance against Italy, in the case of the Empire as a whole, is a much stronger weapon for the Italian government than the adverse balance with each individual country." The somewhat dazed attitude with which the British began negotiations is apparent from the telephone conversation between F. Leith Ross and E. Drummond. Leith Ross: ". . . if they refuse to pay for these [goods already delivered] it would be tantamount to default." Drummond: "I said that these defaults were common nowadays . . . and if old trade was left in the air there might be some doubt as to whether it would be paid for" (March 15, 1935, BT 11/310).

56 The agreement envisaged a revised set of regulations in the definitive treaty. See Cmd. 4883.

57 These assurances were in fact "meaningless" in the absence of an adequate institutional framework; draft of a Telegram that BOT would like to have sent to Rome, FO R 1593/2/22, 1935, and Telegram from F.O. to E. Drummond, March 9, 1935, BT 11/310.

58 These points are repeated in Report by F. Leith Ross, April 17, 1935, FO R 2823/2/22. The importance of the exchange rate risk does not appear to have been clear from the start.

59 The general rule would have placed the risk on the agents of the country in deficit (that is, of those who pay late). This is independently of the wish expressed in any particular negotiated agreement.

60 Cmd. 4960.

61 See, for example, *Board of Trade Journal*, May 2, 1935, p. 736 ff, and June 27, 1935, p. 1015.

62 Minutes of a Meeting held at the BOT, June 25, 1935, BT 11/310, and minute sheet, Aug. 14, 1935, FO R 5026/2/22.

63 FO R 5026/2/22.

64 From the monthly data of the Istituto centrale di statistica, *Commercio di importazione e esportazione*, one obtains a deficit of 114 million lire in 1935, against 81,6 million for the preceding year.

65 Minute sheet, Dec. 24, 1935, FO R 7825/2/22.

66 Minute sheet, FO R 5097/2/22, 1935.

67 See, for example, "Italy" by E. D. Eddison of the Department of Overseas Trade, BT 11/356 and FO R 5097/2/22.

68 However, it raises interesting problems. In the first place, a British exporter who used a compensation account would probably be paid before one using the clearing system, thus worsening the already difficult situation of the sterling account. Furthermore, since Italy's demand for English goods exceeded the supply, Italian importers would be induced to pay a premium to Italian exporters, allowing the latter to sell to Great Britain at drastically lower prices (Federazione Industriali to L. Browett of the Board of Trade, June 21, 1935, BT 11/351). This premium could be borne by British exporters (if the price of coal sold to Italy were to be reduced for the above reason, as contemplated in Memorandum on Compensation Transactions with Italy, May 31, 1935, BT 11/351, or by Italian consumers (ibid., correction in the margin). Freed from quantitative controls, trade would evolve unfavorably to the United Kingdom: because of the war, the Italians would use this system to buy raw materials, which are re-exports and therefore do not increase Britain's domestic product. Guarneri estimated that the premium on these transactions varied from 40% to 60% (*Battaglie economiche*, vol. 2, p. 86).

69 For example, the Società Italiana Scambi Compensati was formed in May 1935 to facilitate these transactions.

70 See United States Tariff Commission, *Italian Commercial Policy and Foreign Trade*; Royal Institute of International Affairs, *International Sanctions* (Oxford, 1938); W. G. Welk, "League Sanctions and Foreign Trade Restrictions In Italy," *American Economic Review*, 27 (1937), pp. 96-107; "Italy's Economic Vulnerability," *The Economist*, Oct. 12, 1935, pp. 693-95.

71 The Istituto nazionale cambi con l'estero undertook the responsibility of collating the necessary information; Tasca, *World Trading Systems*, p. 100.

72 See "Italy Sanctions," no date, BT 11/536, and E. Drummond to A. Eden, April 30, 1936, FO R 2548/1/22. It is actually an estimate which varies from 2.5 million to 4 million pounds, often corrected with marginal notes in the documents.

73 Estimated in "Anglo-Italian Debt," by S. Waley of the Treasury, June 13, 1936, BT 11/536. Guarneri records several under-the-counter sales of British coal during the sanctions. See *Battaglie economiche*, vol. 1, pp. 378-81. This is not noted in the British archives.

74 Banca d'Italia, *L'economia italiana*, part 1, chap. 3.

75 E. Drummond to A. Eden, FO R 2548/1/22.

76 For example, the foreign companies which had broken contracts with the sanctions could be prosecuted.

77 "Quite soon" (marginal note, E. Drummond to A. Eden, FO R 2548/1/22.

78 The British themselves noted that in the event of a devaluation it would be to their advantage to negotiate bilaterally. In any case, the British government's representatives would take no initiative to propose a collective agreement, even though it would probably have helped, at least, to resolve many of the legal aspects of the problem; "Points to be borne in Mind in the Event of the Raising of the Sanctions," May 8, 1936, BT 11/536.

79 Half of the deficit with Germany was paid in gold, and the rest was settled through tourism and the re-purchase of German debt certificates. In fact, the clearing envisaged part of the payment in currency, the so-called peak. Guarneri, *Battaglie economiche*, vol. 2, p. 125. See also the interesting report, "Italian Imports and the Possibilities of American Supplanting British Exporters in Italian markets," in Rome Embassy to Secretary of State, Feb. 21, 1936, in the National Archives of the United States, Washington, D.C., Record Group 59, General Records of the Department of State (briefly, USNA RG-59) 665.1111/15. This had required some caution in the face of U.S. public opinion; see Undersecretary of State to Dr. H. Feis, Nov. 18, 1935, USNA RG-59 665/11/8.

80 "Italy Sanctions," May 6, 1936, BT 11/536; Guarneri, *Battaglie economiche*, vol. 2, p. 71.

81 Only Sweden negotiated a payment agreement similar to the British one, with a high share (25%) allocated to arrears. League of Nations, *Treaty Series*, nos. 4017, 4018, and 4019 (Geneva, 1936).

82 However, this would have altered the chronological sequence of payments, favoring the bigger commercial organizations and leaving the smaller traders in the cold. See above, note 68.

83 S. Wiley to J. Wills, July 1, 1936, BT 11/536.

84 The American market was closed by the Johnson Act. This system, adopted with Brazil, would obviously have recovered the credits over the very long term, with a large discount.

85 For political reasons: both apparently feared that such an offer would embolden Mussolini. Conversation between R. Ashton Gwatkin and V. Azzolini, Nov. 3, 1937, FO R 7654/18/22.

86 Summing up the discussion, Mr. Brown observed that "we should have much to ask for but nothing to offer. It seemed that pre-agreement, financial, and third country debts would have to be left out of the clearing and there were no means of exercising pressure upon the Italians . . . except considerations connected with their financial reputation" ("Italy Sanctions," June 17, 1936, BT 11/536).

87 Guarneri, *Battaglie economiche*, vol. 2, pp. 65-67. For example, the important agreement with France specified a 10% share; Istituto nazionale fascista per il

commercio estero, *Bollettino di informazioni commerciali*, Oct. 31, 1936, p. 520 ff.

88 The text is published as Cmd. 5346 and in United Kingdom, *Statutory Rules and Orders*, 1936, no. 1193. Of the sterling collected by the British Clearing Office between July 15 and November 15, 1936 and placed in a reserve fund (see preceding note 72), 50% was allocated to current trade and 50% to arrears (30% to Sterling Arrears Account A, 15% to B, and 5% to C); see Article 6.5-a of the agreement.

89 This was obviously a British self-limitation, the administration of which, however, was in Italian hands. The agreements were published as Cmd. 5306 and 5345; the goods are specified in the lists of quotas annexed to the latter and are grouped according to the basis of the quota (a specified value, 50% of the 1934 value, 31% of the 1934 value). Some imports required a license, others required past customs certificates.

90 For this year the Italian and British merchandise accounts yield the same balance.

91 The Italian debt was, in fact, greater. On the date of the agreement (Nov. 16, 1936) the balance of the old lire account was close to 83 million lire, which became some 1.4 million pounds (at 60.60 lire to the pound net of bank charges). This sum was entered into the Sterling Arrears Account together with the post-agreement credits (at the official exchange rate) and the pre- and post-agreement credits for freight. With the addition of the 15% in the Reserve Fund at the Clearing Office, these yield the total credit in the Sterling Arrears Account (about 4 million pounds).

92 In 1937 at least 2 million pounds were transferred from Sterling Arrears Account A to Account B (Tr 106/10/201/81/1). The transfers are arranged by an exchange of notes; see, for example, Cmd. 5669.

93 Even if the Italians had wished to, they could not have taken advantage of their position as debtors (as the Germans did) because they had to pay the military expenses in Africa in hard currency. See the clear analysis by the British Ambassador in Rome, E. Drummond to A. Eden, April 30, 1936, FO R 2548/1/22. Guarneri estimated that in the first six months of 1937 the currency cost of Italy's colonial expansion was equal to the normal deficit of the balance of payments (*Battaglie economiche*, vol. 2, p. 207).

94 Istituto centrale di statistica, *Bollettino mensile di statistica*.

95 Minutes of a meeting held at BOT on Sept. 29, 1936, FO R 6053/6/22.

96 Guarneri, *Battaglie economiche*, vol. 2, p. 177.

97 Note of May 11, 1936, with the annotation: "our own exporters have large debts still due to them and will therefore hold back of their own accord," BT 11/536. They do not appear to have done so.

98 The British seemed to realize this only slowly; but they were in any case utterly unwilling to assume direct control.

99 Cmd. 5695. See also United Kingdom, *Statutory Rules and Orders*, 1938, no. 234. It is discussed in *Parliamentary Debates* (Commons), 5th series, 334 (1938), pp. 691-708.

100 Cmd. 5694.

101 The essential points are in "United Kingdom-Italian Negotiations," Feb. 22, 1938, FO R 1629/2/22.

102 The coal import quota was greatly exceeded; but it had been set in the expectation of relatively low British imports. The latter, and therefore the available sterling in the clearing account, turned out to be one and a half times as much as was expected. See Tables 10 and 11.

103 R. Shackle to R. Nosworthy, Aug. 20, 1938, BT 11/851. The licenses were

good for six months and could be issued beyond the set limit since the arrears had been paid (agreement of Nov. 6, 1936, Article 1.5), but had to be recovered the following quarter (Article 1.4). See also "Anglo-Italian Clearing Position," no date, BT 11/851.

104 R. Shackle to R. Nosworthy, Aug. 20, 1938, BT 11/851.

105 Indeed, if British exports were 87% of imports, the value of the latter would be paid in to the Clearing Office, which would set aside 87% of that to pay exporters.

106 The Board of Trade repeated its earlier opinion: "U.K. exporters (large creditors) will probably hold back of their own accord." See "Italy Sanctions," no date, BT 11/536; compare above, note 97.

107 "Anglo-Italian Clearing Position," Oct. 26, 1938, BT 11/851. On the incentives to exports, see also Guarneri, *Battaglie economiche*, vol. 2, pp. 338-60.

108 By 8% in 1938 and 15% in 1939 with respect to the later months of 1936, calculating the parity on the basis of wholesale prices, B. R. Mitchell, *European Historical Statistics* (London, 1980).

109 The Clearing Office examined this possibility, on the basis of Belgium's experience; the additional Italian quota with Belgium was in fact paid outside the clearing system and strictly controlled. S. Reyntiens (Brussels Embassy) to R. Shackle, Aug. 12, 1938, BT 11/851.

110 Embassy to R. Shackle, Sept. 20, 1938, BT 11/851. On this problem see also the source for Table 11.

111 R. Shackle to R. Nosworthy, Nov. 11, 1938, BT 11/851.

112 At the outset Guarneri was resolutely against this; R. Nosworthy to R. Shackle, Nov. 23, 1938, BT 11/851.

113 A purchase policy was planned towards the end of 1938; it included aluminum, zinc, mercury, sulphur, Caproni airplanes and Isotta Fraschini marine engines. See the minute sheet dated Dec. 1, 1938, BT 11/851, and the enclosed letters from R. Nosworthy to R. Shackle, Nov. 25, 1938 and Nov. 29, 1938, and F. Rodd to S. Waley, Nov. 21, 1938.

114 This applied also to coal, which Guarneri threatened to buy from Germany; R. Nosworthy to R. Shackle, Nov. 25, 1938, BT 11/851. See "Situazioni dei pagamenti internazionali effettuate attraverso i clearings," in Istituto centrale di statistica, *Bollettino mensile*.

115 A. Cadogan to A. Overton, March 13, 1939, BT 11/936: "In view of Italy's unsatisfactory behavior at the present time, it may be distinctly embarrassing to have to defend this situation in Parliament seeing that we repeatedly stated that we do not intend to give Italy any credits. We realize . . . that the repayment of this debt can only mean cutting down our exports which would be far from pleasant." The position of the Board of Trade was very different: "as regards the arrears we might await the possibility of a windfall increase of the clearing receipts arising from government purchases of war stocks" (minute sheet, Feb. 3, 1939, BT 11/963). See also minute sheet and S. Waley to R. Shackle, Feb. 15, 1939, FO R 1138/41/22.

116 Cmd. 6020.

117 Guarneri, *Battaglie economiche*, vol. 2, p. 362.

118 Ibid., pp. 356-60.

119 Italy then imported less than she exported, and hence the sums deposited at Istcambi by the importers were insufficient to pay the exporters.

120 Britain's share of Italian agricultural exports was 15% in 1925, 9% in 1934, and 7% in 1939; Germany's share in the same years was 20%, 23%, and 32%.

121 The talk is of "political guarantees" by the Export Credit Guarantee Department; there were no purchases in sight. "Anglo-Italian Economic Relations," no date, BT 11/1265.

122 Sterling receipts could also derive from tourism, remittances, and freight. However, it was feared that the Italians would continue to reduce purchases in

D, so that after recovering the credit the account would become the main feeder of Istcambi E; see Note for the Negotiations on the Anglo Italian Clearing Agreement, Oct. 26, 1939, BT 11/1152. It would have been in Italy's interest not to buy even coal in the United Kingdom, and use all the sterling to purchase dollars.

123 Aide-mémoire [by E. Playfair of the Treasury], in P. Loraine to Viscount Halifax, Feb. 13, 1940, FO R 2218/48/22.

124 The numerous proposals to private firms had ended disastrously. See the correspondence between the Embassy and the Board of Trade in the last few months of 1938, BT 11/851.

125 This was not always possible. Some goods had to be paid for in dollars (for example, toluol for explosives), so that some sales of sterling had to be allowed despite London's wish to avoid them. Note on the Clearing Negotiations with Italy, from E. Playfair, no date, BT 11/1152.

126 For example, 50% of the cost of the Isotta engines was illegally paid into a special account. The sale of the planes was similarly supposed to go through a neutral intermediary, and thus not through the bilateral clearing. The special account was outside the clearing system but worked like Istcambi E. Ibid.

127 Guarneri, *Battaglie economiche*, vol. 2, p. 444.

128 "Treasury may care to advise Service Departments that . . . such purchases would be more welcome than their equivalent in the United States of America, Canada, etc." (minute sheet, Sept. 9, 1939, FO R 7346/41/22).

129 "Italy sells fruit and vegetables on a large scale to Germany . . . If we decrease German coal exports, stopping the seaborne trade, Italian agricultural exports to Germany will fall . . . but the Italians will require an outlet for this produce and it is to be feared that they will seek to make us buy" ("Anglo-Italian Economic Relations," Dec. 4, 1939, FO R 11101/41/22).

130 Minute sheet, Italian Policy, April 1, 1940, FO R 5393/48/22; and "Economic Relations with Italy," April 13, 1940, FO R 5402/48/22. Sir Edward Playfair kindly recalled for me that he and Manlio Masi had prepared a new clearing agreement. "We did so with sorrowful cynicism because we knew that it would never be operative. Masi left it to me to insert the date on which it would take effect. I chose what was my personal guess at the date on which Italy would enter the war. I was only a week out. But before that Ciano summoned the Ambassador and said that our negotiations were broken off" (letter from Sir Edward Playfair to the author, Dec. 23, 1984).

131 Since the credits are trade arrears, one can easily imagine some link between importers and exporters.

132 *The Economist*, May 6, 1939, pp. 317-18, and May 13, 1939, pp. 374-75.