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.*

The author, Ida Greaves, is a Barbadian who has also lived in several other parts of the British Commonwealth. Recently she made an extensive study of colonial monetary conditions under the auspices of the Colonial Economic Research Committee. Her experience includes the teaching of economics in the United States as well as service with British war-time missions in Washington.

The Section sponsors the essays in this series but takes no further responsibilities for the opinions expressed in them. The writers are free to develop their topics as they will. Their ideas may or may not be shared by the editorial committee of the Section or the members of the Department.

The submission of manuscripts for this series is welcomed.

GARDNER PATTERSON, *Director*
International Finance Section

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

"THE COLONIAL STERLING BALANCES"

IDA GREAVES

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*	*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.