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'In Spite of Tooley Street, Montagu Norman, and The Reserve Bank's Governor'

RECOLONIZATION OR THE ECLIPSE OF COLONIAL FINANCIAL TIES WITH BRITAIN IN THE 1930S?*

IN HIS REAPPRAISAL OF NEW ZEALAND'S COLONIAL LINKS with Britain, James Belich suggests that in the inter-war period no major or lasting steps were taken in the direction of New Zealand's economic and political independence.[1] According to Belich, while there were some changes in the internal economy through increasing the size of the state, the external economic system remained intact, and was 'recolonial'. Using the term 'recolonial unity', Belich refers to the ways Britain and New Zealand were connected as a single cultural-economic system.[2] This was based on bilateral trading relations that developed from the 1880s: New Zealand produced protein-based commodities that the British consumed. An 'invisible protein bridge' formed between New Zealand and London's Tooley Street, where the dairying commodities were marketed and the imperial importing firms set the prices.[3]

Belich highlights the long-term importance of London for New Zealand trade and argues for the centrality of this relationship for New Zealand's economic development. However, there was more to New Zealand's external economic system than this 'recolonial' trading relationship. As well as the trade links in Tooley Street there were also links to Threadneedle Street, home to the Bank of England, in London's financial district. Belich seems to recognize that finance was intertwined in the external economic system, but how this played out and the significance of the colonial state being a major borrower in London from the 1880s is not well understood.[4] Nor is the role of public borrowing. During 'progressive colonialization' — Belich's term for the period from 1840 to the early 1880s — British capital poured into New Zealand, fuelling public spending. After 1880 he claims that public debt kept rising thanks to the costs of compound interest and that there were no 'new net capital imports'.[5]

According to Belich, then, the recolonial external system was based primarily on a reciprocal trading relationship. Public borrowing and currency management are not part of his story. Although he notes the creation of the Reserve Bank in the 1930s, it does not appear as part of the external system, nor in any way alters it.[6] Belich also refers to new formal arrangements for inter-imperial trade, negotiated in Ottawa in 1932. But he argues that the Ottawa Agreement enhanced existing economic relationships and that it masked Britain's decline as an economic power.[7] Economic and constitutional change were thus more apparent than real. New Zealand declined the opportunity to pass the Statute of Westminster in 1931 and was not prepared for formal, if only nominal,

independence. Further, Belich argues that the fundamental binary relationship with Britain survived crises of 'recolonization' in the 1930s, thanks to the strength of the Tooley Street relationship.[8] However, public borrowing and currency management should also be part of the story of New Zealand's external economic system. If New Zealand's relationship with Threadneedle Street in the 1930s is examined then a very different tale can be told, a tale that questions Belich's recolonization thesis.

Rather than New Zealand's trade relationship being in jeopardy during the early 1930s, a crisis of 'recolonization' occurred because of a possible default on external loan repayments in London. This financial relationship is central to Belich's interpretation of the economic situation in 1939, when imperial officials made what should have been a routine conversion of a government loan in London difficult. Belich's account of the 1939 conversion crisis is problematic for his recolonization theory. On the one hand, he suggests that New Zealand was threatened with receivership, if not bankruptcy, in 1939; noting that the British Cabinet discussed 'suspending the constitution and taking direct control'.[9] This presumes a link between the constitutional position of New Zealand and its loan contracts in the London market. On the other hand, Belich claims that New Zealand's finance minister, Walter Nash, did not play his economic cards vigorously enough. Apparently, he could have called the imperial authorities' bluff and threatened a repudiation of the loan repayment if a conversion was not arranged. But since Belich argues that New Zealand was economically dependent on Britain, it is difficult to see how threatening to default was a useful strategy, even if it indicated a form of political independence.

Belich's analysis of New Zealand's economic relationship with Britain in the 1930s is based on a misunderstanding of the direct constitutional link with Britain that was involved when the New Zealand government borrowed money in London. Such borrowing required negotiations with the Bank of England, which was not part of the British state. The Bank of England was concerned with colonial government borrowing in London, and the resulting capital exports in sterling, as part of its role in currency management. If the New Zealand government had a 'card' to play, it was only because, earlier in the 1930s, it had gained control of the local exchange rate and the sterling exchange reserves necessary for debt repayment. By ensuring the legal separation of the currency from the pound sterling, the New Zealand government could, for the first time, control all external financial transactions. With these measures in place, a fundamental change in the external economic system occurred, a change that had important ramifications in terms of the government's financial relationship with London, and a change that has important ramifications for Belich's recolonization thesis.

The creation of a separate New Zealand currency followed an earlier exchange crisis in late 1931, when the New Zealand government could not pay the interest it owed in London, nor raise new loans. The Bank of England organized a rescue package for New Zealand: it assumed control of the New Zealand government's borrowing practices in London, and encouraged trading banks operating in New Zealand to lend to the government. The 1931–1932

situation was a fiscal crisis. It resulted in a new exchange policy, which to be effective required reform of the banking system, as well as substantive change in debt management practice. Although historians have referred to the debate over the exchange rate, and the creation of the Reserve Bank, the situation of external default and changes it led to in imperial linkages have never been examined.

What needs to be explored is how New Zealand governments in the 1930s created a new external economic system despite the interests of the imperial authorities in maintaining the status quo. The Bank of England was a key advisor on the creation of a New Zealand central bank, but insisted the exchange rate be legally tied to the value of sterling and not subject to political discretion. The political situation in New Zealand in the 1930s, however, made local control of the exchange rate inevitable. Despite a substantial devaluation of the sterling exchange rate in 1933, local treasury officials and legal authorities saw this as a temporary expedient, and used test cases involving local authority bonds to deny any legal separation from sterling. New Zealand went from having trading banks control the exchange rate in the early 1930s, to formal exchange control in 1938, largely as a result of the prevailing economic conditions of the Depression. But because of the creation of a new currency, the 1939 exchange crisis represented loan contracts that had been negotiated in what were now distinct currencies. Once the New Zealand pound was separated from sterling, it could no longer be assumed that borrowing in London was in the economic interest of imperial linkages, as assumed in the Colonial Stock Act.

The 1877 Colonial Stock Act permitted colonial governments to issue 'inscribed stock' in London, and convert existing issues of government stock into inscribed stock. The effect in London was to admit these stocks to the books of the Bank of England, which allowed for easy transfer by banks and institutions, increasing their attractiveness.[10] Julius Vogel also wanted to have colonial government stocks granted 'trustee status' under British legislation, to make it equivalent to the imperial government's stock. British Trustee Acts specified the possible investments for trust fund administrators, limiting the investments to British 'gilt-edged' stock, with the lowest possible risk.[11] Adding any colonial government stock to the list of trust fund investments required new legislation, which the imperial advisors were reluctant to accede to before 1900, to avoid giving colonial government stocks the appearance of a British government guarantee. But the market perception of an imperial guarantee for colonial government debt issues was Vogel's clear intention.

New Zealand prime ministers were not alone in seeking trustee status for their government stock being issued in London. David Jessop notes that the Canadian government sought agreement on its addition to the trustee list at imperial conferences in 1887 and 1897, with the legislation subsequently introduced being an acknowledgment of the colonial governments' support in the Boer War.[12] The 1900 Colonial Stock Act, though, introduced three conditions for colonial governments to meet if their stock issues were to be added to the trustee list. The first two conditions allowed London bondholders to have legal redress in the British courts, in case of default on interest or

principal repayments, with colonial governments required to make funds available in London for the judgment. The crucial third condition in the 1900 Act allowed bondholders to ask the British parliament for disallowance of the colonial government's legislation in the event of a breach of contract, or default.[13]

Until the 1930s, observance of these three conditions on the loan prospectus for the London market was something of a formality. As J.B. Condliffe suggested at the time, the Act was in effect a form of imperial preference that outweighed any trade concessions, having 'widened the basis and cheapened the cost of colonial development'.[14] It was taken for granted that the 1900 Colonial Stock Act, and subsequent legislation extending trustee status to all the British colonies, helped formalise intra-imperial ties. For Condliffe and other contemporaries, there did not appear to be a downside to these formal ties to London, the financial centre of the world. At least until 1931, the imperial authorities had not exercised control over bond issues. Though trustee status did not confer a British guarantee, the London market saw the effect of the third legal sanction as an implicit government guarantee.[15]

The constitutional significance of the power of disallowance — the Act's third condition — was that it reintroduced the ability of the British parliament to veto New Zealand legislation, despite New Zealand having adopted dominion status in 1907, and the British parliament passing the Statute of Westminster in 1931.

During the 1920s there was substantive debate in Britain over the scale of public borrowing by the dominion governments, particularly regarding the role of the Colonial Stock Acts in this borrowing. J.M. Keynes was concerned about the capacity of colonial governments to keep borrowing and meet the mounting interest costs, as well as the automatic placement of such stock on the London market.[16] In 1924 he observed, in respect of colonial borrowing, that 'imperial piety has silenced tongues and criticism; and its results do not receive enough attention'.[17] As the level of new colonial borrowing exceeded the annual interest payments, the effect of compound interest, or an inability to secure new borrowing, created the potential for loan default. Obvious questions of national solvency in the dominions were approaching. Keynes also questioned the granting of trustee status to other colonies while British municipal authorities were denied the same status. There was certainly evidence that London's capital was funding public works schemes in Australasia, rather than equivalent public utilities in Britain.[18]

In New Zealand, W.D. Stewart, the Minister of Finance in 1925, was aware of Keynes's criticism of the effect of trustee status and the diversion of capital to the colonies.[19] But for those concerned about the perception of dominion over-borrowing in London, Stewart could point to the debt repayment scheme that had been instituted in 1925. The Repayment of Public Debt Act 1925 created a sinking fund to redeem central government debt over a 60-year period, with an allocation of revenue on an annual basis. The legislation was cited in new loan prospectuses for London bond issues from 1925. But the formula for the sinking fund was very complex and adjustments to the legislation and practice of debt redemption caused constant friction between the Audit Office

and Treasury.[20] With its 60-year debt repayment formula, it was difficult to overcome the criticism that New Zealand was still borrowing heavily. Also, there was no overall debt reduction, even though the appearance of allocating revenue for debt redemption was useful for perceptions of the nation's credit standing in London. Little wonder that Keynes suggested a specific condition or test for new borrowing by the dominions to replace the granting of trustee status. He thought there should be a sinking fund for each new loan, rather than a general budget repayment fund.[21]

From the mid-1920s, capital exports also created a problem for the British authorities, since the transfer of borrowed funds impacted on the sterling exchange rate. This was clearly the case for loans to foreign governments, but the debtor countries within the empire also had to service loans from exchange earnings. To pay New Zealand's interest on loans, officials assumed that there would be a surplus of exports over imports in the London market, thus providing the sterling exchange for debt servicing. But the New Zealand government did not hold sterling reserves, and had no direct control over the local trading banks' exchange reserves. So if there was no export surplus or new London borrowing, there was no source of funds for interest payments in sterling. Instead, the New Zealand government would have to purchase sterling exchange from the trading banks at the current exchange rate, a rate the banks set.

In 1925 New Zealand enjoyed a large export surplus and received a new London loan. The effect of this increase in the trading banks' sterling reserves was an exchange rate appreciation. Treasury officials debated how the government could avoid fresh borrowing in London, so as to make transfers of interest on the sterling loans from New Zealand that would utilize the surplus exchange held in London by the banks.[22] Officials recognized that it was better to borrow from the banks in New Zealand to obtain the sterling exchange, but that the banks were not obliged to lend to the government.

From 1925 the New Zealand government continued to make annual loan issues on the London market, ostensibly for public works purposes, which provided sterling for interest payments. This was also necessitated by a drain on Post Office Savings Bank deposits, and an absence of other local sources of funding for the public works programmes.[23] The British Treasury tended to favour the loans to the dominions for public works on the assumption that such loans led to increased British exports.[24] But the capital exports created a problem for currency management after Britain returned to the gold standard in 1925, since the sterling exchange rate was fixed by gold's value. The transfer problem for the Bank of England was seen to be due to the borrowing under the Colonial Stock Act, which was not subject to any political limitations. To defend the reserves of gold under pressure of outgoing capital exports, the Bank of England would have to raise the interest rate on public debt.

The Bank of England managed the New Zealand government's long-term debt in London, advising on issues of new stock, and on the terms to be offered on conversion loans. Up to 1931, however, the Bank's role was more advisory than directive, and the major difference of opinion was over the cost of management charges. Indeed, the Bank of England's governor, Montagu

Norman, complained that his advice on market conditions was usually sought by New Zealand, but not often heeded.[25]

While foreign governments could be shut out of the London market, Norman noted that protestations to the New Zealand High Commissioner had failed in 1925, and a £7 million loan was proceeded with against his advice.[26] But the bond issue was a failure, with 85% of the total being left to the underwriters; and the reduced loan proceeds, with the added brokerage costs, led to a further debt issue in 1925.[27]

In 1929 the New Zealand government had a large maturing loan to cope with, which the Bank of England was closely involved in. The loan conversion operations had to be dealt with in stages; the complexity of the re-financing required that repayments be remitted from New Zealand, via the trading banks. New Zealand treasury bills were also issued in London to facilitate the final part of the long-term bond conversion.[28] The Bank of England usually opposed the issue of such bills for short-term debt, as they complicated money market operations, but assumed the measure was only for this particular conversion operation. But by 1930 the New Zealand government had issued £2.3 million in treasury bills in London, the money being used to make interest payments, thus avoiding transfers through the trading banks.[29]

Public debt operations became progressively more problematic in the 1930s, as the City of London reacted adversely to Australasian governments issuing long-term bonds while also borrowing in the short-term market using treasury bills. Although the New Zealand High Commissioner assured the Bank of England that the fiscal position in Wellington remained sound, in 1930 there was difficulty repaying local debt issues and finding cash for Post Office Savings Bank withdrawals. Reports in the London financial press claimed that the New Zealand government had been trying to make secret treasury bill placements.[30] It appears that in 1931 Treasury continued to offer private sales of short-term debt without the concurrence of the Bank of England. With £4 million of treasury bills on issue by April 1931, the New Zealand High Commissioner informed the Bank that the government's debt commitments in London would be covered by new borrowing, to a total of £9 million.[31] Bank of England officials continued to urge against the treasury bill sales and advocated an experimental bond issue as an alternative.[32] This bond issue was designed to meet market conditions, and be distinct from the usual long-term loans under the Colonial Stock Act. But the bond issue failed in terms of subscription and costs, and the prices of all New Zealand government stocks in London weakened. This led to further treasury bill sales, arranged with individual market institutions from the High Commissioner's office.[33] Later in 1931, monetary conditions worsened as Britain was forced off the gold standard and the interest rate on treasury bills rose steeply. By October, the New Zealand government realized it would have to transfer money to pay interest, as it might be impossible to renew the outstanding treasury bills.[34] As the 1931 election loomed, the incumbent government could not find funds to repay the short-term debt, and the Bank of England stepped in to avoid a default.[35]

In late 1931, the New Zealand government needed to find £1 million in interest on long-term bonds; it also had £2.5 million in short-term debt to be

renewed or repaid. When the High Commissioner approached the Bank of England for help in late November, he was informed that it was too late to retrieve the situation by re-financing the short-term debt.[36] He was then given a lecture on the results of New Zealand's financial policy. The bank's governor had been informed by market brokers that: 'it was quite impossible to make any issue of New Zealand Stock either short or long term [and] at the present moment the Government were unable to borrow at all and were faced with default both on [Treasury] bills and interest payments'.[37] So the solvency of the New Zealand government now depended on the benevolence of the Bank of England and its ability to arrange for finance in the London market. This new dependence came with some restrictions on the conduct of New Zealand's borrowing in London. All private sales of treasury bills in the London market were prohibited, and any proposed long-term issue had to be approved by the Bank of England. The Bank also insisted on a formal arrangement being entered into with the trading banks operating in New Zealand, whereby the New Zealand banks would provide the sterling exchange for all the interest payments on public borrowing in London at £1 million per month for the next year.[38] A similar 'exchange pool' arrangement had previously been created with the Australasian banks, when the Australian government had faced the same trouble with renewing short-term debt in London.[39]

The formation of an exchange pool advantaged trading banks operating in New Zealand. Insisting on regulations to license the sterling payments from the entire export trade allowed them to shut out alternative players in the exchange market, and left the six banks in complete control of the exchange rate.[40] Though the exchange pool had been brokered by the Bank of England, it set a precedent for government borrowing from the banks in New Zealand; treasury bills were issued to cover internal government expenditure on public works, as well as for transfers in sterling. The trading banks set the terms for the issue of treasury bills, with the government being obliged to alter the normal procedure for notification of the payment dates, as well as being forced to pay an interest rate of over 5%.[41]

It took until mid-January 1932 before the Agreement on the Mobilisation of London Exchange was signed. The sticking points included whether the exchange rate would be pegged, or whether the trading banks would be permitted to make further adjustments, which would affect the amount of sterling that the government needed for payments. Treasury also suggested that the banks should supply information on their sterling transactions in London.[42] The banks were not amenable to this; while treasury had to borrow from them, the banks received confidential information on the public accounts.

The formation of the exchange pool was designed to avert an outright default, by providing sterling exchange in London. As the New Zealand government did not have cash to purchase sterling from the banks, it had to borrow from them using treasury bills. Contemporaries were aware of these developments, but historians seem to see the exchange pool as resulting from bad luck rather than bad management.[43] Some have suggested that the demise of the gold standard created such uncertainty in the London market that the New Zealand government thought it had to repay long-term loans rather than renew them. G.R. Hawke has claimed that there was a large loan (by

contemporary standards) maturing in 1932 and a secretly arranged credit with the Bank of England, as well as the exchange pool agreed to by the banks.[44] In fact, the Bank of England had underwritten an issue of short-term bonds to replace the maturing treasury bills. But writing prior to the files being released by archives, Hawke claimed that interest payments were not an immediate problem in the 1930s, and that the 1932 conversion loan coincided with lower interest rates in London, so New Zealand benefited from cheap foreign finance for the next 25 years.[45] In early 1932, however, the New Zealand Treasury had prepared a report for the Cabinet on what was clearly a fiscal crisis, stating that there was no London loan to convert in 1932.[46] The inability to meet even the regular London interest payments also led Treasury to inquire with the Bank of England whether it was worth liquidating the remaining investments in the government's Reserve Fund, having already sold assets to meet urgent expenditure following the 1931 Napier earthquake. Even if there had been a loan to convert in 1932, the Bank of England had imposed an embargo on conversion loans that lasted until 1933. The lifting of that embargo saw Australian conversions take precedence, not just because of the dire financial situation of its government, but also because of the threat of repudiation.[47]

The exchange pool was necessary because the trading banks controlled the sterling funds earned from exports. These had to be purchased by the government to make interest payments if it could not borrow the sterling in London. Hawke has asserted that there was no balance of payments problem during the Depression, apparently because export earnings remained in surplus and therefore exchange reserves continued to accumulate.[48] But the role of the banks in controlling the sterling exchange reserves in London made it impossible to calculate New Zealand's balance of payments. With all the financial transactions of the empire centralized in London, it was difficult to distinguish the balance of payments for all the countries in the sterling system.[49]

Under the sterling system London-based trading banks set the exchange rates between sterling and local currencies, maintaining sterling reserves for the exchange with the local money supply through telegraphic transfers. While the sterling system remained an informal monetary union, the banks made the domestic credit adjustments to maintain exchange rates near to parity with sterling.[50] The banks operating in New Zealand had treated Australasia as one economic unit, and therefore did not keep separate sterling reserves for each country. Contemporary economists, following A.H. Tocker, had used the available statistics of bank assets and liabilities in New Zealand to try to approximate the balance of payments.[51] But the net overseas assets of the banking system in New Zealand could not be identified until 1934, when the Reserve Bank began operating and took control of sterling reserves. This makes it difficult to demonstrate that New Zealand was accumulating foreign exchange reserves before 1934. Examining banking figures in 1934, the government statistician found that £28 million had been repatriated from New Zealand in a ten-year period from private capital movements; A.H. Tocker suggested that the figure was more like £20 million.[52] But Tocker could only guess at what were the net overseas assets of the banking system.

The exchange crisis that developed in 1931 exposed the absence of legislation making New Zealand's currency legally separate from sterling. That a pound was still a pound anywhere in the empire, and had the same value, was a misconception in both popular and legal opinions. The crucial point was that an 'inter-empire' pound existed as a legal concept, since borrowing contracts specified pounds as the money of account, irrespective of the domicile of debt.[53] This legal concept could not be addressed unless there was institutional change, and unless the trading banks relinquished their role in setting the exchange rate and controlling the issue of legal tender. Though the New Zealand government had been under pressure from farmers to devalue the currency further than the 10% depreciation on sterling maintained by the trading banks, the formal agreement for the exchange pool did not permit any political influence over the exchange rate.

By mid-1932 the government felt it had restored sterling reserves, but had not solved the fiscal crisis. The Bank of England was concerned that if the exchange pool ceased to operate, one of the banks would renew pressure for further devaluation.[54] In April 1932, the Bank permitted the High Commissioner to go ahead with a new long-term stock issue, launched on a depressed London market. But then all the New Zealand government stock prices fell on the news of the Depression riots.[55] Nonetheless, the new loan allowed the government to extricate itself from the formal exchange pool arrangements, even if it continued borrowing from the banks for internal public expenditure. With the banks still purchasing treasury bills, there was an expectation that they would be allowed to control the exchange rate.[56]

The need to stabilize the exchange rates linked to sterling had become pressing by mid-1932. Sterling had depreciated after the fall of the gold standard and its future was expected to be on the agenda at the 1932 Imperial Conference in Ottawa. New Zealand's government was particularly keen for an empire currency, or a chain of central banks, even if the British authorities were not enamoured of the former.[57] Ideas of an empire currency, or intra-imperial schemes for managing debt repayment in London, had been raised at imperial conferences before, and complicated the British official agenda of maintaining the gold standard.[58] Given the form of trade concessions that the British made at Ottawa, their officials were non-committal on monetary questions. Ian Drummond has observed that there was an 'Ottawa Policy' on monetary matters, designed to assist in the management of the 'floating pound', without making further commitments to the empire.[59] So while the gold standard was not explicitly mentioned, neither were exchange reserves or London credit facilities. But the gold standard was still critical to the Bank of England's agenda, and was part of the design for central banks in the empire. This was made clear to New Zealand's envoys, W.D. Stewart and A.D. Park, as they held negotiations in London with the Bank, following the Ottawa conference. The High Commissioner had laid the groundwork for the debt negotiations, broaching the matter of converting the bond issue from late 1931, and re-scheduling war debts. Stewart also made it clear to Wellington that to enable him to advance New Zealand's interests, and to repay the banks in New Zealand, progress had to be made on the Reserve Bank legislation.[60]

The creation of New Zealand's Reserve Bank was inspired by the visit of Sir Otto Niemeyer of the Bank of England, in 1930. Niemeyer had been in Australia, advising on Australia's exchange crisis, so was keenly aware of trans-Tasman banking links. He used the idea of a separation in banking practice across the Tasman to promote a central bank, assuming that the New Zealand currency would join the gold standard. Hawke suggests that there was a clear line of continuity from Niemeyer's visit until the Reserve Bank came into operation in 1934.[61] His point reflects Treasury advice that continued to presume that parity with sterling was the ultimate aim; and the official Treasury view that the exchange problems were caused entirely by Australian conditions.[62] That view assumed that the devaluation in early 1933 had no fundamental effect on the legislation, even though devaluation meant that New Zealand had moved farther away from parity with sterling. By 1932, a return to parity was unlikely, although Treasury officials tried to get around this problem by suggesting a clause in the Reserve Bank bill that would 'stabilise' the New Zealand pound at a later date.[63] According to the Bank of England, the 'essential permanent task' of New Zealand's central bank was to maintain the global gold standard, with London at the centre.[64]

Officials in London had been assured that Gordon Coates was supportive of the existing Reserve Bank bill, including the clause defining parity with sterling at the gold trading points.[65] But prior to attending the Ottawa conference, Coates agreed that the exchange pool should be curtailed, and the exchange rate devalued.[66] He recognized that the trading banks would oppose the government obtaining control of the exchange rate through central bank legislation. After returning from Canada, Coates became the focus of pressure for further devaluation, mainly from a persistent farming lobby.[67] In January 1933 local economists recommended a 25% devaluation; as the new Minister of Finance, Coates, forced this on the banks. The Reserve Bank bill was also altered to remove the gold standard clause.[68] But the banks still wanted to avoid loss of business to the outside exchange traders, and wanted compensation from the government for any future exchange loss, if a revaluation occurred. The 1933 Bank Indemnity (Exchange) Act allowed the banks to sell to the government any sterling exchange deemed to be 'surplus', in return for an issue of treasury bills at 5% interest. Treasury seriously underestimated the amount of sterling that had to be purchased under this agreement.[69] While the government accumulated large amounts of sterling exchange, the British silver coin in circulation was being lost to smuggling, and was being exchanged for Australian coin. Coates was forced into drafting the 1933 Coinage Act, minting New Zealand coins for the first time, and beginning the legislative steps to create a legally separate currency.[70] Though Treasury was instrumental in developing the new currency laws, it maintained the view that the New Zealand pound was identical with the pound sterling and assumed the goal was still to return to parity, so did not alter the public accounts to take into account the depreciated exchange rate.[71]

The ritual of seeking imperial approval for financial policy was resumed in mid-1933, with the Reserve Bank bill and debt management being discussed at the Bank of England. This time the Prime Minister, George Forbes, was

in attendance. The Minister of Finance's representative, R.M. Campbell, was left out of the discussions on the Reserve Bank.[72] Trading banks opposed the legislation and given the economic leverage they held over the government, they had to be circumvented. So the British officials devised a plan to repay the New Zealand trading banks once the Reserve Bank commenced operations. This involved the Reserve Bank using its new banknotes to liquidate the treasury bills issued by the government to the trading banks, and thereby take over the surplus sterling exchange accumulated by the government.[73] Up to this point, treasury officials had assumed that the surplus sterling would be used to repay London debt; so loan conversion then became problematic. Forbes had pursued the matter of short-term debt issues in London, but the Bank of England was not giving any ground on this. He also renewed a request for the allocation of revenue into the sinking fund, required under the 1925 Repayment of Public Debt Act, to be waived.[74] The request had been made during the exchange crisis in early 1932, but the Bank of England's deputy chief cashier, Leslie Lefeaux, determined that the failure to make sinking fund provisions according to the loan prospectus offered in London would be a technical default under the Colonial Stock Act.[75]

British officials did not question Forbes over his government's decision to devalue in early 1933, but he seems to have mistaken this as amounting to their tacit approval. The Bank of England had not been consulted on the exchange rate, despite A.D. Park's insistence and his claim that there was no expert (London) opinion favourable to devaluation.[76] There was consensus amongst the British officials that the devaluation was going to make New Zealand's debt obligations more expensive and that it had to take the 'rough with the smooth'. The specific concern was not just with the central government stock issues, but also with municipal debt, and the 'question of payment in sterling or New Zealand pounds of the service of loans sold or issued in the London market by local authorities'.[77]

This problem had been caused by loan contracts that stipulated interest payments with a £ symbol, but with no distinction made between sterling and local currency; and with an option for payment in London. If that option was exercised, this meant 25% more in sterling after devaluation than if the payment was made in New Zealand, and remitted at the official exchange rate. Where there was a contractual obligation to permit a change of domicile to London for interest and principal repayments, there was also now an incentive for trafficking in local body debentures.[78] But litigation before the British courts in 1933 brought by Australian companies repaying London bondholders in sterling also appeared to set precedents for payment in the New Zealand pound.[79] The legal position had been discussed in a local law journal; and the Southland Power Board had obtained an encouraging opinion from the London KC involved in one of the Australian cases.[80] In New Zealand the Local Government Loans Board sought an opinion from the Audit Office to see if the judgment in the Australian case applied to the Southland board's position. The Audit Office agreed that loans raised in New Zealand and subsequently transferred to London should have interest paid in the local currency.[81] In June 1933, the Southland Power Board announced that it

would not be paying interest in sterling, pending a legal test case. With other municipal bodies likely to follow, the London Stock Exchange threatened to de-list New Zealand debenture stocks.[82] This was an acute embarrassment for Forbes, who was obliged to make a statement assuring the market that the central government recognized the moral obligation to pay in sterling.[83] Forbes also instructed Coates to impress upon the Southland Power Board the need to resume payments and drop the legal test case.[84] The Southland Board continued to defy the Minister of Finance during 1933, but eventually acquiesced when they were lent more money to cover exchange costs.

The power board's stand set legal precedents that could affect the wider London market in colonial debt. The Bank of England had resisted any move for another legal test case affecting London bondholders' payments, and did not initially accept that trafficking in New Zealand local body bonds was occurring. But by late 1933 this trafficking had become obvious on the London Stock Exchange, so the Bank of England finally took action to prevent the sale of trafficked securities.[85] The Bank was thereafter resistant to any move for further negotiations on the matter, especially with visiting local body politicians. Indeed, the Auckland Transport Board had also declared that it would not pay interest in sterling until there was a test case to confirm their legal advice. Its chairman, J.A.C. Allum, had arrived in London in October 1933 to negotiate the terms of their loans with institutional bondholders, such as insurance companies. The assistance of the Bank of England was sought. However, Allum was accused of opportunism: his board had paid interest in sterling after the exchange rate had been altered in 1930, not in the depreciated New Zealand pound, until the Australian legal cases had come to light.[86] Allum did not have negotiations with the insurance companies, nor was he invited to visit the Bank of England again. The Bank preferred to deal only with the High Commissioner and he was under the government's instructions to avoid any legal complications.[87] In December 1933 a clause was included in legislation to force local bodies to pay interest in sterling. The Auckland Transport Board believed it was to be exempt from the legislation as board member H.G.R. Mason MP had understood Coates to have earlier made that promise.[88]

On becoming Attorney-General in the first Labour government Mason ensured there was a test case. *Alliance Assurance Co. v. Auckland City Corporation* was heard before the New Zealand Court of Appeal in March 1936. Judgment was given for the plaintiff which meant that the Auckland board still had to pay British bondholders in sterling.[89] The decision was based on an Australian case before the House of Lords in 1934 which deemed there could not be a 'pound' that was legally distinct from sterling.[90] The majority of the appeal court in the Auckland case took a similar view: having reviewed currency law since 1914, it seemed that there was no legally separate New Zealand pound. The Chief Justice, however, argued that when the loan contract had been made in 1920, the New Zealand currency was no longer linked to the gold sovereign as it had been up to 1914.[91] The Chief Justice's dissenting view was an adequate basis for an appeal to the Privy Council. Auckland's mayor sought the Minister of Finance's approval for this action, attempting to link it to the interest payments of the central government in London, while

the Alliance Company lawyers tried to prevent further litigation.[92] The case was heard before the Privy Council in London in late 1936. Counsel for the Auckland City Corporation argued that the initial judgments in the Australian cases were not relevant to New Zealand currency law. But the Privy Council upheld the New Zealand Court of Appeal ruling: though not referring to the contract date, the local body law was passed in 1913 when New Zealand was on the gold standard.[93]

The Auckland Transport Board case was taken to the Privy Council to prove that since 1933 New Zealand had had a legally separate currency. Although the appeal failed, an amendment to the Reserve Bank Act in 1936 suspended the legal obligation of transfer in sterling. The Minister of Finance, Nash, had also worked on a plan for the Reserve Bank to impose control on all overseas transactions.[94] His plans led to a flight of capital from New Zealand which by 1938 reached a level that necessitated exchange control regulations in order to secure sterling funds for payments on London debt. The 1939 London debt conversion, therefore, resulted from inadequate exchange reserves, unlike the 1931 fiscal crisis.

Belich has labelled 1939 a crisis of 'recolonization', an interpretation that closely follows Sinclair's version of events, but without the link between the British officials and the Reserve Bank.[95] Sinclair's research did not include the records of the Bank of England, and the correspondence with its former official, Leslie Lefeaux, the first Governor of the Reserve Bank. Lefeaux had already briefed the Bank of England on the potential for a default under the Colonial Stock Act, and conveyed the local view that the Bank of England was a 'fairy godmother' and would not allow a loan default to occur.[96] The exchange crisis in 1939 concerned a £17 million maturing loan that was a default risk if sterling funds were unavailable for repayment and conversion terms were not accepted. The loan had been issued under the Colonial Stock Act and Lefeaux informed the minister, Nash, that trustee bondholders would usually look to convert maturing bonds unless confidence in repayment was undermined.[97] If default occurred, the bondholders could take action in the British courts which would have political consequences. Lefeaux advised Nash that in the default scenario, London bondholders had the rights to the New Zealand government's sterling funds, including the export returns from the dairy trade.[98] Lefeaux also raised the issue with the Bank of England, recalling his assessment of the Colonial Stock Act sanctions in 1932. He asked the Bank's Deputy Governor to check that the bondholders could take court action and whether the authorities might take the pre-emptive act of disallowing the legislation.

It seems that Lefeaux intended to reverse the changes to the Reserve Bank Act, involving exchange control and control of interest rates.[99] The British officials never expected Nash to threaten to default, given the consequences for New Zealand bonds.[100] However, the negotiations were made arduous for Nash, given his 'impenitence' and his view that borrowing money was a right not a privilege.[101] The outcome was a conversion loan similar to 1931 — a short-term bond issue underwritten by the Bank of England.[102] The Bank's officials knew that Nash could not leave London without having an agreement and by July 1939 compromises had been reached. One Bank official noted that

Nash had gone on with his 'little game of poker' to the last moment.[103] Belich has implied that Nash did not play his cards very well because he did not openly threaten to default as the Australians previously had.[104] But Nash knew that the British officials would not countenance open default.

Creating the Reserve Bank and altering currency laws gave the New Zealand government the ability to devalue the currency. Just as the devaluation of 1933 had given it some latitude to restore its domestic capacity to meet debt commitments, so did the imposition of exchange control in 1938.[105] The ability to devalue against sterling and accumulate funds to repay long-term debt was a fundamental change in the sterling system.[106]

If the external economic binary relationship with Britain did not operate after 1939, how can the 'recolonization' explanation apply? Since major steps were taken to break the financial dependence with London in the 1930s, and this had constitutional implications, the external economic system was certainly no longer colonial. It is possible that the quest for financial independence was short-lived, a mere interregnum. But even if something that can be termed a 'recolonization' occurred after the Second World War, the concept cannot be applied to the 1930s era. Indeed, a reappraisal of the 1931–1932 fiscal crisis, and the public debate over control of the exchange rate, indicates a political force against British financial imperialism. The farmer and social creditors aimed as much at Tooley Street as Threadneedle Street.

SIMON BOYCE

Kapiti Coast

NOTES

*This title comes from a line in a Kendrick Smithyman poem, beginning 'A promised land, land of friendly roads', in his *Imperial Vistas Family Fictions*, Auckland, 2002, p.136.

1 James Belich, *Paradise Reforged: A History of the New Zealanders from the 1880s to the Year 2000*, Auckland, 2001, pp.266–7.

2 ibid., p.458.

3 ibid., pp.64, 459.

4 ibid., pp.62–63.

5 ibid., p.34, where Belich states that this payment of compound interest on external debt lasted until the 1980s. Belich's argument here is contradicted by the later observation (p.293) that in the 1940s overseas debt was reduced absolutely and dropped markedly as a proportion of public debt. Having repaid a large proportion of overseas debt, the government was a net importer of capital in the 1950s.

6 ibid., p.257.

7 ibid., p.247.

8 ibid., pp.263–9.

9 ibid., pp.264–5. Belich's reference to the fate of Newfoundland as evidence of suspension of the constitution and direct imperial control must be doubted as a direct comparison to action taken under the Colonial Stock Act. Nor does Belich provide a source for the British Cabinet view of New Zealand.

10 A.S.J. Baster, 'A Note on the Colonial Stock Act and Dominion Borrowing', *Economic History*, 2 (1933), p.602.

11 A.K. Cairncross, *Home and Foreign Investment, 1870–1913*, Cambridge, 1953, p.89.

12 D. Jessop, 'The Colonial Stock Act of 1900: A Symptom of the New Imperialism', *Journal of Imperial and Commonwealth History*, 4 (1976), pp.154–63.

13 A.S.J. Baster, 'A Note on the Colonial Stock Acts and Dominion Borrowing', pp.602–603.

14 J.B. Condliffe, *The Welfare State in New Zealand*, London, 1959, pp.196, 326. But Condliffe had made a very similar point writing in 1930, in *New Zealand in the Making*, London, 1930, p.228.

15 J.M. Atkin, *British Overseas Investment 1918–31*, New York, 1977, pp.21–22.

16 J.M. Keynes, 'Foreign Investment and National Advantage' in D.E. Moggridge, ed., *The Collected Works of John Maynard Keynes*, Vol.19, Part 1, Cambridge, 1981, p.281.

17 ibid., p.279.

18 ibid., p.280. Keynes compared harbour works in Sydney and London with the funds borrowed for the former having a lower interest cost and more likelihood of attracting finance due to trustee status.

19 W.D. Stewart, 'Loans: Is New Zealand Borrowing Too Much?', *New Zealand Financial Times*, 1 (1930), pp.1–2. Stewart quotes Condliffe on the benefits of having trustee status for lower interest costs.

20 S.A. Boyce, 'Imperial Bonds and Public Debt Management in New Zealand Between the Wars', MA Thesis, Massey University, Palmerston North, 2002, ch.3.

21 J.M. Keynes, 'Some Tests for Loans to Foreign and Colonial Governments', in Moggridge, ed., pp.330–1.

22 B.C. Ashwin to Secretary to the Treasury, 4 March 1925, T52/74/6, Archives New Zealand (ANZ).

23 Boyce, 'Imperial Bonds', ch.4.

24 D.E. Moggridge, *British Monetary Policy, 1924–31*, Cambridge, 1972, pp.216–17; Peter Clarke, *The Keynesian Revolution and its Economic Consequences*, Cheltenham, 1998, pp.150–2.

25 Norman to Parr (New Zealand High Commissioner), 3 October 1929, Bank of England (BoE), Chief Cashiers series (C)40/282, MS-microfilm-20-2925, Alexander Turnbull Library (ATL), Wellington.

26 Norman to Niemeyer, 11 May 1925, quoted in Moggridge, *British Monetary Policy*, p.206.

27 Hore (London Audit official) to Controller & Auditor-General, 20 May 1925, Audit Office (A)29/19 (ANZ); Hore to Controller & Auditor-General, 23 February 1926, A29/19, ANZ.

28 'Summary of proposals', 30 August 1929, BoE, C40/282, ATL.

29 'New Zealand', 27 March 1930, BoE, C40/282, ATL.

30 Hore to Controller & Auditor-General, 9 December 1930, A29/4a, ANZ.
31 'New Zealand', 29 April 1931, BoE, C40/282, ATL.
32 'New Zealand', 5 May 1931, BoE, C40/282, ATL.
33 Notes from meeting with W.D. Stewart, 15 September 1932, BoE, Governors series (G)1/335, MS-microfilm-20-2943, ATL.
34 Minister of Finance to Minister of Public Works, 8 October 1931, T52/77/31, ANZ.
35 Memorandum, 'New Zealand', 1 December 1931, BoE, C40/282, ATL.
36 Record of conversation with High Commissioner, 27 November 1931, BoE, C40/282, ATL.
37 'New Zealand', 4 December 1931, BoE, C40/282, ATL.
38 Boyce, 'Imperial Bonds', pp.79–81, 83–84.
39 C.B. Schedvin, *Australia and the Great Depression*, Sydney, 1970, ch.1.
40 A.H. Tocker, 'Exchange Control in New Zealand', *Economic Record*, 8 (1932), pp.112–15.
41 Minister of Finance to Controller & Auditor-General, 19 February 1932, A29/47, ANZ. That the banks held the upper hand in these negotiations is evident from the archived records of the Associated Banks, if not the Treasury.
42 Secretary to the Treasury to Chairman of the Associated Banks, 16 December 1931, Associated Banks records, MS 96-141-5/1, ATL.
43 The most recent example is from Malcolm McKinnon, in *Treasury*, Auckland, 2003, pp.128, 132. McKinnon refers to 'the Treasury bill debacle' in 1931 but puts this down to the issuing of bills in London in anticipation of a long-term loan, not the situation of outright default that had emerged.
44 G.R. Hawke, *The Making of New Zealand*, Cambridge, 1985, p.134.
45 ibid., p.135. Hawke offers no documentary source for this (or any other) assertion.
46 Secretary to the Treasury to Minister of Finance, 10 February 1932, T52/703, ANZ.
47 N.G. Cain and S. Glynn, 'Imperial Relations Under Strain: The British–Australian Debt Contretemps of 1933', *Australian Economic History Review*, 25 (1985), pp.39–58.
48 Hawke, pp.135, 151.
49 D. Williams, 'The Evolution of the Sterling System', in C.R. Whittlesey and J.S.G. Wilson, eds, *Essays in Money and Banking: In Honour of R.S. Sayers*, Oxford, 1968, pp.285–6.
50 L.S. Pressnell, '1925: The Burden of Sterling', *Economic History Review*, 31 (1978), pp.68–69; A.H. Tocker, 'The Monetary Standards of New Zealand and Australia', *Economic Journal*, 34, 1924.
51 A.H. Tocker, 'The Balance of Trade and Payments', in the Institute of Pacific Relations, *New Zealand Affairs*, Christchurch, 1929.
52 A.H. Tocker to W.B. Sutch, 8 May 1934, Sutch collection, MS 85-185-18, ATL.
53 F.A. Mann, *The Legal Aspect of Money*, 3rd ed., New York, 1982, p.54.
54 'New Zealand', 4 May 1932, BoE, Overseas Finance Division series (OV)59/16, MS-micro-20-2961, ATL.
55 Hore to Controller & Auditor-General, 20 May 1932, A29/65, ANZ.
56 Prime Minister to Controller & Auditor-General, 19 August 1932, A29/14, ANZ.
57 Ian M. Drummond, *The Floating Pound and the Sterling Area 1931–1939*, Cambridge, 1981, p.24.
58 Pressnell, pp.77–80.
59 Drummond, pp.24–27, 254–5.
60 Stewart to Prime Minister, 16 September 1932, T52/717, ANZ; Boyce, 'Imperial Bonds', pp.93–95.
61 Hawke, pp.151–2.
62 B.C. Ashwin, 'Banking and Currency in New Zealand', *Economic Record*, 6 (1930), pp.188–204.
63 'New Zealand Reserve Bank', 3 October 1932, BoE, OV59/16, ANZ.
64 Park's cable to Treasury, 4 October 1932; Forbes to Coates, 5 October 1932, T52/717, ANZ.
65 Park to Treasury, 11 August 1932, T52/717, ANZ.
66 Notes of meeting, 9 March 1932, Associated Banks records, MS 96-141-5/2, ATL. Responding to the Bank of England's opposition, Coates replied that Englishmen were not able to judge this issue.

67 See the correspondence from the Auckland Farmers' Union on T52/839, ANZ. This particular branch of the Farmers' Union also published two journals, *Farming First* and the social credit version, *Why?*

68 The changes are evident in the draft bills in the Sutch collection, MS 93-244-1, ATL.

69 Secretary to the Treasury to Minister of Finance, 16 August 1933, Coates papers MS 1785-39, ATL; Boyce, 'Imperial Bonds', pp.98–102, 104.

70 Boyce, 'The Birth of the £NZ in 1933'. Belich, p.257, mentions the Coinage Act as an unintended side effect of devaluation, although the smuggling had begun in 1931 with legal tender not enforced.

71 Secretary to the Treasury to Controller & Auditor-General, 21 August 1933, on A29/14, ANZ.

72 Notes of meeting with annotated question from Coates to Secretary to the Treasury, 15 August 1933, in Sutch collection, MS 2002-012-29/1, ATL.

73 'New Zealand', 5 July 1933, BoE, OV59/17, MS-microfilm-20-2961, ATL.

74 'Notes of discussion', 19 July 1933, BoE, G1/335, ATL.

75 Boyce, 'Imperial Bonds', pp.81–83, 104.

76 'New Zealand: Exchange Depreciation', 8 September 1933, BoE, G1/337, MS-microfilm-20-2943, ATL.

77 Draft note, under F. Phillips (British Treasury) to E.M Harvey, 13 September 1933, BoE, G1/337, ATL. The draft note was to be sent to the Dominions Office for approval or later amendment.

78 Boyce, 'The Birth of the £NZ in 1933'.

79 Mann, pp.234–41.

80 'Contracts and the Exchange Rate', *New Zealand Law Journal*, 9 (1933), pp.61–62; G. Hurst K.C. legal opinion, 12 April 1933, copy in Sutch collection, MS 2002-012-12/5, ATL.

81 Minutes, Local Government Loans Board, 27 June 1933, T51, box 2, ANZ.

82 'New Zealand Municipal Issues', 4 July 1933, BoE, G1/337, ATL.

83 Forbe's press statement, under letter from London Stock Exchange to E.M. Harvey, 7 July 1933, BoE, G1/337, ATL.

84 Cables from London, 19 and 20 July 1933, T52/731, ANZ.

85 Harvey to Wilford, 3 August 1933, BoE, G1/337, ATL.

86 'Auckland Transport Board', 31 October 1933, BoE, G1/337, ATL.

87 'Auckland Transport Board', 6 November 1933, BoE, G1/337, ATL.

88 'Overseas Interest, Auckland Transport Board', *New Zealand Herald*, 15 December 1933.

89 *Alliance Assurance Co. v. Auckland City Corporation*, Court of Appeal, NZLR, 1936, judgment, pp.435–69.

90 C.H. Weston, 'The Exchange Cases', *New Zealand Law Journal*, 10 (1934), p.33.

91 Solicitor-General to Minister of Finance, 10 June 1936, N2200, 0791-0795, ANZ.

92 Mayor to Nash, 7 July 1936, N2200, 0787; Earl, Kent, Massey & North to Minister of Finance, 17 June 1936, N2200, 0789, ANZ.

93 Auckland Corporation v. Alliance Assurance Co., *The Times Law Reports*, 12 February 1937, p.348.

94 W.B. Sutch to Nash, 18 March 1936, N348, 0272, ANZ; Sutch to Nash, 14 August 1936, (restricted) Sutch collection, MS 2002-012-16/6, ATL. This evidence contradicts the view of Keith Sinclair that Nash did not intend to impose exchange control in 1936 in the 'The Lee–Sutch Syndrome', *New Zealand Journal of History*, 8, 2 (1974), p.109. Economic historians, such as Hawke p.164, assume that Labour did not have a coherent plan for exchange control before the 1938–1939 crisis.

95 Belich, pp.264–5; Keith Sinclair, *Walter Nash*, Auckland, 1976, ch.14, especially p.177.

96 Lefeaux to B.G. Catterns, 17 January 1939, BoE, G1/339, ATL.

97 Lefeaux to Nash, 19 October 1938, Reserve Bank (RB) 17.01/3, ANZ; Lefeaux to Nash, 11 January 1939, RB17.01/3, ANZ.

98 Lefeaux to Nash, 12 July 1938, RB 17.01/3, ANZ; J.B. Were & Sons to Secretary to the Treasury, 2 May 1939, on T52/429, ANZ.

99 Lefeaux to B.G Catterns, 3 April 1939; Catterns to Lefeaux, 25 April 1939, BoE, G1/339, MS-microfilm-20-2943, ATL.

100 'New Zealand', 16 May 1939, BoE, G1/336, ATL.
101 Catterns to H.C. Scrimgeour, 9 August 1939, BoE, G1/336, ATL.
102 'Default by New Zealand', 26 May 1939, BoE, OV59/3, MS-microfilm-20-2958, ATL; 'New Zealand', 7 June 1939, BoE, G1/336, ATL.
103 Catterns to Montagu Norman, 11 July 1939, BoE, G1/336, ATL.
104 Belich, p.265.
105 Drummond, pp.115, 256.
106 A.S.J. Baster, 'A Note on the Sterling Area', *Economic Journal*, 47 (1937), pp.568–74.