The British effort in the Second World War required massive external financing which depended on Lend-Lease and the accumulation of sterling balances. Indebtedness in sterling balances corresponded to almost 38 per cent of this total at the end of the war. Portuguese sterling balances, although a small share of the total, were important because of pre-emptive purchases, especially of wolfram, and because of the ‘gold clause’ which was to be applied to outstanding balances. Portugal’s willingness to finance British purchases contrasts with the requirement of German payments in goods or cash for their purchases in Portugal. The settlement of Portuguese sterling balances in August 1945 was singular as it preceded the Anglo-American settlement of December 1945 which had important consequences for sterling balance holders, as the US insisted that the US$3.75 billion loan should not be used to settle British war debts. Postwar settlement of British debt through a long-term loan from Portugal to Britain contrasts with settlements that involved the sale of British assets. Salazar’s concerns about the postwar international position of Portugal, the Portuguese Empire, and the survival of the Portuguese regime are relevant in explaining his pro-British stance during and after the war.

Britain faced severe external financial constraints after the outbreak of the Second World War. The perception that the loss of traditional markets resulted in the weakening of the bargaining power of neutrals led to the negotiation of payment agreements in 1939–40. Such agreements killed off the free market in sterling and centralized payments of British purchases. Coupled with British export controls, they provided assurance that Great Britain would be financed by neutrals at least for the duration of the war. In Keynes’ words: ‘by cunning and kindness we have persuaded the outside world to lend us [this]
prodigious total’. The accumulation of sterling balances was vital to the British war effort. Total sterling balances of £3,355 million were very substantial, even if compared with the £5,504 million of transfers from the US to Britain under Lend-Lease, net of Reciprocal Aid.

The reciprocal interests of Britain and Portugal were deeply affected by the war. British political objectives were centred on the effort to contain Spain, as the Franco government was pro-German and it was feared that Spain would attack Portugal with German support. Later in the war, Allied access to the Azores bases became the crucial issue. Portugal wished to preserve its sovereignty and control of its colonies. In geopolitical terms it may seem that Portugal faced less stringent constraints in meeting a German threat than other neutrals, due to its access to the Atlantic, but other neutrals, such as Sweden and Switzerland, were less overextended, militarily stronger, and consequently less vulnerable.

British economic objectives in Portugal were in line with its objectives elsewhere: to ensure that the British war effort was financed by means of a payment agreement. The only exceptions were imports from the US until Lend-Lease, and from Switzerland and Sweden until near the end of the war, which had to be paid in dollars or gold. In some cases, such as that of Portuguese wolfram, the war created new opportunities. Economically, Portugal wanted to guarantee access to essential imports and exploit the new supply opportunities.

A payment agreement was signed in November 1940 between the Bank of England and the Bank of Portugal on payments between the sterling area and the Portuguese Empire. All sterling payments due to Portugal were to be credited into a special account of the Bank of Portugal in the Bank of England. There were reciprocal dispositions regulating escudo deposits in the Bank of Portugal.

'It was not by original design that [Portugal] became the holder of a substantial sterling balance'; but this agreement, combined with the dwindling supply of British exports to Portugal and the surge in British expenditure in Portugal related to the war effort—with a crucial role played by pre-emptive purchases—resulted in the accumulation of sterling balances by the Bank of Portugal. By August 1945 they reached £76 million.

Portuguese balances corresponded to 2.3 per cent of total balances, but as a proportion both of Portugal’s GDP and of Portuguese exports, their size put Portugal in the group of those economies that were directly affected by war operations, such as Egypt and the Sudan, Palestine, and India. To Portugal the issue was crucial.

The Portuguese accumulation of sterling balances was significantly larger than Germany’s payments to settle its wartime trade deficit with Portugal. The Portuguese 1940 agreement was important to Britain because it involved gold liabilities and, until 1944, because of strategic imports. The case of Portugal is also of interest because there were no substantial British assets whose sale could contribute to reducing sterling balances after the war. The disposal of Portuguese sterling

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6 Ibid., p. 452.
balances had similarities to the case of India, as sterling balances remained significant well into the 1950s.⁷

This article aims to establish the history of Portuguese sterling balances during the Second World War. It covers the 1940 agreement, the process of accumulation of such balances up to 1945, and the settlement in August 1945. The last stages of the Portuguese case have been overlooked in the literature. The British official history of the Second World War included some material on Portugal in the section on financial relations with neutrals. The Bank of England official histories either do not cover Portugal or confuse the 1945 settlement with the Monetary Agreement of 1946, in spite of the fact that Portuguese sterling balances at the end of the war were equivalent to Argentinean balances which have been extensively considered. This was perhaps due to the fact that British purchases in Portugal sharply declined after mid-1944, in contrast with imports from the Argentine which were substantial in 1945–7. This article is an attempt to cover gaps in the literature from the British point of view and to provide an original analysis from the Portuguese perspective of the long-term issues related to the payment agreement of 1940.

Contrasts between the Portuguese treatment of British and German payments during the war are analysed. The article examines Salazar’s motivations for treating the British better than the Germans up to, say, mid-1943 and then treating the British even better as reflected in Portugal’s proposal in late 1944 which led to the August 1945 agreement. Finally, the article also assesses how Portugal fared under the terms of the 1945 settlement, on the basis of alternative scenarios.

The article has five sections. The first describes the process which led to the Anglo-Portuguese payment agreement of 1940. Section II considers the accumulation of sterling balances in the wake of the 1940 agreement due both to the sharp increase of Portuguese exports, especially of wolfram, and to the contraction of imports. Section III analyses the settlement of the Portuguese balances in August 1945, well before the conclusion of negotiations of the Anglo-American loan towards the end of 1945. Section IV includes evaluations of this settlement—which involved a long-term loan from Portugal to Britain—in terms of counterfactual alternative financial arrangements and also in comparison with other holders of sterling balances.⁸ The final section analyses the singularities of the Portuguese case, focusing on two points: possible explanations for the asymmetrical financial treatment of Britain and Germany during the war, and the extent to which the Anglo-Portuguese settlement of August 1945 reflected Salazar’s concerns about how his authoritarian regime would face the postwar period.

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⁷ Ibid., pp. 452–4; idem, Bank of England; Fforde, Bank of England, pp. 126–7. Pressnell, External economic policy, p. 2, only mentions Keynes’ incorrect statement at the opening of the Anglo-American financial negotiations in September 1945. See Keynes, Collected writings, vol. XXIV, p. 474: ‘negotiations [with Portugal are] now in progress . . . for . . . the revision of the [1940] agreement . . . which would reduce the amount of the accumulated liability payable in gold’. This statement was made more than a month after the Portuguese 1945 agreement had been negotiated (but not yet ratified). For fears of embarrassment with Washington on the compatibility of the Portuguese agreement with the Anglo-American agreement, see TNA, T236/1442, Gunter (United States Treasury, London) to Rowe-Dutton (British Treasury), 15 May 1947, and Ellis-Rees (British Treasury) minute, 21 May 1947. In Schenk, Decline of sterling, the analysis starts after the settlement of the Portuguese balances in Aug. 1945.

⁸ For Portuguese wartime non-economic developments, see Lochery, Lisbon.
Immediately after the outbreak of the Second World War there was friction between the Allies and Portugal concerning economic blockade and foreign exchange matters. Most of the difficulties were related to the British authorities’ limitation of exports to neutrals, such as Portugal, to their 1934–8 average level, and also to restrictions on re-exports. Portugal resisted British proposals for a war trade agreement until the fall of France.9

With the German occupation of France, blockade issues became even more crucial because it became possible for Portugal to export to Germany by land. Portugal became an adjacent neutral as opposed to an overseas neutral, which was separated from the enemy by seas under British control. In July 1940 legislation was introduced by the British to apply rationing to Portugal and Spain and to require that exports had certificates of origin. Navicerts—commercial passports granted to cargoes approved by the British authorities—became compulsory for imports.10

Portugal played a role in the British attempt to contain German influence in Spain, as Salazar agreed to act as an intermediary. Spain was a source of concern due to its unequivocal sympathies towards Germany: an invasion was feared, especially after the defeat of France. The British offered wheat supplies and allowed the export of Portuguese colonial products to Spain through the Anglo-Spanish payment agreement signed in March 1940.11

The sharp devaluation of sterling in relation to the dollar after the beginning of hostilities led Portugal to peg the escudo in November 1939 at escudos 27$50/US$.12 The British started to consider a payment agreement as they wanted to kill the market in free sterling and also pondered whether Portugal ‘would not be prepared to lend us our adverse balance’.13 There were worries that Portugal would divert supplies to Germany.14 After the payment agreement, the escudo–sterling exchange rate was stabilized at escudos 100$00/£ reflecting the stabilization of the sterling–US dollar exchange rate at US$4.03/£.

The negotiation of an agreement dragged on until November 1940. The Portuguese demanded that their credit at the end of the war should be settled in gold in three months, but the British stuck to the position that if the Portuguese insisted ‘they would control [British] imports so as to make such gold transfers insignificant’.15

9 Portugal, Ministério dos Negócios Estrangeiros, Dez anos (hereafter Dez anos), vol. XIV, pp. 55–6, Salazar to Portuguese chargé in Stockholm, telegram 16, 6 Oct. 1939; ibid., pp. 103–7, Selby (British ambassador to Portugal) to Tovar (Ministry of Foreign Affairs, Lisbon), 16 Nov. 1939, 458/52/39, enclosure no. 314; ibid., pp. 156–61, Tovar to Monteiro (Portuguese ambassador in London), ofício 9, enclosed aide-memoire on meeting with King (British Embassy, Lisbon), 29 Jan. 1940.


12 Dez anos, vol. XIV, pp. 94–5, Salazar to Monteiro, telegram 323, 14 Nov. 1939; ibid., pp. 96–8, ofício 11, 14 Nov. 1939.

13 Similar payment agreements were signed with most British trade partners outside the Empire, with the exception of the US, Sweden, and Switzerland. See Sayers, Financial policy, pp. 438–64; TNA, T160/1379, Playfair (British Treasury), minute, 9 June 1940.

14 David Eccles was worried that: ‘There is a grave danger in encouraging an adjacent neutral to think that we know we can’t sell as much as we shall buy. They will then turn to Germany and sell to her rather than pile up useless sterling’; TNA, T160/1379, Eccles to Playfair, 1 July 1940.

Portugal yielded. A payment agreement between the Bank of England and the Bank of Portugal was signed on 20 November 1940. The Bank of Portugal would open a special account in the Bank of England and Portuguese banks would open special accounts in Great Britain. All payments due in sterling from residents in the sterling area to residents in Portugal were to be paid to a Portuguese special account. The Bank of England would open a symmetrical account with the Bank of Portugal. Accounts would carry a guarantee based on the official price of gold of 168s. 6d. per fine ounce. The agreement would remain in force until three months after the conclusion of the hostilities. Instead of settlement in three months, gold delivery would take place as soon as ‘circumstances permit’ and within five years of the end of the agreement.

II

Portuguese concerns about unfavourable imbalances in the bilateral trade made them press for a British diplomatic note that expressed the ‘desire . . . to avoid the accumulation of balance in favour of one country or the other’. Anxiety was more intense in the Ministry of Foreign Affairs than in the Bank of Portugal, where it was said that it would always be possible to reach a settlement.

In 1942 and 1943, as relations became tense over the issue of the supply of goods to Portugal, Salazar repeatedly mentioned the possibility of reviewing the payment agreement. British alarm prompted plans for a visit by Keynes to Lisbon to ‘try the experiment of the power of his seduction on Doctor [Salazar]’. However, it was decided in the British Treasury not to go ahead with it, as it would make clear to the Portuguese the importance attached to the issue by the British government.

British doubts about Portugal’s willingness to accumulate sterling were recurrent. In mid-1942, reports that ‘the Portuguese would be unwilling to accept more sterling unless they receive what they consider an adequate supply of goods’ were discounted. One year later, there were again worries about whether ‘Portugal might not cry “halt”’. There were also worries about whether Portugal ‘in continuing to hold these substantial balances, [might not place] us under an obligation

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20 Dez anos, vol. XV, p. 133, Ministry of Foreign Affairs to British Embassy, note 181, 18 April 1942; Salazar to Monteiro, telegram 327, 18 Sept. 1942; ibid., pp. 186–7, 335–40, memo on Salazar–Campbell–Fish meeting and British aide-memoire, 12 June 1943. Campbell succeeded Selby as British ambassador to Portugal and Fish was the US minister.
21 TNA, FO371/31124, Eccles to Makins (Foreign Office), 30 April 1942.
from which they can expect to derive present or post-war concessions from our part'. However, as it became clear that the Allies would win the war, the Portuguese appetite for sterling remained substantial, as shown by the substantial accumulation of sterling until the payment agreement lapsed (see table 1). British payments to Portugal more than trebled during the war in relation to 1938—from £8 million to an average of £26 million in 1941–5—while receipts stagnated under £10 million. Portuguese sterling balances rose rapidly, reaching a peak in 1942–3 with a monthly addition of £1.5 million.

Britain’s share in Portuguese exports rose from 20.6 per cent in 1938 to 30.5 per cent in 1943, while the share of exports to Germany increased from 13 to 24.4 per cent. Exports of wolfram and fish products rose from 18.7 per cent of Portuguese exports before the war to 43 per cent in 1942 and 1943. Pre-emptive purchases of wolfram played a crucial role in the accumulation of sterling balances,

Table 1.  UK: balance of payments of Portugal with the sterling area and total end of year sterling balances, 1938 and 1940–45, £ millions

<table>
<thead>
<tr>
<th></th>
<th>1938</th>
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<th>1941</th>
<th>1942</th>
<th>1943</th>
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<td>11.0</td>
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<td>2.9</td>
<td>3.5</td>
<td>4.0</td>
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<td>...</td>
<td>6.4</td>
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<td>...</td>
<td>0.7</td>
<td>...</td>
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<tr>
<td>Receipts</td>
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<td>2.1</td>
<td>2.7</td>
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<td>1.5</td>
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<td>End of year sterling balances</td>
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<td>18.1</td>
<td>37.0</td>
<td>55.2</td>
<td>71.1</td>
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Notes: a Aug.–Dec. b Jan.–June. . . indicates the figure is unknown.

from which they can expect to derive present or post-war concessions from our part’. However, as it became clear that the Allies would win the war, the Portuguese appetite for sterling remained substantial, as shown by the substantial accumulation of sterling until the payment agreement lapsed (see table 1). British payments to Portugal more than trebled during the war in relation to 1938—from £8 million to an average of £26 million in 1941–5—while receipts stagnated under £10 million. Portuguese sterling balances rose rapidly, reaching a peak in 1942–3 with a monthly addition of £1.5 million.

TNA, T160/1380, note (Wyatt) on payments agreement, 9 Aug. 1943; ibid., Harmer (British Treasury) to Wyatt (British Embassy, Lisbon), 18 Aug. 1943.

especially up to 1943. The importance of wolfram had been enhanced by its use not only for lamp filaments, steel-cutting tools, and catalysts, but also in armour and armour-piercing shells. Pre-emption became important after mid-1941 as the invasion of the USSR interrupted German access to Chinese wolfram. Imports of non-ferrous metals rose to more than 60 per cent of total British imports from Portugal. While British purchases of wolfram were pre-emptive, Germany depended on Iberian supplies for current production.

Portugal’s aggregate export prices rose, as wolfram prices were almost 29 times higher in 1942 than in 1939. The selection of weights for computing price increases significantly affects the results, as the share of wolfram in total exports increased until 1942, and wolfram exports ceased after mid-1944. Using 1939 or 1945 weights, aggregate export prices increased between 154.7 and 181.9 per cent in relation to 1939, but if 1942 weights are used, average export prices increased by almost 1,300 per cent in relation to 1939.

There were doubts in London as to whether pre-emption of wolfram was justifiable given its high cost, especially in Spain, where prices were much higher than in Portugal: £7,500–8,000 per ton compared to £1,500 in Portugal and £300 in the world market. In spite of misgivings, pre-emption was maintained.

In answer to British pressure to block wolfram exports to Germany, Salazar made the astute comment that, if the German need for it was so acute, an export prohibition would only leave the alternative of the Germans coming to Portugal to obtain it. In early 1942, a Comissão Reguladora do Comércio de Metais (Metal Trade Regulatory Commission) was vested with a monopoly on the purchase of metals. A purchase price of wolfram (65 per cent WO3) of 150 escudos per kilo, including a tax of 70 escudos per kilo, was set. It was understood that the ‘free output’ of wolfram—that is, the output of mines not owned by either British or German firms—would be equally shared between the two belligerents. A quota of 2,800 tons for each of them was fixed. Total war production of wolfram was shared between ‘neutral’ mines (22.2 per cent), Allied-owned mines (56.6 per cent), and German-owned mines (21.2 per cent). The output of German-owned mines was negligible in 1939. Portugal and Germany immediately signed an

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25 TNA, CAB121/507, War Cabinet Chiefs of Staff, memo on wolfram, 7 June 1943.

26 Export price indices have been computed using data from Rosas, *Portugal*, p. 148.

27 Wheeler, ‘Price of neutrality’, pp. 118–19; TNA, CAB121/507, War Cabinet Chiefs of Staff, memo on wolfram, 13 July 1943. The share of Iberian output of wolfram ores in world output reached a peak of 18.9% in 1943. Spanish output, negligible in 1939, reached 60% of the Portuguese output in 1943; Smithells, *Tungsten*, quoted by Caruana and Rockoff, ‘Wolfram in sheep’s clothing’, p. 106. There is evidence for the substantial smuggling of wolfram from Portugal to Spain, induced by the price wedge.

28 TNA, CAB121/503, Cherwell (scientific adviser to the prime minister), minute to Churchill, 19 Nov. 1941; TNA, CAB121/503, Dalton (Minister of Economic Warfare), minute, 17 Nov. 1941; BOE, OV6/213, Cobbold to Waley, 23 March 1942; BOE, OV6/136, Eady (British Treasury) to Cobbold, 19 July 1943; TNA, CAB121/507, Jacob (War Cabinet Office), minute to Churchill on wolfram, 19 July 1943; TNA, T160/1276, Ministry of Economic Warfare (MEW), note on pre-emption of wolfram, 21 Aug. 1943. The impact of wolfram pre-emption on the German war economy is considered in Caruana and Rockoff, ‘Wolfram in sheep’s clothing’, pp. 104–11.

agreement to purchase 2,800 tons in one year. Germany agreed to supply goods—chemicals, railway freight cars, iron products, paper, and mining equipment—whose value would not be less than 60 per cent of wolfram supplies, equivalent to £4.2 million. The balance would be settled in Swiss francs. The Allies complained about the equal sharing of the ‘free wolfram’, as Britain had obtained three-quarters of it before the agreement. Salazar was not sympathetic as he thought that the British were more likely to fulfil the reduced quota due to the larger production of their mines. It was one of those moments when British officials’ admiration for Salazar was tested. A UK–US–Portugal agreement on wolfram was signed in August 1942 to cover purchases up to 4,000 tons. It included the output of British-controlled mines, and 25 per cent of the free wolfram up to 2,000 tons and 50 per cent thereafter.

A one-year agreement with Germany in April 1943 on wolfram supplies involved a slight reduction to 2,100 tons of wolfram. It covered the output of German mines and 50 per cent of free wolfram. The German quid pro quo supply of goods amounted to RM 31.4 million (about £2.8 million) and corresponded to 90 per cent of the value of wolfram to be supplied. Import prices were those of 1938, with the exception of a 10 per cent rise in steel. The German deficit was presumably to be paid in Swiss francs.

This new agreement provoked recriminations from the Allies. Portuguese wolfram export statistics indicate that the Allies were probably right in their complaints that Germany was favoured in 1941–2, as their aggregate imports rose by only 3.9 per cent in 1941 and fell by 19.4 per cent in 1942 (see table 2). German imports increased almost 10-fold in 1941 and by 19.6 per cent in 1942. Only in 1943 was the position reversed, as exports to the Allies more than doubled, while German imports fell by almost 40 per cent. Towards the end of 1943 the US government adopted an increasingly tough line concerning wolfram exports to Germany and sought an export embargo by Portugal. The British stance, initially soft, hardened afterwards as the US authorities remained inflexible. Salazar tried

31 See Telo, Neutralidade portuguesa e o ouro nazi, pp. 221–372, on postwar negotiations concerning German payments to Portugal. The agreement on the supply of wolfram had been preceded in 1941 by an agreement on arms and canned fish. See Louçã, Hitler e Salazar, pp. 47–50.
33 ‘So beautiful to look at . . . like Maynard Keynes, he added to the mastery of his special subjects the magic of clear, persuasive language in which with rare felicity he expressed whatever he had to say or write’, writing in 1983, or ‘Salazar really is a wonder: so quiet, so efficient, so romantic and, I can’t help adding, so extraordinarily fond of me’, David Eccles to Sybil Eccles, 20 July 1940, in Eccles, By safe hand, pp. 97, 142. The official correspondence states that Salazar ‘has the welfare of his people at heart; and that if he allows them to be police-ridden it is for the reason which leads the good-natured schoolmaster to use the birch’; TNA, T160/1198, Campbell to Eden, no. 74, 4 Feb. 1941. Medlicott, Economic blockade, vol. I, p. 511, tempered his enthusiasm for the ‘benevolent despot’ with a quotation from Gordon and Dangerfield, Hidden weapon, p. 103, that it ‘always costs more to buy a man of principle’.
34 Dez anos, vol. XV, pp. 288–90. The agreement covered wolfram exports of 315,000 contos (£3.15 million). German exports account for 90% of this.
35 Dez anos, vol. XV, pp. 300–14, Monteiro to Salazar, telegram 180 and 181, 14 May 1943; British aide-memoire enclosed in Monteiro to Salazar, ofício 214, 14 May 1943; Salazar to Monteiro, telegrams 191 and 192, 15 May 1943; Salazar to Monteiro, telegrams 197 and 198, 16 May 1943.
36 TNA, T160/1276, MEW to Lisbon, telegram 2016 ARFAR, 29 Dec. 1943.
to resist, insisting on strict neutrality. But the Anglo-American pressures mounted. Churchill wrote to Salazar asking for an interruption of sales ‘as any German attack upon Portugal [is] now out of the question’. Salazar, after criticizing the Anglo-Soviet alliance, stated that Portuguese exports made up only a quarter of German wolfram requirements and that, when the Azores agreement on bases had been negotiated, the British had insisted that Germany would not react because of the importance they attached to imports of wolfram and sardines from Portugal. The peremptory British request for total prohibition of wolfram exports to Germany invoked the historic Anglo-Portuguese Alliance. Since the fourteenth century this had been a pillar of Portuguese diplomacy as it involved a British pledge to protect Portugal from its enemies. It had been already invoked in connection with the Azores bases. Salazar agreed to the suspension of all production and exports of wolfram, but lamented that the Allies had not agreed to a limitation of exports to Germany which allowed exports from German-owned mines, doubted the legitimacy of repeatedly invoking the Alliance in matters unrelated to its letter and spirit, and mentioned losses to the ‘national economy’ and to the Portuguese Treasury.

The increase of sterling balances during the war was also due to a decrease in Portuguese imports. Imports from Britain and, after 1941, from the US depended on economic blockade issues. Difficulties related to the economic blockade by the British persisted until the end of 1942. From the start of hostilities the hawkish views of the Ministry of Economic Warfare (MEW) tended to prevail upon those of the Foreign Office, diplomats in Lisbon, and the Portuguese lobby in London. ‘Blockade policy involved a constant battle . . . between MEW “warmongers” who wanted to cut off supplies to Occupied Europe [and adjacent neutrals] as effectively as possible and Foreign Office “appeasers” who were concerned not to alienate neutral governments’. A sharp animosity between Dalton, the MEW

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Table 2. Portugal: wolfram exports, 1936–44, tons

<table>
<thead>
<tr>
<th>Year</th>
<th>UK</th>
<th>US</th>
<th>France</th>
<th>Total Allies</th>
<th>Italy</th>
<th>Germany</th>
<th>Total Axis</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1936</td>
<td>527</td>
<td>0</td>
<td>359</td>
<td>886</td>
<td>0</td>
<td>358</td>
<td>358</td>
<td>76</td>
<td>1,322</td>
</tr>
<tr>
<td>1937</td>
<td>618</td>
<td>0</td>
<td>413</td>
<td>1,031</td>
<td>19</td>
<td>472</td>
<td>491</td>
<td>291</td>
<td>1,815</td>
</tr>
<tr>
<td>1938</td>
<td>744</td>
<td>0</td>
<td>513</td>
<td>1,257</td>
<td>10</td>
<td>230</td>
<td>240</td>
<td>967</td>
<td>2,466</td>
</tr>
<tr>
<td>1939</td>
<td>1,331</td>
<td>84</td>
<td>654</td>
<td>2,069</td>
<td>0</td>
<td>37</td>
<td>37</td>
<td>970</td>
<td>3,078</td>
</tr>
<tr>
<td>1940</td>
<td>1,783</td>
<td>768</td>
<td>540</td>
<td>3,090</td>
<td>30</td>
<td>185</td>
<td>215</td>
<td>135</td>
<td>3,443</td>
</tr>
<tr>
<td>1941</td>
<td>2,363</td>
<td>848</td>
<td>0</td>
<td>3,210</td>
<td>173</td>
<td>1,814</td>
<td>1,987</td>
<td>36</td>
<td>5,235</td>
</tr>
<tr>
<td>1942</td>
<td>2,589</td>
<td>0</td>
<td>0</td>
<td>2,589</td>
<td>43</td>
<td>2,169</td>
<td>2,212</td>
<td>0</td>
<td>4,801</td>
</tr>
<tr>
<td>1943</td>
<td>5,321</td>
<td>0</td>
<td>0</td>
<td>5,321</td>
<td>0</td>
<td>1,342</td>
<td>1,342</td>
<td>5</td>
<td>6,668</td>
</tr>
<tr>
<td>1944</td>
<td>1,987</td>
<td>0</td>
<td>0</td>
<td>1,986</td>
<td>0</td>
<td>701</td>
<td>701</td>
<td>0</td>
<td>2,688</td>
</tr>
</tbody>
</table>

Source: Telo, Neutralidade portuguesa e o ouro nazi, p. 128.
minister, and Salazar can be perceived in the relevant documents. There was friction with regard to import quotas, restraining re-exports, and the level of pre-blockade stocks.41

In early 1941 the Portuguese had agreed to stock limitation, navicerts in the colonies, and the re-export of goods from foreign sources. But difficulties did not abate, as Portugal still resisted the restriction of exports.42 Towards the end of 1942 there was a truce as a war trade agreement with Great Britain was signed. A supply-purchase agreement was also signed by the Allies with Portugal at the end of 1942, extended until the end of 1943, and renewed until mid-1945.43

Concern about the rising cost of imports from Portugal led to an attempt by the Allies to increase export prices in 1943. The British thought that the Portuguese were willing to accept import surcharges to compensate for export charges on tin and wolfram.44 The justifications were to keep the trade deficit ‘within limits’ and to compensate for the taxation of mineral exports by the Portuguese government.45 Prices of ammonium sulphate, copper sulphate, and oil were increased by 100 per cent. Salazar was outraged, in spite of arguments by the Allies that prices of wolfram had been increased by 782 per cent since the beginning of the war, prices of tin by 755 per cent, prices of rosin by 318 per cent, prices of turpentine by 257 per cent, and prices of sardines by 219 per cent. The Allies argued that the proposed price increases would cover only 50 per cent of the wolfram tax but, with an eye on the Azores negotiations, agreed to lower most increases to 50 per cent.46

Some evaluations of the impact of the war on the Portuguese balance of payments have stressed that Portuguese exports increased fourfold between 1938 and 1942 and then 16.8 per cent in 1943—an exaggeration as exports in fact increased 3.4-fold and an additional 2.4 per cent in 1943—and that the export of strategic materials at inflated prices was beneficial to only a few profiteers and to the country’s external financial and trade position.47 Terms of trade improved by 191 per cent until 1942, and then deteriorated in 1945 to levels only 11 per cent above those of 1939. But these evaluations overlook an essential element. This certainly was profiteering at the firm level, but from the point of view of the national economy proceeds could not be cashed in the short term, in contrast with countries that either were favoured by pre-emptive sales, but did not accumulate

42 See Dez anos, vol. XV, pp. 54–7, MEW, memorandum on the application of the quota system to Portugal, 9 March 1942.
47 Gordon and Dangerfield, Hidden weapon, p. 215.
sterling balances, such as Spain, or countries that used their balances much faster than Portugal, such as those in South America. Most of the increased export proceeds in 1940–5 resulted in increased Portuguese sterling balances and were not used to increase imports. Almost 70 per cent of the accumulated increases in exports were matched by increased sterling balances. Total Portuguese wolfram exports to Britain were less than £25 million compared to £76 million of sterling balances in mid-1945. Wolfram-related fiscal extraction by the Portuguese government is unlikely to have exceeded £14 million. As already mentioned, nominal imports stagnated between 1938 and 1942 with import volumes falling by about 45 per cent. Nominal imports rose by more than 60 per cent between 1942 and 1945, but import volumes in 1945 were still almost 25 per cent below the 1939 level.48

The yearly accumulation of sterling balances rose to more than 5.5 per cent of Portugal’s GDP in 1942 and hovered between 4.5 and 5.6 per cent of GDP between 1941 and 1944 (see table 3). By comparison, the sterling balance–GDP ratio of Argentina, another neutral country holding significant balances, was only around 2 per cent.49

Increased sterling balances as a proportion of increases in the means of payment in Portugal were never below 30 per cent and rose to 56.3 per cent in 1943. The accumulation of sterling balances was accompanied by an acceleration of inflation. Portuguese inflation was similar to that in Argentina, where the accumulation of sterling balances reached 50.9 per cent of the expansion of the means of payment in 1944.50 But most of the Argentinean inflation occurred later in the war, while in Portugal inflation erupted after 1941. Portuguese inflationary pressures were enhanced by the payment agreement with Britain as exports increased without a corresponding rise in the supply of imports, even if Portuguese import–GDP ratios in 1938–45 hovered only between 7 and 10 per cent.

### Table 3. Sterling balances as a percentage of GDP and of increased means of payment, 1940–5, in 1,000 contos

<table>
<thead>
<tr>
<th>Sterling balance accumulation</th>
<th>Nominal GDP</th>
<th>Sterling balance accumulation as % of GDP</th>
<th>Cost of living (1938 = 100)</th>
<th>Increase in means of payment</th>
<th>Sterling balance accumulation as % of the increase in means of payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1938</td>
<td>0</td>
<td>23,149</td>
<td>0</td>
<td>100</td>
<td>n.a.</td>
</tr>
<tr>
<td>1939</td>
<td>0</td>
<td>23,381</td>
<td>0</td>
<td>94</td>
<td>366</td>
</tr>
<tr>
<td>1940</td>
<td>350</td>
<td>24,500</td>
<td>1.4</td>
<td>99</td>
<td>1,170</td>
</tr>
<tr>
<td>1941</td>
<td>1,460</td>
<td>29,068</td>
<td>5.0</td>
<td>111</td>
<td>3,368</td>
</tr>
<tr>
<td>1942</td>
<td>1,890</td>
<td>34,021</td>
<td>5.6</td>
<td>135</td>
<td>5,207</td>
</tr>
<tr>
<td>1943</td>
<td>1,820</td>
<td>36,267</td>
<td>5.0</td>
<td>153</td>
<td>3,233</td>
</tr>
<tr>
<td>1944</td>
<td>1,590</td>
<td>35,123</td>
<td>4.5</td>
<td>157</td>
<td>3,840</td>
</tr>
<tr>
<td>1945</td>
<td>510a</td>
<td>36,439</td>
<td>1.4</td>
<td>172</td>
<td>3,049</td>
</tr>
</tbody>
</table>

Note: a Until 8 Aug. 1945. Obtained by residual.
Sources: Tab. 1; Valério, ‘Portuguese capital market’, p. 21.

50 Fodor, ‘Argentina’s sterling balances’, p. 44.
After D-Day the British started to consider negotiations with Portugal to cancel, if possible, the gold guarantee included in the 1940 agreement. Keynes would be satisfied if the gold obligation ceased to apply to new accretions. But it was recognized that if new balances did not carry a gold guarantee the Portuguese would spend them first and preserve the guaranteed balances.

The settlement was outlined in September 1944 by Álvaro de Sousa, Vice Governor of the Bank of Portugal. Sousa proposed that the 1940 agreement should continue in force, and that after the war imbalances should be settled in gold. Balances accumulated during the war would remain frozen for five years and be settled over 25–30 years. Interest rates between 1 and 1¼ per cent were mentioned. British documents do not mention either a gold guarantee or an initial release but it is clear that Sousa had both issues in mind. Sousa’s proposal for settlement entailed a substantial Portuguese concession compared with the terms of the 1940 payments agreement. While it implied that a ‘gold guarantee’ would be maintained, the settlement period was extended from ‘within five years after the end of the agreement’ to a longer period.

The British would have liked to merge negotiations on the settlement with those on post-war payments, but this proved impossible. Recognition that the Portuguese had ‘treated us generously by providing credit to us . . . when we were fighting alone’ did not prevent comments such as ‘we are winning the war and they obviously want to be close to us. They should have faith in the pound and not seek to deprive us of gold which we need for other purposes’. What was feared was ‘whetting the appetites’ of other holders of sterling balances.

In late 1944 the British presented a proposal expressing the hope that Portugal would agree to hold sterling ‘for what is worth’, conscious that the Portuguese would refuse. Sterling balances were to be divided between two accounts. Fifteen million pounds would be transferred to an Account A to cover capital goods purchases. The balance would be deposited into Account B to be repaid ‘in gold’ from the 11th to the 46th year at the rate of 2½ per cent yearly. The balance of Account B would carry interest of 7⁄8 per cent. The British insisted on low rates of interest based on Keynes’ early, unconvincing, argument that it was ‘absurd to pay...
interest on these war debts which have left no productive assets behind them to amortize the debt’.

The British suspected that Salazar was dragging out the negotiations with an eye to a settlement concerning wolfram, but in March 1945 the Portuguese reacted. Besides insisting on a gold clause, they thought the repayment period too long and proposed a repayment schedule that would start in the sixth year at the rate of 5 per cent of the initial balance, that is, five plus 20 rather than 10 plus 36 years.

Portugal insisted on repayment after five years, but Britain stuck to 10 years, offering to shorten repayment to 20 years. Agreement was reached between the Bank of England and the Bank of Portugal on 8 August 1945, exactly three months after V-E Day, as stipulated in 1940. The Bank of Portugal letter was backed by a letter from Salazar to the British Ambassador. Outstanding sterling balances amounted to £76,195,000. Of these, £15 million were deposited in Account A for capital goods expenditure, as already mentioned. The residual £61,195,000 was covered by a Treasury bond with instalments falling due yearly after August 1955.

There were minor releases in 1948–9 (see table 4). Amounts outstanding were revalued by 43.9 per cent in 1949 and 16.7 per cent in 1967 due to sterling devaluations. Yearly amortizations started in 1955.

The British government insisted that the terms of the agreement should be kept secret, apparently due to concern that the ‘gold guarantee’ could create difficulties with other holders of sterling balances, notably India. When prompted to give publicity to the terms of the agreement, after the Anglo-Argentinean agreement of September 1946 mentioned a revaluation guarantee, the British insisted on a postponement. British reluctance to make public the details hinged on the rate of interest of 7/8 per cent yearly, contrasting with 1/2 per cent included in other agreements. It was agreed that only a reference to the ‘gold clause’ would be

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58 TNA, T236/2684, Ellis-Rees memo, 25 April 1947, repeating Keynes, ‘The problem of India’s sterling balances’, 10 Aug. 1943, in Keynes, Collected writings, vol. XXIII, p. 343. It is relevant to remember that the US loan under the Anglo-American settlement at the end of 1945 carried a 2% rate of interest. In a meeting with the Americans in mid-September, Keynes explained that the British had ‘made it clear to the governments concerned that it was not in the spirit of arrangements concerning these balances that they should be invested in longer-term securities’; Keynes, Collected writings, vol. XXIV, p. 476, minutes of a meeting held at the Federal Reserve Board, 16 Sept. 1945; TNA, FO371/49479, draft letter, enclosure in Ellis-Rees to Garran (Foreign Office), 4 Jan. 1945. Keynes had also been in doubt about payments in gold after only five years; TNA, T60/1275, Keynes to Waley, 6 Nov. 1944.


60 Ibid., vol. XV, pp. 600–3, memorandum handed to Clarke (British minister, Lisbon), 14 April 1945.

61 Ibid., vol. XV, pp. 614–16, memorandum, 28 June 1945, enclosed in Mathias (Ministry of Foreign Affairs) to Neves (charge in London), ofício 26, 30 June 1945; TNA, FO371/49481, London to Lisbon, telegram 392, 7 June 1945; TNA, FO371/49482, London to Lisbon, telegram 510, 16 July 1945, and Lisbon to London, telegram 740, 18 July 1945. In the middle of the negotiations, Portugal agreed, in a demonstration of goodwill, that sterling balances would not be adjusted to take into account an increase in the London gold price from 168s. 6d. to 173s. 8d. per fine ounce in line with the exchange rate of 4.03 US$/£ and the price of gold in the US. See Dez anos, vol. XV, pp. 607–8, aide-memoire, 28 May 1945, enclosed in Palmella to Salazar, ofício 225, 28 May 1945.

62 BOE, C44/202, Catto (Governor, Bank of England) to Branco (acting governor, Bank of Portugal) and Branco to Catto, 8 Aug. 1945; Arquivo Histórico do Banco de Portugal, Lisbon, Acordos Comerciais e de Pagamentos-Inglaterra, Diversos 1935/1952, Salazar to O’Malley (British ambassador to Portugal), 8 Aug. 1945.


64 TNA, T236/1442, Grant to Weston (both British Treasury), 22 Oct. 1946.
made.65 In 1947, the Minister of Finance, Costa Leite, answered a question by a deputado on the agreement in general terms: ‘the liquidation agreement allows, without loss of the gold guarantee, the utilization of such credits’.66 In 1951, when the subject of writing a history of the Bank of Portugal was discussed, it was clear that ‘only some clauses [of the 1945 agreement] were publicly known’.67

The Portuguese case was singular as there had been a firm British commitment in 1940 to settle ‘in gold’ within five years of the end of the agreement. It was an achievement of British diplomacy—based on a rather generous opening Portuguese offer—to make sure that ‘only some clauses [of the 1945 agreement] were publicly known’.67

The Portuguese case was singular as there had been a firm British commitment in 1940 to settle ‘in gold’ within five years of the end of the agreement. It was an achievement of British diplomacy—based on a rather generous opening Portuguese offer—to make sure that there was a postponement of payment beyond the five years even if it carried a revaluation clause. The British government had good reasons to negotiate rather early with Portugal—before negotiations with other sterling holders, as well as before negotiations of a financial agreement with the US at the end of 1945—and to keep some details secret.

In the early 1950s the British tried to convince Portugal to accept redemption of balances through yearly payments in sterling to be converted into European Payments Union units and to forego the revaluation guarantees. Portugal resisted and payments were made by Britain between 1955 and 1973, as agreed in 1945.68

In parallel with the negotiations on the settlement of sterling balances accumulated during the war, Britain and Portugal negotiated a monetary agreement to regulate bilateral payments after August 1945.69 Portugal pressed for a revaluation

### Table 4. Portuguese sterling account B, 1945–73, £ millions

<table>
<thead>
<tr>
<th>Year</th>
<th>Transfers to Account A</th>
<th>Amortization</th>
<th>Revaluation adjustment</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug. 1945</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>61.2</td>
</tr>
<tr>
<td>1945</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>61.2</td>
</tr>
<tr>
<td>1946</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>61.2</td>
</tr>
<tr>
<td>1947</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>61.2</td>
</tr>
<tr>
<td>Feb. 1948</td>
<td>3.8</td>
<td>0</td>
<td>0</td>
<td>57.4</td>
</tr>
<tr>
<td>1948</td>
<td>0</td>
<td>25.2</td>
<td>82.6</td>
<td></td>
</tr>
<tr>
<td>Sept. 1949</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>81.0</td>
</tr>
<tr>
<td>?1949</td>
<td>1.6</td>
<td>0</td>
<td>0</td>
<td>81.0</td>
</tr>
<tr>
<td>1949–54</td>
<td>0</td>
<td>4.4</td>
<td>0</td>
<td>76.6</td>
</tr>
<tr>
<td>1955b</td>
<td>5.1</td>
<td>4.0</td>
<td>25.7</td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td>2.1</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

**Notes:**
- a End of year unless otherwise stated.
- b Yearly amortizations of £4.4 million until 1966.
- c Yearly amortizations of £5.1 million until 1972.


67 Soares Branco to Costa Leite, 29 Sept. 1950, reporting an interview with Teixeira Ribeiro. Soares Branco’s summary of the agreements on sterling balances was that Portugal treated Britain with magnanimity by providing a ‘blank cheque’—quoting Ellis-Rees—and Britain reciprocated by providing gold guarantees not offered to any other country. For the quotation from Ellis-Rees about the ‘blank cheque’, see his memorandum, TNA, T236/1446, 15 Jan. 1946, mentioned in Portugal, *Relatório da Comissão de Investigação*, pp. 35–6.


69 *Dez anos*, vol. XV, pp. 660–4, enclosed in Palmella to Salazar, telegram 270, 16 April 1946.
guarantee but the British did not budge as it was thought ‘perhaps a little rash to assume that there was any intention on our part to alter the value of sterling’.70 After difficult negotiations, an agreement was signed in April 1946.71

IV

The Anglo-Portuguese settlement of 8 August 1945 preceded the Anglo-American financial agreement signed in December 1945, in contrast with other settlements of sterling balances. It was unaffected by American pressure for a scaling down of sterling balances, a corollary of the Anglo-American agreement as Washington did not want to see its loan to Britain used to settle the sterling balances. In Britain, Churchill and Cherwell early in the war had been in favour of a write-off of sterling balances, especially in the case of Egypt and India. They faced opposition from the Treasury, stronger opposition from the Bank of England, and very strong opposition from the India Office and the Colonial Office. As sterling balances increased, Keynes became increasingly hawkish regarding a write-off.72

Two angles are relevant in assessing the settlement: first, comparison to alternative financial returns which could have been obtained in unrestricted conditions; and second, comparison to other sterling balance holders.

For Portugal a solution based on the purchase of sterling-denominated British assets was not possible.73 The sterling-denominated foreign debt of Portugal had been reduced by a conversion in 1940 of almost £20 million of the 3 per cent 1902 sterling loan, corresponding to more than 53 per cent of the total foreign debt, into a consolidated 4 per cent internal loan. In 1945, a further £7.9 million was redeemed so that by the end of the year only £8.4 million of sterling-denominated debt was outstanding. The 1940 conversion was carried out in response to the devaluation of sterling following the outbreak of the war.74 The stock of British direct investment in Portugal was modest. There is no detailed information on British direct investment in Portugal at the time of the 1945 agreement, as Bank of England estimates do not specifically identify Portuguese investments.75 Data on British capital collected by the Foreign Office in 1952, however, suggest a total stock of British direct investment in Portugal of £25 million, of which £10 million involved the provision of public services.76 Data on the main suppliers of public services—the Portuguese Telephone Co., the Lisbon Electric Tramways, the Benguela Railway, and the Trans-Zambesia Railway—suggest that, if anything, this is an overestimate.

70 TNA, FO371/49484, Ellis-Rees, memorandum on negotiations in Portugal, 30 Aug. 1945.
71 Tensions included a temporary suspension of Portuguese purchases of sterling being deprecated as ‘typical Salazar behaviour’; TNA, FO371/49485, Garran to Cadogan (Foreign Office), 12 Dec. 1945.
72 The most explicit defence of a scaling down of sterling balances was a speech by Dalton, the Chancellor of the Exchequer, on 7 April 1947: ‘this vast accumulation of debts represents an unreal, unjust and unsupportable burden . . . Sooner or later this must be substantially scaled down. Britain is strong, but one sign of her strength must be a refusal to take on fantastic commitments which are beyond her strength and beyond all limits of good sense and fair play’; Abreu, ‘Brazil as a creditor’, p. 459.
75 Bank of England, *United Kingdom overseas investments*.
Evaluation of the 1945 settlement abstracting from comparison with other sterling balance holders hinges on comparisons between the implicit rate of return of the 1945 settlement and the return that could have been obtained on alternative investments. Without a revaluation guarantee the rate of return of holding Portuguese sterling balances between 1945 and 1973 would have been 0.875 per cent, the nominal rate of interest on Portuguese sterling balances. The internal rate of return implied in the 1945 settlement, taking into account the revaluation of outstanding balances and of amortization payments due to the sterling devaluations of 1949 and 1967, was 3.2 per cent (see table 5). This was still below the interest rate that reflected the long-term cost of borrowing in London. Using yearly yields on British Consols and the cash flow implied in the 1945 settlement, the rate of return would have been 5.1 per cent. The rate of return on investment in 10-year dollar bonds—without revaluations and maintaining the modest releases in 1948 and 1949—would have been 3.1 per cent.

These comparisons underestimate the extent of the Portuguese losses involved in such a long-term arrangement. The postwar period was marked by a steep increase in the prices of capital goods which the Portuguese would have preferred to import. Between 1945 and 1974 the sterling prices of iron and steel increased four-fold. If the volume of capital goods that could have been bought at 1945 prices is compared to the volume that could have been bought over the 1955–73 period, the implicit rate of return is −2.2 per cent.

Could Portugal have done better? Sousa’s initial proposal containing a devaluation clause implied an internal rate of return of 4 per cent in an ex post evaluation including the consequences of the sterling devaluations of 1949 and 1967. The British opening bid was 0.875 per cent, excluding a revaluation clause. When it became clear that the Portuguese would not accept exclusion of a ‘gold’ clause the British counterproposal involved a rate of return of 2.6 per cent. The rate of return which resulted from the final agreement was 3.2 per cent, midway between the initial bids. The end result would appear to be a reasonable compromise between the initial proposals.77

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Table 5. Implicit internal rates of return in Portuguese and British proposals for the settlement of sterling balances, 1944–5

<table>
<thead>
<tr>
<th></th>
<th>Sousa, Sept. 1944</th>
<th>UK 1, end of 1944</th>
<th>UK 2, end of 1944</th>
<th>Portugal, April 1944</th>
<th>Final, Aug. 1944</th>
</tr>
</thead>
<tbody>
<tr>
<td>‘Gold’ clause</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Interest rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Before 1st payment</td>
<td>1.5%</td>
<td>?</td>
<td>0.875%</td>
<td>0.875%</td>
<td>0.875%</td>
</tr>
<tr>
<td>During repayment</td>
<td>1–1.25%</td>
<td>?</td>
<td>0.875%</td>
<td>0.875%</td>
<td>0.875%</td>
</tr>
<tr>
<td>Grace period</td>
<td>5 years</td>
<td>?</td>
<td>10 years</td>
<td>5 years</td>
<td>10 years</td>
</tr>
<tr>
<td>Repayment period</td>
<td>25–30 years</td>
<td>?</td>
<td>36 years</td>
<td>20 years</td>
<td>20 years</td>
</tr>
<tr>
<td>Internal rate of return</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No devaluation</td>
<td>1.25%</td>
<td>0.875%</td>
<td>0.875%</td>
<td>0.875%</td>
<td>0.875%</td>
</tr>
<tr>
<td>Perfect foresight</td>
<td>4%</td>
<td>0.875%</td>
<td>2.6%</td>
<td>3.2%</td>
<td>3.2%</td>
</tr>
</tbody>
</table>

Sources: See text.

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77 Assuming that all alternatives involved short-term payment of £15 million for capital goods imports. An ex post evaluation indicates that if Portugal had waived the gold guarantee that would be equivalent to almost half of the amount actually received (47.5%, based on 1973 present values).

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Comparisons with other sterling balance holders are enlightening, but it is misleading to compare nominal interest rates applying to outstanding balances and revaluation clauses. From this point of view the Portuguese settlement was slightly better than other settlements, such as the Argentinean one, since the rate of interest was 7/8 per cent rather than 1/2 per cent and both agreements carried a revaluation clause. But the South American settlements were negotiated with the expectation that sterling balances would soon be used to purchase British assets.

Comparisons with other neutral sterling balance holders in Europe show how atypical was the case of Portugal. As the British official history puts it, ‘the problems varied from the Spaniards’ chronic shortage of sterling to the embarrassingly large accumulation in Portuguese hands, with the Swiss and Swedish problems in between’. In Spain, the problem was ‘to buttress her neutrality against Germany’s seduction’. In Switzerland, Britain bought as little as possible, and settled the balance in gold held in Canada.\(^{78}\) The case of Sweden is instructive as it hinged on an evolving assessment of the outcome of the war at different points in time. Swedish wartime exports to Britain until 1944 were paid for in gold. The Swedish behaviour was unfavourably compared in London to that of the Portuguese, who had treated Britain ‘so well’. With the Allied victory approaching there was, in 1944, a reversal of the balance of bargaining power and the British resorted to tit for tat: as we ‘took it out at [them] . . . they realised they had to work their passage’. ‘We proposed that they should hold up to £50 million over a period of 5 years. This covered the gold we had had to deliver to Sweden during the war’. This compares with the £5 million balance settled with Portugal in the monetary agreement negotiated in 1946. So an arrangement with Sweden that during the war seemed more favourable than the 1940 Anglo-Portuguese payment agreement and its settlement became less so after the war. Comparison with arrangements involving South American sterling holders is difficult, as much hinges on the details of the sales of British-held assets whose value was controversial. Both neutrals for the duration or eventual belligerents used their sterling balances to buy either the railways or foreign debt.\(^{79}\)

It was in relation to the sterling area holders that British liabilities had aspects similar to those involved in the 1940 agreement with Portugal. Given the size of Indian balances, the possibility of settling the balances by the disposal of British assets was, as in Portugal, never considered a significant part of the solution. On the other hand, balances were reduced by a range of initiatives specific to the Indian/Pakistan case such as the purchase of surplus military supplies and funding of central government and provincial pensions.

The arrangements between Britain and India under the Defence Expenditure Agreement of 1940 stipulated that Britain should meet the cost of Indian troops beyond Indian borders. As Indian sterling balances soared, this caused trouble in London, including criticisms such as those of Churchill, who thought that India should pay more for the defence of the Empire. In spite of British pressure in


\(^{79}\) See Ellis-Rees, ‘Convertibility crisis of 1947’, pp. 8–9, on Swedish negotiations and ibid., p. 15, on Keynes’ volte-face on how Portugal should be treated in 1946, changing his stance from ‘indignation’ over what he deemed excessively generous treatment of Portugal to agreement with Ellis-Rees’s proposal which reflected Portugal’s good behaviour during the war. See Sayers, *Financial policy*, p. 451, for references to the ‘mystical significance’ of the barely disguised tit-for-tat British proposal to the Swedes, and ibid., pp. 447–9, for comments on other neutrals holding balances. See also UK, Treasury, ‘Sterling balances since the war’, pp. 20–1.

negotiations, there was no reduction of balances. But, on the other hand, there was no revaluation clause coupled with an average rate of interest of around 0.8 per cent yearly.\textsuperscript{80}

V

What makes the Portuguese accumulation and settlement of sterling balances worthy of attention? In spite of the gold clause and the provision on the agreement’s validity for three months after the end of the war included in the agreement of November 1940, the arrangement was favourable to Britain and became more so as the war continued. This was in contrast with the case of other adjacent neutrals or non-belligerents, as illustrated by the Swedish case.

Britain was also better treated than Germany in relation to wartime purchases. This requires explanation. Germany exported to Portugal about 80 per cent of the value of its purchases and settled the balance in gold or Swiss francs equivalent to perhaps £33 million over the 1939–45 period, while the British were able to finance imports from Portugal of around £80 million in 1940–5.\textsuperscript{81}

There are multiple explanations for the asymmetry, but full discussion of this issue is beyond the scope of this article. At the time the agreement was signed, the British did not anticipate that their trade deficit with Portugal would be so significant.\textsuperscript{82} Pre-emptive purchases of minerals, especially of wolfram, only became important after the German invasion of the Soviet Union. Salazar, after the French defeat, conjectured that Portugal’s trade deficit with Britain could persist.\textsuperscript{83} There is no reason to believe that the British thought differently.

When the payment agreement was signed in November 1940, the British were fighting alone. It is likely that expectations of a German defeat were at their lowest level in Portugal.\textsuperscript{84} Even so, Salazar decided to sign the agreement. Salazar’s evaluation of the war’s outcome was certainly decisive in justifying different payment arrangements with belligerents. From this perspective, the signature of the Anglo-Portuguese agreement is surprising. But there were political and geographical realities to be taken into account. The ‘oldest ally’ argument, stressing the close relations between Portugal and Great Britain, in spite of the Portuguese declaration of neutrality, had gained new strength as Portuguese—and British—fears of a military initiative by Spain and Germany against Portugal increased. There was a sustained Anglo-Portuguese effort as early as 1939–40 to contain German influence in Madrid.

\textsuperscript{80} Tomlinson, ‘Indo-British relations’; BOE, OV56/92, memo by Commonwealth Relations Office on India’s sterling balances and independent dollar holdings, 2 April 1957.

\textsuperscript{81} The amount of German war payments to Portugal is the subject of controversy: they were initially in Swiss francs, but afterwards in gold, through the Swiss National Bank. Wartime net gold acquisitions through account C in the Swiss National Bank—to a large extent reflecting the settlement of German purchases in Portugal—amounted to 44.9 tons. It is known that imports of arms from Germany of some £6.5 million in 1941 and 1943 were not included in the Portuguese trade statistics (see Louçã, Hitler e Salazar, pp. 237–8), but this does not affect the argument that the accumulation of sterling balances was substantially larger than German war payments.


\textsuperscript{83} \textit{Dez Anos}, vol. XIV, pp. 254–5, Salazar to Monteiro, telegram 220, 14 July 1940.

\textsuperscript{84} Salazar is reported as believing in a peace of compromise by late 1941 and in an Allied victory by mid-1942. See Rosas, Martins, Amaral, and Rollo, História de Portugal, vol. 7, pp. 307, 470.
The Portuguese record on abiding by political or economic neutrality was mixed and, of course, changed as the prospects of an Allied victory became clearer. Politically, neutrality was strict until the major concession in 1943 on the Azores. Economically, British advantages concerning the payment of imports were compensated by the favourable treatment of Germany with regard to wolfram export allocations, which was only reversed in 1944.85

Portugal faced a dearth of imports during the war. Allied supply was 2.5 times German supply in value and most of the residual of almost 60 per cent of total Portuguese imports depended on Allied-controlled shipping. Portugal depended even more on Allied-controlled sources of vital bulky supplies such as wheat, coal, fuels, and lubricants. The Allies knew this and played the supply card forcefully.

From the point of view of the settlement of sterling balances in 1945, there were important Portuguese singularities. In contrast with negotiations with most of the other British creditors, an early agreement avoided most of the problems raised by the lack of compatibility with the terms of the Anglo-American loan negotiated at the end of 1945. As mentioned, the stocks of British investments in Portugal, or of sterling-denominated Portuguese debt, prevented a solution similar to those in South America. This made inevitable a long-term arrangement which took the form of a loan from Portugal to Britain. Even the Indian sterling balances ended up having a shorter history than that of the Portuguese balances, which ended only in 1973 when the loan was finally repaid.

Doubts remain as to why Alvaro de Sousa—instructed by Salazar—made an initial proposal involving modest interest rates and long repayment periods. It suggests that, by being accommodating to the British, as acknowledged in London, Salazar was trying to build on the Azores agreement and ensure that Portugal would not face problems in the postwar period with regard to the controversial aspects of its neutrality policy.

Factors that may explain Salazar’s treatment of Britain can be detected in his speeches of August 1945, in which he enthusiastically stressed the importance of Britain in the Allied victory and of the British alliance in face of difficulties related to United Nations membership.86

British support would be important to improve the chances of the postwar survival of Salazar’s domestic rule without significant change. In spite of all the political instability that would mark the 1943–7 period, the regime continued. There was uncertainty about the US stance on the issue, and there are indications that Salazar counted on the British to counter this potential threat.

Finally, given Salazar’s postwar record on colonialism, another possible explanation for Salazar’s pro-British bias is an evaluation of the impact of different war outcomes on the integrity of the Portuguese Empire. It is true that the British had considered a ‘reshuffling’ of African colonies as part of appeasement until 1938, but this was abandoned.87 Suspicions about Germany’s colonial intentions in the event of victory in continental Europe became acute. In 1945, Africa was deemed

85 See Reginbogin, Faces of neutrality, pp. 24, 126, 197.
86 Salazar, Discursos, pp. 93–4, 101–22; Nogueira, Salazar, pp. 570–1; Rosas et al., Portugal, pp. 296–7, 373–5, 394.
87 See Stone, Oldest ally, pp. 82–113, for ‘colonial appeasement’ involving Portuguese colonies, the German colonial campaign in the mid-1930s, British initiatives, Portuguese suspicions, and Hitler’s refusal to link European and colonial appeasement in March 1938.

by Salazar to be especially important, as the centre of gravity of the Western Alliance had moved to the Atlantic. It is hard to deny that Salazar’s stance on Britain throughout the war, but especially in 1944–5, helped to make the Portuguese regime and its priorities more acceptable to the US and other Allies, though this was certainly enhanced by the emergence and deepening of the Cold War.

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88 Portuguese sensitiveness concerning the colonial empire was shown by the difficulties with the Allies concerning Timor; see Telo, Portugal, vol. II, pp. 209–18.

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