

The Sterling Area

by

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PART I - ORIGINS AND DEVELOPMENT

Origins in the Nineteenth Century.

The formation of the present day sterling area is often said to have begun with the decision of a number of countries, particularly the British Commonwealth dominions, to maintain their exchanges stable in terms of sterling rather than gold following Great Britain's abandonment of the gold standard in 1931. But the close commercial and financial relationships which prompted these decisions, have roots that go back far beyond the nineteen thirties. The breakdown of the gold standard at that time did not create the sterling area; it merely revealed the existence of a set of commercial and financial connexions which, though only fully recognised for the first time as forming a « sterling bloc », had been in fact maturing over many decades previously. A proper understanding of the sterling area must therefore take into account this long historical tradition.

The existence before 1914 of an international gold standard centred on London had served to obscure the existence of such a separate currency system in the international economy. London at that time was the centre of an efficient system of international clearance; it provided a common medium of financing world trade; it was unrivalled as a supplier of short-term credits, while in the size and composition of its long-term investment it overshadowed those of all other countries. The prices of the principal raw materials entering into international trade were determined in the markets of Liverpool, Manchester and London, while in many other commodities foreign buyers and

sellers followed the lead given by British merchants. The bill on London became the most efficient means of financing international trade. Where the financial and commercial predominance of Great Britain was so great, all countries had a common interest in maintaining their currencies as stable as possible in terms of sterling. The most important factor maintaining equilibrium in the system was the movement of short-term funds. The mechanism for bringing about immediate adjustment was the Bank rate policy of the Bank of England. In such an economic environment sterling was synonymous with gold. Before 1914 « the international gold standard was in effect a sterling exchange standard » (1). These features of the international economy before 1914 have long been commonplace.

But within that economy a more intimate system of economic relationships, associated with Great Britain's imperial economic expansion, had been growing up. In these nineteenth century imperial economic connexions can be seen the germs of the present day sterling area. The system dates back to the time when almost all territories outside the United Kingdom in which it operated were British colonial dependencies.

The first major step in the formation of the sterling area was taken in 1825 when, in a Treasury minute concerned with payment of British troops in the colonies, it was decided to establish the silver shilling as the standard coin in use in the colonies and to fix the rate

(1) WILLIAM ADAMS BROWN, *The International Gold Standard. Reinterpreted 1914-1934*, p. 783.

of exchange between it and the very heterogeneous collection of foreign currencies then in circulation in most of these territories (2). The scheme was for the Treasury to send out an initial stock of silver to pay the troops. The troops having spent it, the money would find its way into the hands of local merchants who, in turn would hand it in to the local Army command against bills on London. The rate of exchange with the other circulating coins was fixed and it was expected that the shilling would become the dominant, if not the only, currency. The scheme in effect amounted to the establishment of an official sterling exchange standard.

If the idea was a simple one, its application proved more complicated, not least because, as a result of choosing a wrong sterling parity with the Spanish dollar, the latter became overvalued and the shilling failed to make progress. This was corrected first in the West Indies in 1838 and later in other colonies. Additional help came from the gold discoveries of 1850 which by raising the gold price of silver tended to drive the silver dollar out of circulation. Thus the hopes of a universal currency for the Empire was very much slower in coming about than had been expected in 1825 (3).

Closely associated with the spread of a common coinage for the colonies were developments in their banking facilities. At that period it was assumed that such banking facilities would be taken care of by private institutions

(2) The coins current in the British colonies at that time included the Spanish and Mexican dollar, Spanish Pistareen, Spanish Doubloon, Portugese Moldore and Johannes, Barbary ducat, coins of France and the United States. See R. CHALMERS, *History of Currency in the British Colonies* (1893), for the development of nineteenth century colonial currency systems. Sir GERRARD CLAUSON, *British Colonial Currency System*, in «Economic Journal» (1944) and the articles in «The Banker», July 1948-February 1949, bring the story up to date. For a short useful summary of the whole history see H. A. SHANNON, *The Evolution of the Colonial Sterling Exchange Standard*, International Monetary Fund Staff Papers Vol. I No. 3. All these sources are drawn upon for the following account.

(3) As Canada and Newfoundland adopted currency systems which took them outside the sterling area the vision of a single currency for the Empire was never realised. Apart from these, the exceptions to the adoption of a colonial sterling exchange standard for all territories are Aden, which uses the rupee, Basutoland, Bechuanaland and Swaziland which use South African currency; British Solomon Islands, Gilbert, Ellice and Tonga islands, New Hebrides, which use Australian currency. SHANNON, *op. cit.*, p. 349.

having their own right of note issue. This assumption was in keeping with the laissez-faire spirit of the age. But in 1847 a bank failure and consequent financial crisis in Mauritius forced the British Government to intervene by sanctioning a local government note issue. Some years after this the imperial government put this note issue on a firmer basis by requiring that it have the backing of a certain proportion of specie and the rest in Imperial or Mauritius government securities. In this decision the British Government had hit upon the principle of a formal sterling reserve for colonial note issue. The growth in government note issue in other territories after the crisis in Mauritius was, however, very slow and did not become fully developed until the inter-war years.

A colonial sterling exchange standard was not therefore the product of theory systematically applied, but a piecemeal and empirical development arising out of pressing needs and force of circumstances.

In the twentieth century the issue of local notes and coins and the redemption of local currency for sterling became the function of a Currency Authority set up for one or more territories (4). These authorities now deal only through local banks which are almost without exception subsidiaries of banks in Great Britain and therefore maintain their reserves in London. The exchange of local currency for sterling and vice versa is a purely automatic function and is not left to the discretion of the Currency Authority. Nearly all these authorities have funds containing more than 100% sterling cover for the whole note issue in the territories for which they are concerned so that they are well able to meet any run in sterling and therefore to maintain the parity (5). They charge a small commission to the local banks for their currency issuing functions, which together with the income derived from invested reserves, often forms a substantial contribution

(4) Such an authority might be a Currency Board or a Currency Commissioner. The Straits Settlement for example had a Currency Commissioner in 1906, while a Currency Board was set up for West Africa in 1913, for East Africa in 1919 and for Central Africa shortly before the late war.

(5) See for example the figures given by CLAUSON, in «Economic Journal», 1944.

to colonial government income (6). Alternatively this income could be available for meeting interest payments on new capital raised by colonial governments.

It must be emphasised in respect of present day colonial currency systems that they are completely subordinate to Great Britain. There is no scope for local currency management and any credit policy in these territories is in fact the credit policy of the centre country. «In such matters there is in effect no more room for a policy for an individual colony than there is for a policy for an English county» (7). This much was true before the institution of the existing exchange control system which has merely served to underline their subordinate role, for local exchange control regulations are identical with those of Great Britain. No colony has a separate pool of foreign exchange and all foreign currency must be obtained from a local bank through the London exchange control machinery.

The advantage of these arrangements for the colonies is that while they are provided with a stable currency over a wide trading area, with access to large reserves of additional money and credit when required, they are free from the responsibilities of currency management. Moreover as costs are not usually so inflexible in colonial as compared with industrial economies, their inability to alter their exchange rates to meet particular economic difficulties is not such an obvious disadvantage (8).

What this summary of the origin and development of the sterling area has so far ignored, is that a number of colonial territories in which the principles of a sterling exchange standard first operated, became independent sovereign states within the British Commonwealth of nations, and began, albeit only in the inter-war years, to practise their own currency management. The features of the subordinate

(6) In the five years ending June 1947 West Africa, for instance, received £ 1,550,000 in this way. «The Banker», July 1948, p. 22.

(7) *Ibid.*, p. 23. It follows that colonial currencies have no international status and are included with the United Kingdom as a single unit for purposes of the International Monetary Fund.

(8) «The Banker», February 1949. The sterling area dollar pool raises other questions which will be dealt with in the second part of this article.

currency system find no reflection in the right of the British Dominions to manage their own credit policies and fix the value of their currencies in terms of foreign currencies as they please. Yet the Dominions are members of the sterling area. The fact that they adhere to this currency system of their own free will makes their case perhaps more interesting than that of the colonial dependencies. Again, a full understanding of their position in the present day sterling area must take into account the long tradition of close commercial and financial ties with Great Britain.

For early Victorian Britain the colonies were probably more important as sources of raw materials than as markets. But the tendency for an increasing amount of British overseas investment to go to territories under the British flag and the growing trade competition of continental rivals made them important outlets for British manufactures (9). With few exceptions in the 1850's, all colonies lacked adequate machinery for financing trade and production and remitting money to England. But between 1850-1870, reflecting an increased tempo of economic development, there was established in all parts of the Empire large Anglo-Colonial banks directed from London and with large resources of English capital. The Bank of Australia whose charter dates from 1875, was the first of the chartered banks to be operated from London (10). The Australian banks for example were fundamental in financing Australian foreign trade, particularly the export of wool, by discounting bills of exchange drawn on London merchants and in this way providing local short term capital. These Anglo-Colonial banks also became the agencies by which large sums from Indian planters and civil servants or Australian sheep-farmers were

(9) «The export trade to the colonies occupied a rather peculiar role in the development of mid-nineteenth century capitalism; it was more than any other branch of England's trade the channel through which the manufacturers of England continued to dispose of the surplus production necessary to achieve the full economies of large scale production». H. J. HABBAKUK, *Cambridge History of the British Empire*, Vol. II, p. 757.

(10) Banks could only secure the advantages of limited liability before it was generalised by legislation, if they secured a royal charter of incorporation. For the development of banking structures in the Dominions, see A. S. J. BASTER, *The Imperial Banks*, 1929.

remitted to Britain. Before 1914 moreover the only Reserve Bank of the Empire was the Bank of England. By means of manipulations in bank rate therefore the Bank of England could influence credit conditions in these countries.

In those areas where white settlement was predominant the problems of currency were simplified by the fact that the British immigrant thought and calculated in terms of the money he had been used to. In countries like New Zealand, Australia and South Africa, there were none of the same obstacles to the use of sterling as in other colonial territories. In their trading connexions, in their source of capital investment and banking facilities, these future Dominions were largely dependent on the United Kingdom. For all these reasons the countries in question were led by « inducements of habit, convenience, self-interest and efficiency, to keep their currencies in step with sterling, to hold their external reserves in London and to maintain the backing to their currencies invested largely in sterling securities » (11). Canada as already noted is something of an exception to this development, because of her much closer financial and commercial ties with the United States and hence the adoption of the dollar, rather than the pound, as her autonomous monetary standard. The Indian continent used the rupee but nevertheless adopted, in effect, a sterling exchange standard in the few years preceding World War I (12). Up until 1893 the rupee had been based on silver freely minted, the gold value of the rupee fluctuating with the gold value of silver bullion. This had the disadvantage that India's exports and imports fluctuated arbitrarily in accordance with changes in the relative value of silver and gold. In 1893 the Indian mints were closed to the free mintage of silver and the value of the rupee was divorced from the value of the metal contained in it. Eventually a system was evolved by which the rupee

(11) PAUL BAREAU, *The Sterling Area*, British Commonwealth Affairs pamphlet, 1950.

(12) For the drift of India on to the gold exchange standard, in effect a sterling exchange standard, see J. M. KEYNES, *Indian Currency and Finance* (1913). India was the first major economy fully to develop the gold exchange standard for which at that time Keynes predicted a big future.

was brought on to the gold standard. Gold was to be used to support the exchanges, but in practise the use of gold even for this purpose was normally unnecessary, since the currency authority stood ready to sell rupees for sterling or vice versa at rates which made it unprofitable to ship gold. In this way, sterling assets were accumulated in London against issues of local currency. The Anglo-Indian banks also kept their reserves in London.

Within the pre-1914 international gold standard system there had therefore developed a set of close commercial and financial connexions between the United Kingdom and its colonies and Dominions which formed the nucleus of what was to be known as the sterling area. Nearly 50% of British long-term overseas investment in 1914 was in the Empire (13), while just over 30% of its trade was with these same territories.

Developments in the Inter-War Years.

The effect of World War I was to distort the international economy and to weaken the position of Britain in it to such an extent that it could not be claimed that the international gold standard of the nineteen twenties was in effect a sterling exchange standard. It destroyed the world wide dominance of the pound but did not substitute the dollar for it or even create the prospects of a true dollar exchange standard. « The motives that had led all countries to endeavour to preserve stability of their rates in terms of sterling, though still powerful enough to create a group of so-called sterling countries persisting throughout the period of war and reconstruction were neither so universal nor so powerful as before » (14). Nevertheless, the widespread return to gold in the nineteen twenties served to prevent full recognition of a distinct sterling currency system. It was already clear that the use of sterling balances in London by the Dominions was the essence of the management of the Commonwealth exchanges. But not until the disin-

(13) For the magnitude and composition of British foreign investment at this time see H. FERR, *Europe the World's Banker, 1870-1914*.

(14) W. A. BROWN, *op. cit.*, p. 183.

tegration of the gold standard, when sterling was devalued in September 1931 and a number of other countries, who valued stability in sterling more than in gold, followed suit, did observers sufficiently recognise the emergence of a clearly identifiable currency system to adopt the label « sterling bloc ». By the early thirties the single currency system dominated by a single centre London which existed before 1914, had split up into a number of currency groups, reflecting the existence of several centres of industrial power with lesser economies clustered around them.

The sterling area that emerged from these bouts of exchange depreciation consisted in the first place of the British Commonwealth — with the notable exception of Canada, whose currency took a middle course between the pound and dollar — with other nations joining the association at intervals: Portugal, for example, joined immediately; the Scandinavian countries in 1933; Iran and Latvia in 1936 and so on. In addition there were several countries like Japan and Argentina, which for many years kept their official exchange rates fixed in terms of sterling, but who were not regarded as full members of the sterling bloc. In the main however the area consisted of the British Commonwealth and the countries of northern Europe.

The closeness of these various currencies to sterling varied from country to country. At the time of the Ottawa Conference of 1932 the currencies of the Dominions were all over the place; sterling was at a discount to gold; the South African pound still rested on gold and at a premium to sterling (15); the Australian and New Zealand pounds were at a discount to sterling (16). India, Egypt, Portugal held

(15) South Africa eventually moved with sterling in 1933. « It was a crucial test, because it demonstrated that even South Africa, the greatest gold producer, was not on the gold standard but on a sterling exchange standard ». HENRY CLAY, in *Current Financial Problems and the City of London*, Institute of Bankers, 1948. South Africa differed for example from New Zealand, not in basing its money on gold rather than sterling, but in replenishing its sterling reserves by sales to England of gold instead of wool, butter and lamb.

(16) Australia and New Zealand, as debtor countries and faced with acute balance of payments problems as a result of falling commodity prices, had been forced to abandon convertibility with gold in 1929 and allow their currencies to depreciate.

closely to their old parity with sterling, while the Scandinavian countries permitted occasional variations relative to sterling, though on the whole, held their rates stable for considerable periods. Those who pegged their currencies to sterling at a discount were in the majority and there was no example of a currency pegged to sterling above its old parity.

Though all members of the sterling area were anxious to maintain long run exchange stability with sterling, none of them surrendered their freedom to differ from sterling if they so chose (17). The motives which induced countries to maintain stability in terms of sterling were as different as the levels at which these pegging operations were brought about. The forces that pulled South Africa into the area were not the same as those which kept Australia within it at 25% depreciation in sterling. Denmark was powerfully influenced in following sterling by the direct competition with New Zealand in the British market (18). Sweden was strongly influenced by the fact that a large part of her export trade at the time Britain left the gold standard was being carried on by sterling contracts. No doubt political bonds would also influence the Dominion members. Again, the desire to avoid serious loss on their London reserves, in terms of their own currencies, if they stuck to gold and the deflationary pressures this would have entailed, was another powerful motive for following sterling (19).

(17) New Zealand for example allowed its pound to depreciate further in terms of sterling in 1933. In 1938 in the face of an acute balance of payments problem and dwindling reserves, brought about by a combination of a domestic programme of increased public works and social services and falling export prices, New Zealand adopted exchange and import controls rather than depreciate still further. These regulations however applied to sterling as well as non-sterling area countries.

(18) Argentine, Bolivia and Uruguay were likewise heavily dependent on the British market and had thus a great interest in maintaining exchange stability with sterling. In the case of Japan it was less her trade with the United Kingdom that proved the strongest motivating factor, than her trade with other sterling area countries.

(19) The Netherlands by sticking to gold suffered substantial exchange loss on its balances held in London and did not avoid the rigours of deflation in the early 1930's. The French in the late 1920's avoided exchange loss by a rapid withdrawal of their short term funds in London with consequent heavy drain of gold, much to the discomfiture of Great Britain's efforts to maintain sterling on gold.

But undoubtedly the most important reason for maintaining stability in terms of sterling, and which all these countries shared in common, were their strong commercial ties with the United Kingdom. The following table illustrates the importance of these commercial connexions.

PERCENTAGE SHARE OF THE UNITED KINGDOM
IN THE FOREIGN TRADE
OF STERLING-AREA COUNTRIES (20)

	Exports			Imports		
	1929	1933	1937	1929	1933	1937
Australia	45	54	52	41	42	42
Denmark	56	64	53	15	28	38
Egypt	34	41	31	21	23	22
Eire	92	94	91	78	70	50
Estonia	38	37	34	10	18	17
Finland	38	46	43	13	21	19
India	21	30	32	42	41	32
Latvia	27	43	38	28	22	21
Norway	27	20	25	21	23	18
New Zealand	74	86	76	49	51	50
Portugal	23	22	22	27	28	18
Sweden	25	26	23	17	18	12
South Africa	66	78	79	43	50	43

The above countries had a strong interest in protecting their export prices and hence their competitive position in the British market, by allowing their currencies to depreciate with sterling. Moreover their imports from Great Britain were big enough for their sterling balances to act as a useful reserve. Clearly, the greater the dependence of a country on Great Britain for its imports, the more « liquid » its sterling balances become. Moreover, these balances could also be used to pay off the long term liabilities to Great Britain and there is evidence in the nineteen thirties that a number of Commonwealth countries, for example, were using their London balances for long term debt repatriation (21).

It is of the greatest importance in an exchange standard that there should be reasonable

(20) From: *International Currency Experience*, LEAGUE OF NATIONS, 1944.

(21) The building up of sterling balances would tend to broaden the domestic credit base in the dominions. « The resulting decline in interest rates made it possible and advantageous for domestic borrowers to repay foreign debt by issuing new loans at home ». *International Currency Experience*, LEAGUE OF NATIONS (1944), p. 60.

stability in the centre country and in this respect Great Britain had an undoubted advantage over other industrialised nations. The decline in money incomes and business activity in the early 1930's was less severe in Britain than in other leading industrial countries, while its recovery began early and was steadily maintained. Moreover, through the device of an Exchange Equalisation Account set up in 1932, fluctuations in the exchange as a result of short term capital movements, were smoothed out (22).

Though little was done by the United Kingdom deliberately to consolidate and enlarge the sterling area there was an important strengthening of the nucleus of Commonwealth economic relations as a result of British preference to the Empire countries in respect of long term capital issues placed in the London money market and of preferences granted under the Ottawa trade agreements (23). In 1932 the British Government requested a complete cessation of new issues on the London money market to enable the Government to embark on a major conversion of war bonds. In 1933 the embargo was relaxed in favour of United Kingdom and Empire issues and in 1934 this favour was extended to other members of the sterling area. The aim of this policy was to grant loans which would directly assist British industry or which by building up the sterling balances in London would assist countries in the sterling area to maintain stability with the British pound in times of economic stress (24). In the nineteen thirties there was

(22) « The account is simply a device which puts Treasury bills "on tap" for foreigners and permits them to increase or decrease their holdings without unduly influencing the sterling exchange ». N. F. HALL, *The Exchange Equalisation Account* (1935), p. 24. High bank rate and the gold reserves of the Bank of England were no longer used to support the exchanges. In so far as movements of short term funds to London led to an increase in demand for bills and a subsequent shortage of them for the commercial banks, there was a check to the expansion of bank credit. The effect was thus similar to that under the orthodox gold standard though very much weaker.

(23) On Commonwealth economic relations and policies in the inter-war years see W. K. HANCOCK, *Survey of Commonwealth Relations*, Vol. II, Part II.

(24) This was not the first occasion of government influence or interference in British overseas investment. In 1900, by the Colonial Stocks Act, securities of British colonial and dominion governments which observed certain Treasury safe-

a noticeable contraction of the frontiers of the British Empire, though the two did not become conterminous.

This preference for the Empire in respect of British capital exports was the small and barely perceptible beginnings of a feature of the sterling area which, today, has become of the greatest importance to the management of its currency problems.

If imperial preference in overseas investment was barely perceptible, the same could not be said for the system of imperial preference which resulted from the Ottawa Trade Agreements of 1932. Some imperial statesman at that time even talked in terms of imperial economic self-sufficiency (25). It is true that there was a relative and absolute increase in the share of world trade enjoyed by British Commonwealth and Empire countries in the 1930's. Yet imperial self-sufficiency was a grand illusion. It was not possible to fit the trading pattern of the Empire into its political pattern. For many important products the Empire market was too small; while for many of its commodity requirements the Empire was by no means self-sufficient. Great Britain, in particular, had to be wary of inflicting harm on some of her best customers in markets outside the Empire. Moreover, it proved difficult to reconcile the various conflicting economic interests within the Empire; Great Britain needed to protect British agriculture against the competition of the Dominion producers, while the Dominions did not intend to relax their protection of young and growing industries in favour of British manufactures. By the late nineteen thirties more enlightened statesmen

guards were made eligible for purchase by trust bodies whose choice was restricted by law. This provided a strong market for colonial and dominion bonds in which foreigners could not compete. During World War I there was an embargo on foreign investment, except for some important Empire issues, while under the Trade Facilities Acts 1922-27 the Treasury was authorised to guarantee the principal and interest of loans whose proceeds were spent directly on the products of British industry.

(25) On the genesis of the ideas of imperial preference see HANCOCK, *op. cit.* It should be noted that the dominions were the first to adopt imperial preference, beginning with Canada in 1897 and throughout the nineteen twenties dominion statesmen were repeatedly trying to persuade the United Kingdom to adopt the system.

were thinking in terms of harmonising the interests of the Empire with those of the wider community of trading nations. Nevertheless this tendency towards a strengthening of the economic relations of the Empire through trade and investment policies and the appeals that went with it, were to find greatly increased favour in the years of post-war dollar shortage.

The nucleus of the sterling area had drawn close together in the face of the difficulties of economic depression; it was to become very much more compact in the years of post-war dollar shortage.

One last feature of the sterling area as it appeared in the nineteen thirties should be noted and that is the position of the centre country in such a system. Certainly, the Bank of England was assisted in its domestic credit management by the fact that the sterling area central banks (26) entrusted to it the administration of a major part, if not the whole of their London funds. The use of Treasury bills for this purpose meant that the bulk of the sterling area funds did not enter the balance sheet of the Bank of England. If fluctuations in these balances at the Bank of England had been exposed to the public view, offsetting operations by the Bank would have been necessary to preserve stability in the credit base (27). The payment of interest on these reserves by the United Kingdom could not be regarded as an undue burden for the market rate on Treasury bills in London rarely rose above ½% in this period. Moreover, this interest payment was, in one sense, the price which the centre country had to pay for the increased liquidity it enjoyed by enabling it to use its own currency as a means of settlement throughout the area over which the system operated (28).

A more serious disadvantage perhaps for the centre country was that other members could « go off » sterling, but not the United Kingdom. Member countries therefore could obtain com-

(26) Australia set up a central bank in 1911, South Africa in 1920 and New Zealand, Canada and India between 1934-35. All regulated domestic credit with reference to their London balances, though it should be noted that more and more their policy became to be defined in terms not of maintenance of exchange stability but internal stability.

(27) LEAGUE OF NATIONS, *op. cit.*, p. 63.

(28) LEAGUE OF NATIONS, *op. cit.*, p. 64.

petitive advantages at the expense of the United Kingdom by pegging their currencies to sterling at an unduly low rate (29).

A more serious matter for the United Kingdom was the fact that these balances tended to fluctuate with the cyclical movements in the

Great Britain had to meet some of the strain falling on the sterling area through fluctuations in raw material and agricultural prices and this rendered « the centre vulnerable to international disequilibria in which it was not otherwise concerned » (31).

RESERVES OF STERLING-AREA MEMBER COUNTRIES
CENTRAL FOREIGN EXCHANGE RESERVES (in L. sterling)
(millions)

End of	1929	1931	1932	1933	1934	1935	1936	1937	1938
Australia	7.9	13.3	18.0	34.7	39.2	30.4	30.2	38.5	32.2
Denmark	5.0	0.8	-0.3	-1.5	-3.8	-4.1	-2.3	3.4	4.7
Egypt	28.8	19.2	15.7	18.7	17.8	22.2	21.7	17.7	18.2
Eire	7.1	7.4	7.4	7.7	7.9	8.3	9.1	9.7	8.9
Estonia	1.2	0.9	0.3	0.2	0.4	0.3	0.6	1.2	1.1
Finland	3.5	3.0	3.8	6.9	7.4	6.9	7.7	10.5	11.9
India	57.0	26.1	41.9	44.4	62.6	62.7	64.7	62.9	53.2
Latvia	2.3	0.7	0.6	0.2	0.2	0.4	1.1	1.8	1.5
New Zealand	—	—	—	—	17.1	17.3	13.3	13.7	3.8
Norway	3.7	1.2	1.7	0.3	2.3	2.6	6.0	12.9	12.1
Palestine	1.9	2.3	3.0	4.2	5.0	5.3	4.8	4.8	4.2
Portugal	2.5	4.7	4.3	1.1	2.3	2.7	3.9	4.1	3.7
Sweden	14.7	2.7	11.9	24.8	30.7	34.9	39.8	54.7	41.7
Thailand	8.8	0.1	0.4	7.5	9.1	9.7	10.2	10.8	11.3
South Africa	6.6	—	—	18.6	10.5	11.5	10.8	6.9	7.6
Total	150.9	82.4	108.7	167.8	208.7	211.1	221.6	253.6	216.1
Total Central Gold Reserves (in £ at current market rates)	97.5	139.3	150.7	161.1	186.0	200.9	215.6	208.4	250.1
Total (in £)	248.4	221.7	259.4	328.9	394.7	412.0	437.2	462.0	462.0
Exchange as % of total	61	37	42	51	53	51	51	55	46

The above data are derived from *International Currency Experience*, LEAGUE OF NATIONS (1944). The table does not cover the whole sterling area since the British colonial dependencies are not included. Though central banks do not usually specify the currencies in which their liquid foreign assets are held, the presumption here is that members of the area held them largely in sterling.

Under the gold exchange standard of the nineteen twenties the share of foreign exchange in total reserves never rose above 42%; it will be noticed how much higher was this proportion in the sterling area.

prices of primary products of payments. The centre had to keep reserves for the whole area for settlement with the outside world and that meant keeping gold (30). In other words,

(29) There were some examples of a tendency to undervaluation of other currencies in the area in terms of sterling, due in the main to the pressure from exporters, for example Danish farmers or South African gold producers. See A. S. J. BASTER, *A Note on the Sterling Area*, « Economic Journal », September 1937. It should be noted however that some undervaluation of members' currencies at the outset may be necessary for such a system to come into operation at all so as to permit the building up of balances at the centre.

(30) Sterling remained freely convertible into gold and other currencies at this time and member countries could use their sterling balances for this purpose as they pleased. There was no pooling of gold and foreign exchange.

The fact that the system was exposed to cyclical fluctuations often originating from outside its boundaries gave the centre country a particularly heavy responsibility for maintaining liquidity throughout the whole area. This responsibility foreshadowed the much greater difficulties that were to be encountered in the administration of the sterling area dollar pool in the face of fluctuations in the dollar earning capacity of sterling area products.

Shortly before the outbreak of the late war,

(31) LEAGUE OF NATIONS, *op. cit.*, p. 64. An example of this occurred in 1938 when the great fall in world primary product prices led to a big decline in sterling balances in London.

fears of an outbreak of hostilities led to a run on sterling, which depreciated in terms of the United States dollar. This fall in sterling led to the withdrawal of most of the non-Empire countries from the area. As most of these countries intended remaining neutral in the event of war they could not anyway have remained members of a currency system linked to one of the belligerents. These defections meant that the sterling area became practically identified with the countries of the Commonwealth. With the imposition of exchange control in the out-

break of war it was given, for the first time in its history, formal definition.

The sterling area is thus an outgrowth of British imperial economic expansion in the nineteenth century; its maturity as a currency system was revealed to observers in the nineteen thirties. The time had now arrived when the pressing needs of war made it necessary to give the system statutory definition and subject it to systematic regulation.

(To be concluded)