

What's a little debt between friends?

By Finlo Rohrer
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The UK is about to pay off the last of its World War II loans from the US. But it hasn't always been so fastidious.

On 31 December, the UK will make a payment of about \$83m (£45.5m) to the US and so discharge the last of its loans from World War II from its transatlantic ally.

It is hard from a modern viewpoint to appreciate the astronomical costs and economic damage caused by this conflict. In 1945, Britain badly needed money to pay for reconstruction and also to import food for a nation worn down after years of rationing.

"In a nutshell, everything we got from America in World War II was free," says economic historian Professor Mark Harrison, of Warwick University.

"The loan was really to help Britain through the consequences of post-war adjustment, rather than the war itself. This position was different from World War I, where money was lent for the war effort itself."

Britain had spent a great deal of money at the beginning of the war, under the US cash-and-carry scheme, which saw straight payments for materiel. There was also trading of territory for equipment on terms that have attracted much criticism in the years since. By 1941, Britain was in a parlous financial state and Lend-Lease was eventually introduced.

The post-war loan was part-driven by the Americans' termination of the scheme. Under the programme, the US had effectively donated equipment for the war effort, but anything left over in Britain at the end of hostilities and still needed would have to be paid for.

But the price would please a bargain hunter - the US only wanted one-tenth of the production cost of the equipment and would lend the money to pay for it.

As a result, the UK took a loan for \$586m (about £145m at 1945 exchange rates), and a further \$3,750m line of credit (about £930m at 1945 exchange rates). The loan was to be paid off in 50 annual repayments starting in 1950, although there were six years when payment was deferred because of economic or political crises.

Generous terms

It's easy to cough and splutter at the thought of our closest ally suddenly demanding payment for equipment rather than sparing a billion or two as a gift.

But the terms of the loan were extremely generous, with a fixed interest rate of 2% making it considerably less terrifying than a typical mortgage.

Still there were British officials, like economist JM Keynes, who detected a note of churlishness in the general demeanour of the Americans after the war.

Nobody pays off their student loan early, unless

they are a nutter
Dr Tim Leunig

His biographer, Lord Skidelsky, says: "Keynes wanted either a gift to cover Britain's post-war balance of payments, or an interest-free loan. The most important condition was sterling being made convertible [to dollars]. Everyone simply changed their pounds for dollars. [Loans were] eaten up by a flight from sterling. They then had to suspend convertibility. The terms were impossible to fulfil."

Anne Moffat, the MP for East Lothian, asked the parliamentary question that revealed the end of the WWII loan after being pressed by an interested constituent. She is a little surprised that we are still paying the Americans off all these years later.

"It is certainly bad that no-one seems to have known about it. It seems to be a dark, well-kept secret."

Historic debts

Yet for Dr Tim Leunig, lecturer in economic history at the LSE, it's no surprise that the UK chose to keep this low-interest loan going rather than pay it off early.

"Nobody pays off their student loan early, unless they are a nutter. Even if you've got the money to pay it off early, you should just put it in a bank and pocket the interest."

And if it seems strange to the non-economist that WWII debts are still knocking around after 60 years, there are debts that predate the Napoleonic wars. Dr Leunig says the government is still paying out on these "consol" bonds, because it is better value for taxpayers to keep paying the 2.5% interest than to buy back the bonds.

In a 1945 state department survey on the US public's attitudes to its wartime allies, Britain was one of the least trusted countries
Dr Patricia Clavin

And while the UK dutifully pays off its World War II debts, those from World War I remain resolutely unpaid. And are by no means trifling. In 1934, Britain owed the US \$4.4bn of World War I debt (about £866m at 1934 exchange rates). Adjusted by the Retail Price Index, a typical measure of inflation, £866m would equate to £40bn now, and if adjusted by the growth of GDP, to about £225bn.

"We just sort of gave up around 1932 when the interwar economy was in turmoil, currencies were collapsing," says Prof Harrison.

Nor were we alone. In 1931, US President Herbert Hoover announced a one-year moratorium on war loan repayments from all nations so the international community could properly discuss what it was going to do.

British resentment

Many Britons felt that the US loans should be considered as part of its contribution to the World War I effort.

"The Americans lent Britain a lot. Britain resented making payments," says historian Dr Patricia Clavin, of Oxford University.

And although Britain was unable to pay its debts, it was also owed the whacking sum of £2.3bn.

OUTSTANDING WWI LOANS

Britain owed to US in 1934: £866m

Adjusted by RPI to 2006: £40bn

Other nations owed Britain: £2.3bn

Adjusted by RPI to 2006: £104bn

These loans remain in limbo. The UK Government's position is this: "Neither the debt owed to the United States by the UK nor the larger debts owed by other countries to the UK have been serviced since 1934, nor have they been written off."

So in a time when debt relief for Third World nations is recurrently in the news, the UK still has a slew of unresolved loans from a war that finished 88 years ago. HM Treasury's researchers descended into its archives and were unable to even establish which nations owe money. The bulk of the sum would probably have gone to allies such as nations of the Empire fighting alongside Britain, says Dr Clavin.

Nor is HM Treasury able to say why the UK never repaid its WWI debts - even though, at the time, many Americans took a dim view of repayments being suspended, for they had bought bonds which stood little chance of showing a return on their investment.

Thus despite fighting on the same side in WWII, an air of financial distrust remained after hostilities ended.

"In a 1945 state department survey on the US public's attitudes to its wartime allies, Britain was one of the least trusted countries," says Dr Clavin.

During the crisis years of the 1930s, only one nation continued to pay in full - Finland. Perhaps a conscious effort to foster a good reputation with an increasingly influential power, Finland's actions generated thousands of positive stories in the American media at the time. Nor has it been forgotten; the Finns celebrated this achievement in an exhibition last year.

But for the UK, a reputation for reliability has taken longer to restore.

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