

ESSAYS IN INTERNATIONAL FINANCE

No. 20, September 1954

"THE COLONIAL STERLING BALANCES"

IDA GREAVES



INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS AND SOCIOLOGY

PRINCETON UNIVERSITY

Princeton, New Jersey

This is the twentieth number in the series ESSAYS IN INTERNATIONAL FINANCE published from time to time by the International Finance Section of the Department of Economics and Sociology in Princeton University.

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GARDNER PATTERSON, *Director*
International Finance Section

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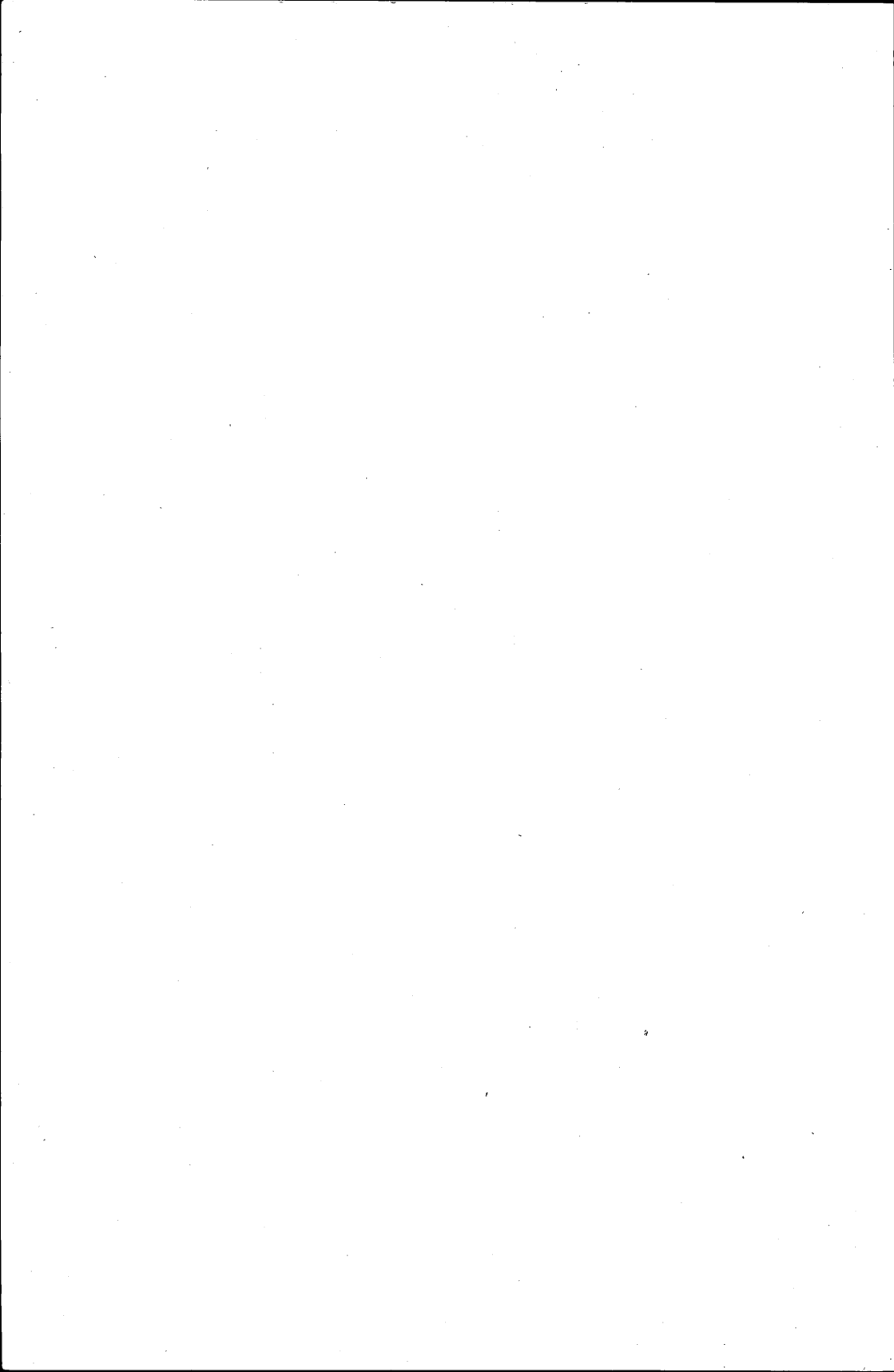


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I. INTRODUCTION

A NOTABLE postwar addition to the international financial scene has been the "sterling balances," more explicitly described in official publications as "sterling liabilities of the United Kingdom" to overseas countries. Discussion was at first concentrated on the total volume of this indebtedness, which amounted to some £3.7 billion at the end of the war. But in the past three years attention has been increasingly directed to the fact that the balances held by the colonies have steadily increased while those owing to the Dominions and foreign countries have been reduced. Thus, from 1946 to mid-1953, the liabilities of the United Kingdom to the colonies under this account more than doubled while those to other areas declined by over 20 percent. As of mid-1953, these "sterling assets of the colonies" had risen to nearly £1.3 billion.*

* Unless otherwise noted, the data on "colonial sterling balances" used in this essay are those given for the "sterling assets of the colonies" in the annual reports on *The Colonial Territories* by the Secretary of State for the Colonies. Another official publication—the semiannual White Paper on *United Kingdom Balance of Payments*—also gives information on the United Kingdom "sterling liabilities" to "dependent overseas territories." The balance-of-payments White Papers have followed a policy of treating as secret everything about the sterling balances except the bald figures of the territorial totals. On the other hand, in his reports to Parliament, the Colonial Secretary has given some details about the colonial balances and his figures are used here inasmuch as this essay is largely concerned with an examination of the nature and purposes of the component parts of the total.

The White Paper figures on "sterling liabilities" of the United Kingdom to the colonies, frequently used by economists, have in recent years been from £97 million to £145 million less than the figures on "sterling assets" of the colonies. Virtually all of these differences arise from the fact that London is the normal market for all colonial government transactions on capital account. The colonies therefore buy as well as sell securities there and in the course of this process become debtors and creditors of each other and of other parts of the Commonwealth. While the loans of one colony or Dominion are the sterling assets of others, they are not liabilities of the United Kingdom to the holders and are therefore not included in the United Kingdom's balance-of-payments White Papers. The aggregate amounts of colonial and Dominion securities included in the colonial assets used in this paper are reported to have been £97 million at the end of 1950, £122 million at the end of 1951, and £145 million at the end of 1952. Data for earlier years are not available. This increase reflects not only the rise in the colonies' sterling assets but also the expansion in colonial borrowing in London since the war.

Clearly there is evidence here of a special colonial situation. But exactly what is its nature? Are the balances a tribute the colonies are forced to pay to the United Kingdom? Do they represent a last effort of the erstwhile international banker to prevent the collapse of sterling? Certainly the subject of the colonial sterling balances has produced a notable unanimity of opinion among people who do not usually show such harmony where other matters are concerned. Conservative ministers and Communist spokesmen, practical bankers and impractical spenders, *The Economist* and *The Daily Worker* have all agreed that the sterling balances represent exploitation of the colonies and that they ought to be repaid. Some critics go further and warn that when the inevitable day of repayment comes the inherent weaknesses of sterling, partially concealed since the war at the expense of the colonies, will be fully revealed and it will be impossible to deny the bankruptcy of the banker for the Sterling Area.

It has in recent years been fashionable to be indignant about colonial conditions, and official British spokesmen have learned to be apologetic. It is, however, precisely in this period when they have not only expressed repentance but promised reform that the most striking increases in the colonies' sterling balances have taken place. And the attention of some critics has been caught by the fact that the accumulation of London balances by the colonies has in effect offset the declared policy of increasing the capital available to them from the United Kingdom by the Development and Welfare Acts and special purpose bodies, such as the Colonial Development Corporation. Far from the United Kingdom expanding its investment in the colonies, these critics charge, the colonies are being forced to invest in the United Kingdom.

The colonial sterling balances, therefore, offer two aspects of interest and importance. One is their relationship to the international position and prospects of sterling. The other is their economic significance for the various colonies to which they belong. The importance of judging correctly whether a certain trend in its external liabilities is evidence of a growing weakness in London's money markets is obvious. The second aspect also has wide implications at the present time because of the international attention directed to "imperialism" and "colonialism" and all their conditions and effects. This aspect, moreover, is relevant to an assessment of the new international policy of assisting and improving "underdeveloped countries." The monetary and financial organisation of the British colonies represents a long historical evolution of economic relations between the type of country now called "underdeveloped" and an international capital and industrial centre. The evidence this organisation can provide of relative cost or gain, of

hardship or benefit, to the different parties should be of value in formulating future policy for similar economic conditions.

II. THE SPECIAL POSITION OF THE COLONIES

The serious strictures and forecasts to which the figures of the colonial balances have given rise all too often take a great deal for granted and explain nothing about the nature and causes of their rising volume. But there are certain conditions characteristic of the colonies and of their economic relations with the United Kingdom which must be clarified if the significance of these sterling balances is to be understood: What particular places come under the description of colonies? What are the major differences between their economic position and that of the Dominions and other countries? What are the composition and origins of the published figures of colonial assets in London?

The colonies, or colonial territories, are those parts of the Commonwealth for whose administration the Colonial Office is responsible. It is probably simplest to think of them in seven geographical groups comprising (1) the West Indies, British Guiana, British Honduras, the Bahamas and Bermuda; (2) the West African territories of Gambia, Gold Coast, Nigeria, and Sierra Leone; (3) the Central African territories of Northern Rhodesia and Nyasaland; (4) the East African High Commission territories, Kenya, Uganda, Tanganyika and Zanzibar; (5) Singapore and the Malayan Union, which includes North Borneo and Sarawak; (6) the Pacific islands, Fiji, Tonga, Gilbert and Ellice Islands, and the Solomons; and (7) the global ring of ports and bases, Gibraltar, Malta, Cyprus, Aden, Mauritius, the Seychelles, Hong Kong, the Falkland Islands, and St. Helena.

There are, of course, differences between the various colonies in the organisation of their political and economic affairs and in their economic and administrative relations with the United Kingdom. What interests us here, however, are the respects in which, as a group, they are distinguished from the Dominions in their financial and economic relations with the United Kingdom. None of the colonies, no matter what its degree of self-government, has its own central bank or an internal capital market adequate for the needs of its finances, public or private. All colonies make local issues of currency in their traditional denominations of dollars and cents, shillings and pence, rupees, or piastres, and use the London money market for practically all their long and short term capital financing. It follows that they have neither foreign exchange rates nor external currency transactions separate from those of London, and that their loan rates and other credit conditions are closely related to those prevailing at the same time in the London market. Colonial Governments, indeed, borrow in London at

the "gilt-edged" rate because their loans have been given trustee status by a series of Colonial Stock Acts. With this special status they enjoy a credit rating only a shade lower than that of the Government in the United Kingdom and considerably higher than that of foreign countries which negotiate loans in London according to private bankers' estimates of the complex of risks involved. In fact, therefore, the whole monetary and financial relationship of the colonial territories to London is of a different character from that of the Dominions, each of which has its own central bank, relies for most of its financing on its own capital market, and controls its own interest and exchange rates separately from those of the London market. It follows that the assets and reserves which the colonies hold under the head of sterling balances are not on the same footing as those held by the Dominions and other countries. The same economic significance should not, therefore, be attached to them, either from the standpoint of the London market or the overseas creditors. Where the colonies are concerned, the sterling balances are the result of transactions in their one and only capital market, London. These transactions are external from the geographical but not from the economic standpoint because the colonies are essentially overseas parts of the English monetary system.

It must also be noted that none of the sterling held in London by the colonies was ever frozen or placed in a segregated account which could only be drawn down by special agreement with the United Kingdom authorities. This procedure was adopted in connection with the abnormal wartime accumulations of some other countries, but the present colonial balances have always been at the disposal of the various bodies in whose names they were held. Another difference was in the handling of military expenditures during the war. The colonies were paid on current account for everything they shipped to Britain and to other parts of the Commonwealth; moreover, the costs of their contribution to the war effort in the form of manpower and local bases were met from the finances of the Government in the United Kingdom and not from those of their own Governments. The Dominions, which did not then include India, Pakistan and Ceylon, paid for their own part in the war and also provided some measure of reverse lend-lease; the liabilities to them which the United Kingdom incurred during the war years were chiefly for essential imports for which the customary export payments were not available during that period.

The colonies had sterling assets before the war of the same type (except for the funds of the new commodity marketing boards) as they have had since, but no figures of their volume have been published. Therefore, when we look at the colonial total of £504 million at the end of December 1946, the date at which the survey of sterling balances

usually begins, and watch its subsequent steady rise in contrast to the downward trend of other balances, it is important to remember that the figures at this date show not only the normal differences between the financial relations of the colonies and other countries to the London markets, but also the results of the abnormal war years when the Dominions, India, Egypt, Argentina and some other countries accumulated sterling credits for reasons which did not apply to the colonies. It follows that where the latter were concerned there was no exceptional situation to undo and no common basis of comparison for the subsequent trend of their balances and that of the balances of other sterling creditors. The colonial balances represent routine transactions which were established in principle before the war and have increased in variety and volume since.

III. THE COMPOSITION OF THE COLONIAL BALANCES

The report on *The Colonial Territories 1952-1953* has a paragraph entitled *Sterling Balances* which reads: "Sterling assets of colonial territories comprise the net assets in sterling held with banks (including acceptance houses and discount houses) in the United Kingdom by their branches and by other banks and residents in colonial territories, including any British Government securities held by banks; funds of the East and West African Currency Boards; funds held with the Crown Agents for the Colonies by Colonial Governments and other public bodies, including funds held as cover for local currencies; loans by Colonial Governments to Her Majesty's Government in the United Kingdom, expressed in sterling or sterling area currencies; and, so far as known, sterling securities held by official bodies, but not those held by private individuals or firms."* It is not strange that this obscure verbiage should have facilitated, if not created, misunderstanding and confusion on the subject of colonial sterling assets. It is our primary task here to clarify the above description in terms of the colonies' normal financial affairs. The most notable general point about the above statement is that it identifies the colonies' balances with assets, a term indicative of permanent and specific provisions rather than temporary or fortuitous credits. Its more particular importance is to be seen in the list of London

* Cmd. 8856, para. 441. It should be noted that the term "net assets" applies only to the London holdings of the banks. The description of "resident" is applied to persons or business concerns located in a colony of which they are not natives. Hence all externally owned and organised business is "resident" in the colonies where it operates. Since 1943 banks in the colonies have been required to report their balance sheet position. This shows their London assets, but if a "resident" business keeps funds in a United Kingdom bank which does not have a colonial branch, there is no public record of its sterling holdings. The East African and West African Currency Boards are mentioned separately because they have their headquarters in London.

"funds" which make up the sterling balances held by the colonies. These are as follows:

Assets of the Colonies Comprising their Total "Sterling Balances"
(millions of pounds)

	1950	1951	1952		
	Dec. 31			June 30	Dec. 31
Currency Funds	282	308	337	343	363
Other Funds with the Crown Agents:					
a. Special	151	164	181	195	199
b. General	114	158	180	203	244
West African Marketing Boards & Uganda Price Assistance Funds	83	109	133	132	133
Funds with Banks in the United Kingdom	219	275	255	282	271
Total	849	1014	1086	1155	1210

Source: Cmd. 8856.

These data by no means completely reflect colonial financial relations with the United Kingdom, either on capital or current account. Indeed, they are not even a selection of special significance except that they do fully represent the sterling balance figures which have been the occasion of the deprecation, indictment, and foreboding noted earlier and with the validity of which this essay is concerned. The marked limitations even of the limited records used in the compilation are shown by the restriction of bank assets to United Kingdom securities only, although the banks carry investments in other sterling securities; in excluding the sterling holdings, other than securities, of public bodies, which in this context mean the Marketing Boards; and in omitting altogether the securities of private individuals and firms. The published figures nevertheless have a certain meaning, and we will examine the various funds listed above with a view to clarifying the nature of each and the purpose it serves in the general system of colonial economy.

At the outset it should be noted that there is no line or figure in the table for the type of colonial asset described as "loans by Colonial Governments to Her Majesty's Government in the United Kingdom," a description that readily suggests forced contributions to the British Exchequer. The relatively small number of loans of this type made by a few colonies during the war have nearly all been repaid, and it is misleading now to have this empty category colouring the record of the

present balances. None of the assets for which figures are provided above represent loans or contributions to the Government in the United Kingdom. As we shall see, they are the result of routine transactions by certain public authorities and institutions in the separate colonies who retain full control of the various monies and investments involved. Indeed, it is because records are normally kept of these transactions that this particular list of assets has been available. There is no published evidence of an attempt to discover the overall credit or debit position of the colonies.

The first three heads of the table, Currency Funds, Other Funds with the Crown Agents for the Colonies, and West African Marketing Boards and Uganda Price Assistance Funds, represent the holdings of various public bodies whose investment practices are regulated by law. They have acquired their London funds in the course of the routine operation of various Government departments and authorities. The last head, Funds with United Kingdom banks, represents the London assets of commercial banks with colonial branches, all of which are private institutions. If we can discover the reasons why the funds under all these heads are held, we will be able to see what the colonial sterling balances mean in relation both to the economy of the colonies and to the position of sterling in general.

Funds with United Kingdom Banks

I shall start my survey with the head which comes last in the official list, that is, Funds with United Kingdom banks. The banking system is the basis of all colonial monetary organisation and therefore forms the logical point from which to approach other aspects of the organisation, especially the Currency Funds. Moreover, I regard the bank funds as an anomalous element in this official list of assets because the banks concerned are all private institutions and their funds are not on the same footing as those under the other heads which represent the operations of public bodies. Moreover, the presence of these funds in this context is misleading inasmuch as they represent for the most part assets held by branch banks in their own London head offices, which is a different position from that of an investor in external securities.

The real nature of these funds would be more readily recognisable if they were described as the London assets of all *commercial* banks doing business in the colonies. These banks are to a predominant extent branches of large, long-established institutions with head offices in London and the Dominions. Those incorporated in the Dominions, such as the Canadian banks with branches in the West Indies and the Hong Kong and Shanghai Banking Corporation which is registered in Hong

Kong, have London offices which handle their sterling business with the colonies. Some colonies—for example, Trinidad, Malta, Mauritius, Nigeria, Malaya—have an independent local bank or two as well as branches of external institutions. Only Bermuda has local banks alone, and only a few small colonies, such as St. Helena, the Seychelles, and Tonga, have no commercial banks of any kind. The branch banks keep their sterling funds in the London offices of their own institutions. The independent banks, playing only a minor role in colonial finances, make special arrangements for London facilities; some have an agreement with the local branch of a London bank for handling their external requirements, others keep an account with a United Kingdom bank which does not have colonial branches.

Unfortunately, much secrecy still shrouds the details of the London funds of the colonial banks. It follows from the nature of the branch banks' reports, however, that their London assets represent, subject to a few trivial corrections, that part of their total deposits which they are not holding in local cash or using for local loans and advances. The branches do not include any capital of their own in their estimate of liabilities. Nor should the funds with which we are dealing here—a part, however illogical, of the colonies' assets in London—be confused with the capital of the parent banks in the United Kingdom and elsewhere. These funds comprise London assets of different degrees of liquidity which the branch banks in the colonies hold on account of their own business.

Some observers have regarded these funds, for which there are no statistics of debits and turnover, as being idle and stagnant. They are nothing of the kind. Their London assets constitute provision for meeting drafts the banks expect to be presented for payment in London, the investment of local deposits which cannot be employed more profitably in the colony, and short term earning assets which are not available in the colonies. These bank funds are subject to considerable seasonal variation, being normally higher in June, the slack post-marketing season in most colonies, than in December, the peak month of some crop seasons and the beginning of others. Local currency flows out of the banks during the production and marketing season and steadily returns when the season ends. The level of bank funds from year to year is affected by several factors, the more important being the amount of savings deposits the banks are holding, the deposits of United Kingdom and other overseas firms engaged in colonial business, and the deposits of internal business concerns in the colonies, which originate largely in loans and advances from the banks. The total volume of deposits from all these sources follows movements in the price level and responds to

such other important influences upon a colony's income as increases and decreases of military activity and fluctuations in tourist traffic.*

Apart from investments for their savings deposits, therefore, the London balances held by the banks are closely related to their total business deposits. All the petroleum industry in colonial territories, almost all the mining, most of the plantations, nearly all the public utilities not owned by Governments, and a large part of the import-export trade, is owned in the United Kingdom and financed from the central accounts of the owners. To a great extent, these concerns handle the financial side of their colonial business through the United Kingdom offices of banks having branches in the colonies. The firms obtain credit in the United Kingdom as far as possible because it costs less than bank loans in a colony. At the same time, the bank commissions on remittances between the United Kingdom and overseas branches are a strong deterrent to making unnecessary transfers of funds, and the choice between paying either a commission or a higher rate of interest must in some instances be a close one. In general, however, external firms keep only working funds in the colonies for meeting their local costs of operation. Their main assets and residual funds are kept at home. And it must be remembered that it is often not necessary to transfer funds from the colonies in consequence of export sales as exports are usually paid for in the overseas markets where they are sold. It is the *local* producer of exports who brings the proceeds of his sales back to the colony, although from his standpoint he "gets the money from the bank" at the time of shipment. Small farmers usually sell their produce for cash to buying agents and export merchants who have brought funds to the territories to finance their purchases.

When deposits increase in a colonial bank, whether they originate in a local branch or in the United Kingdom office, the bank's assets of course increase correspondingly. And if conditions in one or more colonies are such as to cause the accumulation of idle or stagnant deposits, the bank will show an increase in its earning assets in London. The conditions giving rise to this situation are various: market expectations may cause traders to run down stocks and build up cash; uncertain internal conditions, as in Malaya in recent years, may discourage increased investment and even normal maintenance; political changes may commend liquidity instead of new commitments; or there may merely be abnormal delay, as in 1944-1948, in getting deliveries of certain goods. Bad weather may ruin some crops, reducing the need for seasonal financing and so leaving London funds unused. When the statistics of colonial

* A few colonies have begun to sell a limited quantity of "Treasury Bills" to local banks, but, in general, colonial economies do not provide the liquidity the banks traditionally require for most of their short term investments.

bank balances in London show a change, and the change does not always have to be upward as it has been since the war, it is important therefore to look for the particular cause responsible, and not to assume that there is an adverse overall monetary factor at work. And of course the operations of foreign business concerns in the colonies have the same effect upon local bank deposits and assets as those of the United Kingdom firms we have considered, although the first source of the business funds is different.

What meaning is there in calling bank assets of this nature and origin external liabilities of the United Kingdom? Some of them, as we have seen, are held against savings deposits subject to withdrawal in certain colonies. A considerable part, however, represent the current accounts of business concerns in the United Kingdom, and a reduction in these accounts is a liability that the banks would meet by an internal transfer of assets in that country.

The Currency Funds

These funds are the sterling counterpart of the local currency issues of the several colonies plus approximately ten per-cent accumulated income from the operations of the currency authorities. They are not in origin or function equivalent to the reserves of an independent monetary system. These funds have been built up in the course of issuing colonial currency under what is commonly called the "Currency Board system." Except for St. Helena, which uses English currency, every colonial government has, either separately or as part of a regional group, a currency authority in charge of issuing and redeeming its currency. The East African and West African Currency Boards have their headquarters in London. The other currency authorities, some of them regional boards and some commissioners of currency in separate colonies, are located in the places they serve, and the sterling with which their currencies are purchased is paid into their accounts with the Crown Agents, who take charge of the ensuing funds and investments. The currency authority for each colony has the simple technical function of issuing local currency upon demand in exchange for an equivalent amount of sterling paid into its accounts in London, of redeeming local currency with payments from its sterling funds when required, and in general of supervising the physical character and condition of the circulation.*

To avoid misunderstanding, which seems to be remarkably easy on

* There are a few minor exceptions to the general practice of using London sterling as the basis of local currency in the colonies. For example, the Gilbert and Ellice and the British Solomon Islands use Australian currency, and Tonga has its own currency issue, but based on Australian pounds.

this point, let us add that the currency authorities are neither bankers nor dealers in foreign exchange. They have no discretionary power in the monetary affairs of a colony. They exercise no initiative, make no decisions, run no risks, and the cost of their operations is low. Their issue and redemption procedures merely make stable and uniform the position of the colonies as overseas parts of the English monetary system. This is by no means an insignificant function, but it does not carry responsibility for all the monetary aspects of colonial economy, many of which are necessarily derived from the close English connection. Indeed, the crucial factor in the working of the whole colonial currency system is the capacity and the willingness of the banks in the colonies to provide the sterling for purchasing all the local currency required. In effect, colonial currency is an incidental part of the branch banking system with its centre in London which we examined in the preceding section. Increases in the Currency Funds represent a transfer of sterling from a bank's assets to those of the currency authority in exchange for approximately the same amount of local currency. No colonial government makes capital provision from its budget or earmarks earnings from external trade for the purpose of currency reserves.

The currency authorities deal in minimum amounts of £1500 to £10,000, according to the size and requirements of different colonies, and charge a commission, usually $\frac{1}{4}$ - $\frac{1}{2}$ %, for transfer between local currency and sterling. Normally, the authority is not restricted by law to dealing only with banks, but in practice it is only the banks who buy and sell currency for sterling as occasion warrants. The local public obtains all the currency it requires for both personal and business purposes from the banks. This method of issuing colonial currency means that each currency authority comes into possession of sterling in London equivalent in value to the currency issued plus the commission charged on the transaction. Therefore, unless the authority's expenses absorb more than its commission, it will always be in possession of at least as much sterling as there is local currency outstanding. The aggregate of the sterling of all the authorities constitutes the Currency Funds with which we are concerned here. In general, the authorities are required by their governing statutes to invest the sterling they do not need for working purposes in the securities of Commonwealth governments other than their own, and to accumulate the income from these investments until they have total assets amounting to 110 percent of the value of the currency for which they are responsible. After this point is reached, they pay their net income into the general revenue of their governments.

This "Currency Board system" first came into operation with the establishment of the West African Currency Board in 1912, and was

gradually extended to other colonies. The latest authority to be set up is that of Malta in 1947. The Malayan Board has recently been reorganised to bring additional territories in that region within the scope of a common currency. The older currency authorities have for some time been able to make contributions to public revenue from their investment income, and the size of these naturally depends upon the volume of each colony's circulation, which varies widely between different colonies. There was, for instance, about £7 of currency per head in the Gold Coast in 1949-1950, only a little over £1 per head in Nigeria at the same date, and somewhat over £2 per head in Barbados and Jamaica.

To appreciate fully the significance of this system one should know something about the earlier methods of currency supply in the various colonies when gold and silver coins of international standing, along with such objects as cowrie shells and *manillas* were in general use, when the chartered banks issued their own notes, and when English token coins were being imported in increasing quantities. Such matters are, however, too long for the present essay. They are also outside the scope of my immediate topic, which, let us recall, is the meaning of the present Currency Funds for the economy of the colonies and the international position of sterling. All we need note here is that there were a variety of local currencies which the banks had been financing since the middle of the nineteenth century, and that since 1825 there had been an official policy of giving the legal tender units in the colonies the same value as sterling. Against this background the "Currency Board system" is seen to be merely a new administrative method, not a new monetary policy. It is, however, a method which provides the colonies with a circulation that yields seigniorage and counterpart assets that yield income, advantages which were lacking in the earlier media of exchange.

It is implicit in the system we have been discussing that the Currency Funds increase automatically with an increase in the issue of a colonial currency. Why and how does such an increase occur? Obviously, the banks will take steps to obtain more currency only if they expect to have to pay more to their customers. For what reasons are they required to do this? The reasons are in general the same as those indicated in the previous section as causing an increase in their deposits: rises in prices, especially the prices of a colony's exports; greater military activities in a colony by an external power; or an increase in tourist trade. All of these increase local incomes. A striking example of the effect of expanded military activities upon local currency supplies is provided by the bases program of the United States in the West Indies during the last war. The Trinidad note issue, also legal tender in some other colonies of the region, rose from £442,800 in 1940 to £4,763,400 in 1943. Since the war, the higher prices for exports have caused an increasing demand

for currency in most colonies, especially in West Africa and East Africa where such crops as cocoa, cotton, and groundnuts (peanuts) are produced almost entirely by native smallholders who are paid for them in cash each season. In other colonies, where the organisation of production is different, wages and salaries have increased, and so have government scales of pay everywhere. The general result has been that the banks find their customers requiring more currency. In providing it the banks increase the Currency Funds by the method we have just examined. It follows that the rise in these funds has no more and no less significance than the conditions that cause it. It is not an isolated phenomenon of the colonial sterling balances. If these conditions were in any degree reversed, the currency circulation would contract and the banks would redeem such amounts as they found in excess of their needs, thereby transferring an equivalent amount of sterling from the Currency Funds to their own assets. This is the only means of reducing the Currency Funds under the existing regulations.

Having acquired this sterling, over £360 million of it by the end of 1952, an important question is: can the colonies make no better use of it than to keep it invested in securities in London? The prime purpose of these investments is to make the redemption of excess colonial currency certain and prompt, but that the whole issue in any colony will be withdrawn is hardly a contingency for which practical provision is needed. Therefore, sterling assets equal to that part of the local issue which will never be presented for redemption can be regarded as superfluous for the original purpose of the Currency Funds. That part could be diverted to other uses without impairing the stability of the currency.

But when we begin to reckon how much sterling would be superfluous on this basis, it appears that the amount of assets thus freed would not be impressive. Prices of the chief colonial products, both agricultural and mineral, have been very high in the past few years, unprecedentedly high in some cases. Can it be assumed that a downward trend will never set in? May the military operations which have affected conditions in some regions since the war not be reduced in the years to come? Where local income has risen permanently may there not be increasing use of checks, and less need for currency? If half of the existing Currency Funds were liquidated and then a declining demand for currency led to 50 percent of the currently outstanding issue being presented for redemption, the currency authority would have no funds left.* This

* These figures are used here merely in illustration. I have not forgotten the 10 percent of sterling assets over the value of the currency that are held by the Currency Board authorities. It must also be noted that in practice they carry a spread of securities redeemable at different dates. Since the market value of their portfolios is subject to fluctuation with changes in interest rates and other conditions, they might not

would not matter if no further demands for transfer into sterling were made before the resumption of new issues in the future, but in some regions short-term transfers of currency are often made between marketing seasons, and the authorities need working funds to meet them. To reduce the sterling counterpart funds by anything like 50 percent would be to take a great risk in circumstances so largely dependent on the course of international affairs, economic and political, beyond the control of the colonial authorities. Probably around one third of the present total is as much as could safely be released from the funds of the older currency authorities; the percentage would certainly be smaller from those of the newer ones.

When the amount available to each colony separately is considered, it does not have the impressiveness of £360 million in the lump. This total owes a great deal to the three large Currency Boards: West African, £109 million; Malayan, £104 million; and East African (including Aden), £52 million. Further, not only do several colonial governments have claims to the assets of each of these Boards, but the larger territories concerned have other assets and sources of finance in amounts which would make a currency windfall from liquidating the Currency Funds relatively unimportant.* The very poor colonies, such as the Leeward Islands, have little currency and would acquire only paltry sums. Whether the recent gush of "development" capital for the colonies needs to be bolstered by diversions from the Currency Funds, or whether these might better be kept for less affluent times, is a question requiring more space and more data than this essay permits. Perhaps the most satisfying reflection for the critics of the "idle" balances locked up in the Currency Funds is that the colonies with the largest amounts will perhaps soon have central banks and independent currencies. They will then find the funds very useful as reserves.

Other Government Funds with the Crown Agents

The Crown Agents for the Colonies (called Crown Agents for Overseas Governments and Administrations since April 1954) are, among other things, the financial agents and advisers of colonial governments, although this part of their work seems to be little known even to specialists in colonial affairs. The Crown Agents act as custodians of liquid funds, manage the investments of departments and various public bodies, and make arrangements for raising government loans. They are not

always obtain the original cost of their investments if a large part of these were liquidated in advance of their maturity dates.

* The total sterling reserves and assets in the accounts of the Gold Coast Government at the end of September 1953, for instance, were £158.5 million. This colony's share in the assets of the West African Currency Board was £30.3 million.

bankers or brokers. They merely serve as a link between overseas governments and the financial institutions and facilities of London. With the steady growth in the size and number of the investment portfolios managed by the Crown Agents, they have, however, become an important factor in the market for securities the colonies enjoy in London. All the London assets of the colonies under the heads of Currency Funds and Government Funds are handled by the Crown Agents.

The division of the Government Funds into Special and General (see table on page 6) corresponds to the purposes they serve in the financial and fiscal scheme of colonial governments. The Special Funds comprise savings bank reserves, the largest single class and amounting to over £70 million at the end of 1952; sinking funds for government loans; the investments of a number of pension and provident funds for public employees; and a minor item classed as renewals funds, representing such depreciation reserves as are accumulated by departments using highly-capitalised equipment. The General Funds in the list, which have increased more rapidly since 1950 than the Special Funds, comprise unspent revenue balances; budget surpluses intended for future use in development projects; and the proceeds of loans raised in London and awaiting expenditure. The Special Funds represent long term calculations for specific, well-established purposes. The General Funds, on the other hand, are largely the result of unpredictable revenues from rising import and export taxes and other adventitious windfalls from royalties on increased mineral output, bigger taxes on better business, and higher levies on larger incomes—all representing the transplanting of modern Westminster doctrine to the colonies in a period when prices and incomes were steadily increasing. The aggregate revenues of colonial governments rose from £57 million in 1938 to £357 million in 1952. But in addition to progressive taxation, there is another modern article of faith in the colonies—economic development—and most of the tax proceeds shown under the head of General Funds are regarded as development reserves of the governments holding them. Nearly every colony has a long term Development Plan for which part of the financing is to be provided out of its own current and accumulated revenues, with the remainder to come from Development and Welfare grants and from loans raised in London. Indeed, the proposed means of financing is sometimes a more specific part of the plans than the uses to which the monies are to be put. Hence, in addition to building up their own surpluses, some colonies have also been floating loans in London as and when the Capital Issues Committee permitted; the resultant funds are held by the Crown Agents in the accounts of the borrowing government until they are spent.

There are, then, three ways in which colonial governments accumulate sterling funds in London. One, they have revenue surpluses accruing there. The external firms doing business in a colony usually pay the income and export taxes, royalties, and other levies to which they are subject, direct to the colony's accounts in London. In general, colonial governments manage their finances without making regular transfers of funds between London and the colonies; liabilities payable in the United Kingdom are generally covered by income received there. Two, they accumulate specific reserves in London to meet present and future liabilities. The sinking and the renewals funds, and a considerable part of the pensions funds, will, as claims upon them mature, be paid out in the United Kingdom and not in the colonies. Three, they hold in London the proceeds of their London issues prior to expenditure. When these are spent, it will be to a considerable extent on equipment and material in the United Kingdom. These procedures have been developed over a long period of time. They are not the result of post-war conditions or decisions. Although it is probable that only the savings bank reserves represent voluntary personal saving, the taxes which provide the other assets are under the control of the colonial governments which impose them—methods and rates of taxation are by no means uniform in all colonies. Modern Westminster doctrine on the subject of heavy taxation has been transplanted by "education," not by decree. It may conflict with the conventional view of colonial poverty to find colonial governments in possession of such ample assets, but this is far from meaning that they are being impoverished to support the tottering economy of the United Kingdom. It is probable, on the other hand, that without their close financial relations with London the colonies would not have acquired so highly developed a system of public finance and would have less scope for investing long-term assets.

West African Marketing Boards and Uganda Price Assistance Funds

These Boards are the only new, post-war elements in the London assets of the colonies. They handle their own finances instead of using the services of the Crown Agents, and their investments did not appear in the official record of sterling balances until 1950. Following the war, a separate Board was established by statute to deal with each major export commodity from West Africa and Uganda, where production is almost entirely in the hands of native producers. Fluctuating prices had been a serious problem in the inter-war period and had caused considerable hostility to the export firms who then bought the native crops. One of the chief functions of each Board therefore was to stabilise the seasonal price of the crop and to reduce inter-seasonal fluctuations as much as possible. Commodity prices after the war were commonly regarded

as abnormally high, and the Boards adopted a policy of paying a fixed price to growers in each season which was less than that which the crop as a whole was expected to fetch, thereby building up a reserve from which growers could be paid a higher price than that for which the crop was sold when a decline in world prices set in. Because the high prices have continued for an unexpectedly long period, the Boards have not drawn upon their reserves for subsidising falling prices, and the accumulating funds have been invested in London. The ultimate disposal of all these assets, plus the not insignificant amounts of working capital, remains under the control of each Board. Some of the Boards have announced that they do not plan to increase their price stabilisation funds beyond the present level, and a few of the governments concerned are considering whether a part of the present funds should not be diverted to other purposes than eventual price stabilisation.

IV. THE LIMITATIONS OF THE PUBLISHED FIGURES

It was pointed out at the beginning of the previous section that the published figures with which we were dealing did not offer a complete picture of financial relations between Britain and the colonies. Now that we have examined the make-up of the record it is clear that the figures are merely those which happened to be available. Apart from the banking funds, they represent official transactions of which each colonial government and the departments concerned in London necessarily had a record. In their partial presentation of the position, these official figures are misleading in two important respects. First, by showing a one-way movement of funds from the colonies to the United Kingdom, they ignore the substantial movement in the other direction. Second, by omitting all private sterling assets other than those of the banks—which are not even stated to be private—they give the impression that only public bodies hold London investments, a position open to the inference that private interests do better elsewhere while the public interest is sacrificed to the needs of the United Kingdom. But in fact there has been since the war a steady flow of payments from the United Kingdom to the colonies under various Parliamentary votes, and private investment in a number of colonies by United Kingdom residents has been steadily expanding. Data are not normally collected on private investments held in the United Kingdom by colonial residents, business or individual, but there is no doubt that both types of investors use the London capital market for purposes for which the economic conditions of their own colonies do not provide.

I know of no published summary on an annual or cumulative basis, comparable to that of the colonial sterling assets, of the loans, grants,

and *ex gratia* payments made by the United Kingdom to the various colonies. We can, however, take note of certain pieces of evidence that funds of this kind have been an important factor in colonial economic affairs. The report on *The Colonial Territories 1952-53* cited earlier states that the total revenue in the year under review for all colonies listed includes *ex gratia* payments by the United Kingdom to various colonies amounting to £9.9 million, of which £7.5 million went to the Governments of Malaya and Sarawak as installments of War Damage Compensation Schemes. This, it should be noted, had nothing to do with the current military campaign against the Communists in Malaya. Malta and Hong Kong have also received varying sums for compensation and reconstruction since the war. Payments recorded in this way in the annual reports are quite separate from appropriations and disbursements under the Development and Welfare Acts. These Acts provide funds on which drawings can be made by a colony over a period of years, once its plans for using the funds have been approved in London.

The total funds available to a colonial government for annual expenditure are seldom limited to the proceeds of its own taxes and loans raised on a market basis. The only way to learn all the sources of a particular colony's revenue is to look at its own annual statement of accounts. A statement made last year by the Minister of State for the Colonies in the House of Lords on Parliamentary grants to the West Indies provides a timely illustration of the general relation of colonial finances to the United Kingdom. Speaking on a motion that the United Kingdom make a free gift of £100 million in quinquennial installments to the Federal Government of the proposed Federation of the West Indies, the Minister was reported as having said that: "... since 1945 West Indian Governments had borrowed £14 million in the London market, and the Colonial Development and Welfare Fund had provided them with £23 million. Projects undertaken there by the Colonial Development Corporation had cost £7 million. Grants-in-aid of the administration had totalled £2 million, and to meet the burden of reconstruction caused by natural disasters the United Kingdom Government had given more than £4 million and loaned £1½ million. A considerable sum of money had also been provided by private investment."* That is, in seven years this small group of colonies, with a population of less than two and a half million people, had received in various ways the sum of £37.5 million from the public funds of the United Kingdom and had raised another £14 million in long term loans at "trustee" rates in London. It is not to be implied that on a per capita basis all colonies have received as much help from the United Kingdom as those in the West Indies.

* *The Times* (London), July 2, 1953.

In addition to transfers from the Government in the United Kingdom to a colonial government, substantial expenditures have been made in some colonies by the two special purpose corporations established by Parliament after the war, namely, the Overseas Food Corporation and the Colonial Development Corporation. These were provided with £50 million and £100 million respectively from the Treasury and were given additional borrowing powers. The Overseas Food Corporation launched only one colonial venture, the highly publicised Groundnut Scheme in East Africa, which was reorganised and reduced after a few years with a loss of nearly £40 million. The Colonial Development Corporation initiated a number of less spectacular projects spread over a number of colonies, details of which are given in its annual reports. It has not committed all of its available funds, none of the projects has yet been profitable, and several have already been wound up as failures. What concerns us here is not the various questions raised about the merits and efficiency of these public Corporations, but the fact that they have been channelling funds into several colonies since 1948.

There is little detailed published information about private investment in the colonies. The record is quite clear, however, that there has not been a withdrawal of external capital from the colonies since the war similar to that from India and Ceylon, which withdrawals to some extent financed the reduction of the official sterling balances of those Dominions. Indeed, there is widespread evidence that there has been a marked increase in the private investment in many colonies from the United Kingdom as well as from the United States and Canada. This investment has gone into the extension of such established industries as oil, copper, tin, lead, zinc, gold and diamonds; into the development of production in new places, such as bauxite and gypsum in Jamaica; into plantation agriculture; into additional power and communications installations; and into new offices, shops and housing. In addition, the general rise in prices has resulted in more than doubling the amount of private capital tied up in financing imports and exports.

The funds which are alleged to have been "drained out" of the colonies to provide sterling balances have not left a mark behind them in the form of dwindling real assets. On the contrary, it is in fact the increase in investment in various forms from external sources which has caused the rise in colonial incomes, and these, we have seen, are reflected in higher sterling assets. While the official figures of these assets are not net (they make no allowance at all for offsetting movements of United Kingdom capital to the colonies) neither are they gross because they do not include all the sterling investments and other claims held by residents in the colonies. Like the public bodies we have listed, private business and individual investors in the colonies also find in the London market de-

sired security, liquidity, and the opportunity to spread their risks. Those United Kingdom trustee issues which are tax-free to overseas residents are regularly bought; and only the system of tax deduction from dividends at the United Kingdom standard rate prevents larger purchases of stocks and shares. One outstanding item in the private capital account is insurance. Policies of all kinds on life and property, with annual premiums running into millions of pounds, are held by residents in the colonies with United Kingdom firms. If the total value of all the policies in force were added to the present figures of United Kingdom liabilities to the colonies, the increase would be startling.

V. CONCLUSION

After this long examination, what can we say in summary of the stirring charges made against the "colonial sterling balances" with which we set out to deal? It might be well to recall at this point that the subject of this essay is not whether the colonies could or should have more novel and adventurous methods of public finance. Rather, it is whether the sterling aspects of the methods they do in fact have qualify for the adverse and minatory criticisms levelled against them.

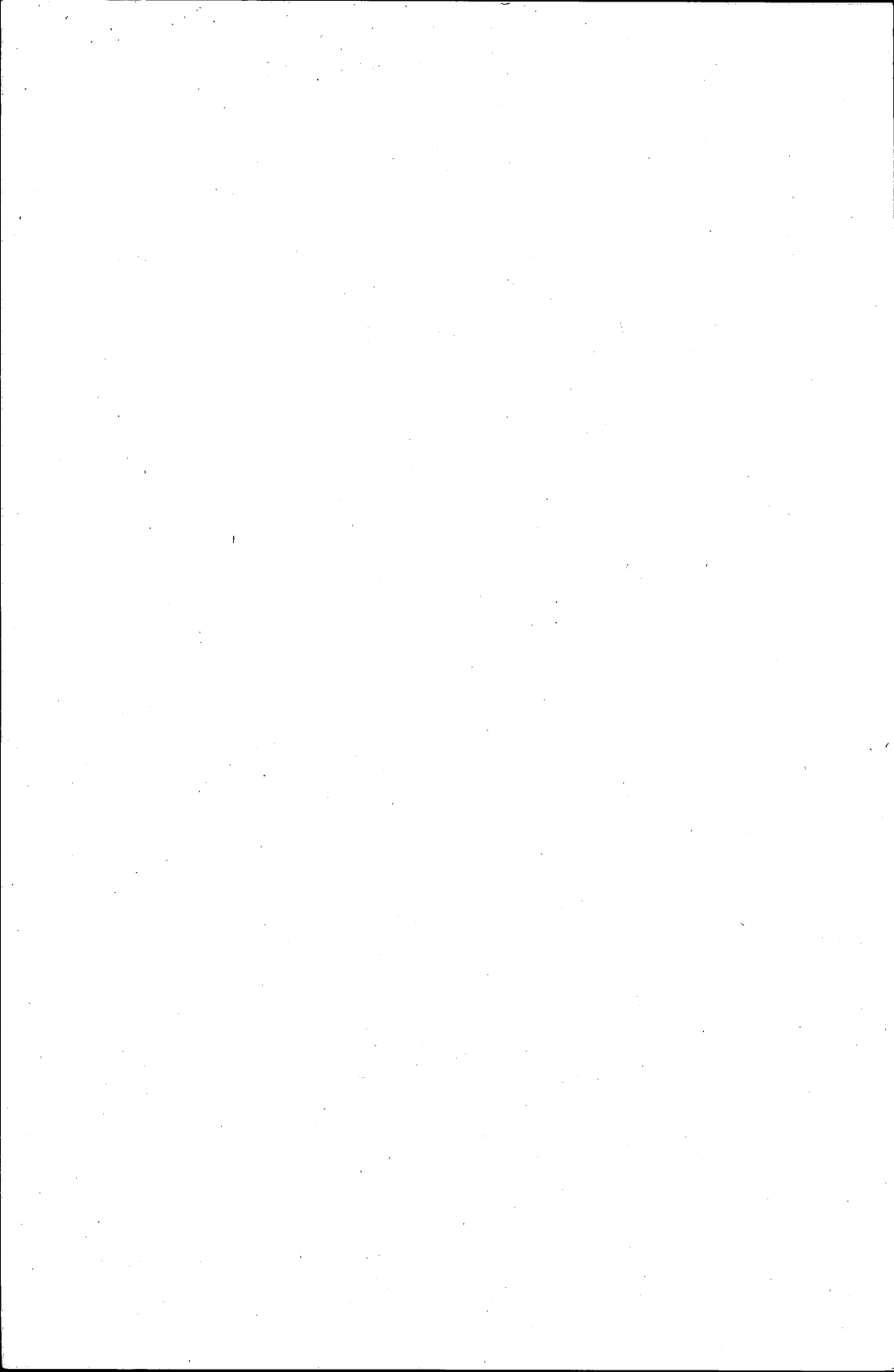
These methods are not a wartime improvisation to meet the United Kingdom's balance of payments difficulties. The sterling assets existed in principle and in smaller amounts from long before the war, from the time when England was on the gold standard and sterling was the world's international currency. Their increase in the past few years is their only aspect that has received much public attention. This rise has been due in some measure to the general rise in prices, which means that colonial economic conditions have been in step with those of other countries, and in other respects to increased expenditures from external sources for a number of purposes, commercial and eleemosynary. In other words, colonial economic conditions since the war have been of the kind widely advocated for the salvation of "underdeveloped" countries: rising raw material prices, more personal savings, bigger development plans, larger external loans, increased civil services, and higher pay and pensions.

It is clear that the colonies' sterling assets are far from being "idle balances." They represent commitments to specific long-run purposes, each of which is an important factor in the colonial economies as a whole. At the same time they have the effect of guaranteeing the stability of the local currency and credit in relation to sterling. The benevolent plea that all the colonial balances be repaid very soon is, like the acrimonious charge that they represent exploitation, based on a misconception. Repaying these funds might well mean pushing the colonies

out of the London capital market; converting all colonial government investments to cash; and undermining the reserve position these governments maintain against current risks and future obligations. It is true that for the short period while the flood of liquidation lasted the colonies might very well consume more. Experience in other areas indicates that the long run cost of this indulgence might be high.

Under the present system the colonial assets cannot be withdrawn from London suddenly or capriciously. It is therefore misleading to regard them as "short term" liabilities of the United Kingdom. Even in the normal process of contraction that could occur with a fall in world prices, some of them will be paid off inside the United Kingdom and not withdrawn from that country. A decline in commodity prices, for instance, would cause a redemption of local currency for sterling which would reduce Currency Funds, but the sterling involved would go into the London assets of the colonial banks. If banking funds were reduced because of the contraction of business, some of the capital used in colonial trade and finance would automatically be withdrawn to the United Kingdom.

It follows that it is also inaccurate to regard the recent expansion of the colonial assets as a peculiar threat or hazard to the international position of sterling. On the contrary, this expansion means that the central core of the sterling area has become richer and stronger. It is higher colonial incomes and more production which have caused the rise in assets, not the growing indigence of the United Kingdom. The asset structure has a high degree of basic stability and operating flexibility. It is not doomed by the first breath of adversity.



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