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**Imperial Bonds and
Public Debt Management in New Zealand between the Wars:
*an Analytic Study of Public Policy Subject Files***

A thesis presented in fulfilment of the requirements of the degree of
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ABSTRACT

This thesis examines the role of New Zealand's public borrowing in the London money market, between 1925 and 1939. The study focuses on the issue of long term government stock as 'trustee securities', with the trustee status indicating that the conditions of the 1900 Colonial Stock Act were being observed. Public and private trusts in Britain could invest in New Zealand government securities, knowing that the securities were 'gilt-edged', and had the lowest possible risk. The gilt-edged nature of colonial stock was only attained by agreeing to three conditions imposed by the British Government, which permitted British bondholders to secure their investment through a court order, in the event of default on loan repayments. The conditions also included the right of reservation on the colony's Parliament, or a 'power of disallowance', which meant that the British Parliament could force changes to a colony's own legislation. The constitutional aspects of the Colonial Stock Act were significant in the 1930s, as the passing of the Statute of Westminster for New Zealand would mean the option of borrowing in London would be altered. The economic significance of the Colonial Stock Act emerged in 1932 when New Zealand faced loan default in London, and an inability to transfer funds to pay interest. The Bank of England had lent sterling exchange in London, and the trading banks also provided cash in New Zealand. The problems with exchange emphasised the weakness in the system of public finance. Though there was a strict form of accounting maintained by the Audit Office, public works programmes had to be re-funded from annual London loans, as the Treasury found it increasingly difficult to maintain cash balances for spending programmes and debt commitments in London. When exchange rates were devalued the fiscal problem worsened, even with the central bank that had been promoted by Treasury. The Reserve Bank's role in local banking situations did not ease the management of the sterling exchange reserves needed for debt repayment. New Zealand once again faced default under the Colonial Stock Act in 1939. The thesis indicates how this was avoided, due to the imperial political underpinning the interests of London bondholders. Imperial bonds helped ensure national solvency and domestic public works programmes continued. But at the same time as a national currency was secured, the altered banking system also had implications for debt management, ending the elaborate system of statutory accounts.

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1 IMPERIAL BONDS And COLONIAL DEBT MANAGEMENT

*“Consider the curious fate of the English immigrant:
his wages were taken from him
and exported to the colonies;
sated with abstinence, gorged on deprivation,
he followed them: to be confronted on arrival
with the ghost of his back wages, a load of debt;
the bond of kinship, the heritage of Empire.”*

(from A.R.D. Fairburn, ‘One Race, One Flag’, first published in *Dominion*, in 1938)

The poet and satirist, Rex Fairburn, was definite about the nature of the imperial bond, and the legacy of colonial debt. Dominion status meant that the junior members in the empire still awaited the birth of a nation. New Zealand’s political leaders felt uneasy with the very idea of constitutional independence being even discussed, let alone moving to ratify the Statute of Westminster in 1931. According to the poet, the nation being established by the statute-makers was “caught in the calculations of the actuaries.”¹ The countryside was ‘mortgaged in bitterness’, the city built on the ‘rock of debt’. Paper debt obligations were binding. With the imperial bonds: “our credit holds, the chain is long.”²

Writing in the midst of the Depression, others were less concerned with New Zealand nationhood as a stage of its history. Economists and Treasury officials were acutely aware of the economic crisis and national solvency. This was perceived as a question of financial co-ordination, and the maintenance of the foreign exchange reserves in London, needed to make interest payments on loans. A drain on the sterling reserves, as in 1938, “brought into proper perspective the futility of insulating the Dominion against external factors at this stage of its existence.”³ To the Treasury official, financial co-ordination meant mobilizing the strong ties with Great Britain: those of sentiment, trade and debt⁴.

The imperial ties in debt took the form of the Colonial Stock Acts, which had fused constitutional links with the financial interests of British bondholders. There was a form

¹ From section 10 of ‘Utopia’, in A.R.D. Fairburn *Collected Poems*, Christchurch 1967, p.20.

² Fairburn, ‘Stages of History’, p.24. In this first section of the poem, Fairburn writes that ‘our gold was shipped away to prop up the pound against the dollar,’ something that was perhaps not entirely correct, although the perception of control by Lombard Street was real enough to Fairburn, as a Social Creditor.

³ A.D. Park/W.D. Stewart, 24/7/39, Stewart Collection MS-985-1/1/179, Hocken.

⁴ *Ibid.* Park had been the Secretary to the Treasury while Stewart was Minister of Finance in 1932.

of 'colonial preference' in the London financial market: "the basic aim of the Colonial Stock legislation was to further economic development within the colonies and to cement the ties between the mother country and her dependencies."⁵ J.B. Condliffe has referred to New Zealand's government stock attaining the status of trustee securities in London as a form of 'imperial preference' that outweighed trade concessions.⁶ This was because the Colonial Stock Act, 1900, had enabled New Zealand government stock to qualify for the list of Trustee fund investments, which had the 'gilt-edged' status of British government stock. Condliffe noted that there was no British government guarantee on New Zealand stock, but didn't explain why it could therefore be given trustee status. Certainly, no express imperial approval for loan issues appeared to be required. It may be that there was an implicit guarantee, from the point of view of the London market, because of the formal sanctions included in the Colonial Stock Act.⁷ But writing first in 1930, and again in 1959, Condliffe did not mention the constitutional implications of these sanctions. Although New Zealand's eventual ratification of the Statute of Westminster in 1947 was discussed, the constitutional implications of maintaining adherence to the conditions of Colonial Stock Act were ignored. The only question was that of the relative economic merits of borrowing in London compared to the imperial preference in trade.

"In fact, as long as London was the financial centre of the world, the Colonial Stock Act of 1900, which listed colonial stocks as trustee securities, was more helpful to New Zealand than preferential duties in the British tariff might have been. It widened the basis and cheapened the cost of colonial development."⁸

Yet this is the only local example of historical writing which links the New Zealand public borrowing in London specifically with the Colonial Stock Act, and the effect of the trustee status applying to the stock issues. This legislation did have implications for sovereignty, as the British Government was permitted the power to 'disallow' the legislative enactments in a Dominion Parliament, if the contract with British bondholders was breached. The 'power of disallowance' was not identified with the Colonial Stock

⁵ J.M. Atkin, *British Overseas Investment 1918-31*, New York 1977, p.19.

⁶ J.B. Condliffe, *The Welfare State in New Zealand*, London 1959, p.196. Condliffe had made exactly the same point in the first edition of *New Zealand in the Making*, published in 1930, on page 228.

⁷ Atkin, pp.21-2.

⁸ Condliffe, *The Welfare State*, p.326.

Act, until the 1979 article by Angus Ross.⁹ This noted the link between the economic and constitutional dimensions of the Colonial Stock Act in 1930, and why New Zealand opposed the Statute of Westminster affecting the power of disallowance. However, Ross did not explain what happened to the Act when the Statute of Westminster was passed in 1947, unless it assumed that New Zealand government stock no longer had trustee status in London. New Zealand government stock did continue to be issued with trustee status, and the on-going protection for British investor rights was provided in 1947 legislation.¹⁰

Colonial development seems to be integrally linked with public borrowing under the Colonial Stock Act, at least until 1947. Condliffe described New Zealand as a 'great borrower', and that the trustee status was justified because there had never been a loan default. The reward was that colonial stock could be floated at relatively low rates of interest, only slightly above the rate for the British government. But the choice to utilise the trustee status was made because this was favourable to the bondholders in the London market for sovereign debt, given the low risk and relatively high yield on colonial stock.

The role of the City of London as a financial centre depended on the 'fortunes of sterling' as a world currency, not necessarily the constitutional bonds of the British Empire. In *Sterling and British Policy*, Susan Strange charted the relative decline of sterling as the world's 'top' currency to that of a 'master' currency, when the Sterling Area became formalized in 1939. Strange did refer to the Colonial Stock Act, with an analysis based on the role of Dominion borrowing in London, in the 1920s. Whatever emotional ties New Zealand and Great Britain had, and would continue to have, the emphasis was placed upon the "bonds, at once closer and less amicable, between client and banker."¹¹ One more recent book, following Strange, states that: "successive [NZ] governments made heavy use of the privileged access to the London financial markets granted by the Colonial Stock Acts."¹² Mabbett observed that the management of New Zealand's sovereign debt necessarily had political as well as financial aspects, but she identified the

⁹ A. Ross, 'New Zealand and the Statute of Westminster', *Journal of Imperial and Commonwealth History*, 8, 1979.

¹⁰ In the 1947 NZ Loans Amendment Act. The British investor rights had been in legislation since 1908.

¹¹ Strange, *Sterling and British Policy*, Oxford 1971, p.95.

risk of repudiation without examining the constitutional safeguards in the legislation.¹³ If the Colonial Stock Act did not entail any scrutiny of colonial finances, it did provide sanctions for British bondholders otherwise open to default on repayments. Imperialism, as the formal meetings with Dominion representatives, has been seen as “nothing so much as an interview between a bank manager and his improvident clients.”¹⁴ The 1930 Imperial Conference certainly discussed the implications of constitutional equality, to be embodied in the 1931 Statute of Westminster, and the role of the Colonial Stock Act. The British had “no wish to see their clients free from the toils of debt”, as John Darwin has written.¹⁵ But dire threats of punishment unleashed upon a Dominion government at risk of loan default would not seem necessary if bondholders had the safeguards built into the Colonial Stock Act. The key player in this would be the Bank of England, and any suspicions of repudiation would have been a matter of the Bank’s active financial management. The Bank would probably be more concerned than bondholders, when the Dominions’ solvency appeared to depend on constant fresh borrowing in London.

The inability of a Dominion to “kick the borrowing habit,”¹⁶ had been illustrated by the case of Australia in the 1930s. As C.B. Schedvin has put it, “the struggle to avoid default on public interest obligations abroad underpins the entire history of the depression.”¹⁷ Certainly, it was acknowledged that this dire situation was due to the scale of borrowing by Australian authorities in the late 1920s. However, Schedvin saw this as caused by the domestic pressures for public infrastructure investment, rather than an ‘easy’ market situation in London.¹⁸ The result was over-exposure to international financial conditions and an ‘immense transfer problem’: how to make the payments on fixed interest loans in London, when export receipts had fallen dramatically and domestic incomes with them.¹⁹

¹² D. Mabbett, *Trade, Employment and Welfare*, Oxford 1995, p.116.

¹³ *Ibid.*, p.118; apparently “some left-wing members of the Labour party advocated default.”

¹⁴ J. Darwin, ‘Imperialism in Decline? Tendencies in British Imperial policy between the wars’, *The Historical Journal*, 23, 1980, p.664.

¹⁵ *Ibid.*, pp.664-5.

¹⁶ Darwin’s point is the Dominions’ summoning the will, rather than being granted permission, p.665.

¹⁷ C.B. Schedvin, *Australia and the Great Depression*, Sydney 1970, p.3.

¹⁸ *Ibid.*, p.5.

¹⁹ N.G. Cain, ‘Trade and economic structure at the periphery: the Australian balance of payments, 1890-1965’, in Forster (ed), *Australian Economic Development in the Twentieth Century*, Sydney 1970, p.117.

The transfer problem in the balance of payments was felt as soon as it became clear that proceeds from new loans had to be used to pay interest in London. When no fresh loans could be floated in 1929, the Australians then had to buy foreign exchange from trading banks to finance interest obligations.²⁰ This depleted the sterling reserves of the banks in London, reducing the exchange available for Australia's imports. The liquidity crisis resulted in an agreement with the banks to prioritize governmental interest payments, to avoid default. This analysis of the Depression is significant, as it emphasizes borrowing under the Colonial Stock Act. Schedvin has suggested that "Australian governments [saw] their London borrowing status as a right rather than a privilege."²¹ But it was clear that the borrowing practices had been established over time, and had become entrenched.

Australasia as a unit had become the object of criticism in regard to British capital exports in the 1920s. The economic historian, G.R. Hawke, has said that many London financiers "had come to maturity at a time when New Zealand was indeed one of a number of Australian colonies which borrowed separately in London."²² Apparently this made them wary of New Zealand loans. Hawke has portrayed New Zealand's transfer problem as merely derivative of Australia's, because of a shared banking system. Indeed, he implies that New Zealand may have avoided the transfer problem entirely under alternative institutional conditions, and with a central bank before 1933. Hawke has claimed that the Depression in New Zealand was not caused by the balance of payments, in contrast to Condliffe's view of profligate borrowing in the 1920s.²³ Nor was the making of interest payments in London an immediate problem for the government.²⁴ So the fall in export prices was not significant for the balance of payments, nor for the government's policy of re-funding debt obligations, and the only real financial difficulty for New Zealand had been precipitated by a minor crisis in the London market in 1931.

²⁰ Schedvin, p.7.

²¹ *Ibid.*, p.99.

²² G.R. Hawke, 'Australian and New Zealand Economic Development', in K. Sinclair (ed), *Tasman Relations*, Auckland 1987, p.116.

²³ G.R. Hawke, *The Making of New Zealand*, Cambridge 1985, p.135. Hawke appears to have inverted the title of Condliffe's book, first published in 1930, if not its central themes and arguments.

²⁴ G.R. Hawke, 'Depression and recovery in New Zealand', in R.G. Gregory & N.G. Butlin (eds), *Recovery from the Depression*, Cambridge 1988, p.123.

What Hawke seems to suggest is that, because the London market was only temporarily unavailable to New Zealand, the ability to meet its debt obligations was never at risk.

The Bank of England's historian, R.S. Sayers, has stated that New Zealand received a secret loan from the Bank in 1932. Sayers had noted the Dominions' position as 'sterling debtors' seeking a reduction on the contractual rates of interest on the bonded debt.²⁵ The Bank of England may have felt obliged to bail the New Zealand government out, but in doing so the Bank could also compel changes in its borrowing practices. The Bank of England's lending was merely the precursor for the trading banks' financing of Treasury's local spending commitments. It is difficult to conclude, therefore, that the government was able to fund its on-going interest payments in London without the trading banks' assistance. The very real question of New Zealand defaulting on London debt would also take into account the legislative obligation to make sinking fund payments. Besides the Bank of England actually managing New Zealand government stock issues in London, it also had a role in interpreting the obligations (such as sinking fund payments) on which default was defined under the Colonial Stock Act. An understanding of the historical context and role of public borrowing necessarily involves the sovereignty question.

In a recent version of British Imperialism, the form of 'responsible government' in the Dominions involves the gaining of a degree of constitutional freedom.²⁶ However, to finance 'nation-building' infra-structural investment, Dominion governments borrowed heavily in London, creating a form of economic dependency on the imperial metropolis. The idea of constitutional autonomy is therefore separate from the question of economic sovereignty, even though public borrowing in London had formal conditions or a form of imperial constitutional sanction. Cain and Hopkins have described the distinguishing feature of imperialism, not by its economic or political form, "but that it involves an incursion into the sovereignty of another state."²⁷ This definition is intended to include aspects of both informal empire, characterized by economic relations such as public borrowing; and also British sovereign control over territory, that is described as the

²⁵ R.S. Sayers, *The Bank of England*. Vol.2, Cambridge 1976, p.449.

²⁶ D. Cannadine 'The Empire Strikes Back', *Past & Present*, 174, 1995, p.186.

'Constitutional empire'. Cain and Hopkins state that using a constitutional definition only, gives imperial history a political and legal bias, and suggest that this is too narrow for a satisfactory economic history. Constitutional definitions vary in their applicability, especially as some "parts of the empire rose to dominion status and acquired formal control over their own affairs."²⁸ The purely constitutional arrangements, and the exercise of deliberate political authority by Britain, do not cover the dependence upon British trade and credit facilities.²⁹ Economic dependence diminishes sovereignty; whereas, sovereignty was enhanced with the "indigenisation of public foreign debt."³⁰

This definition of financial imperialism draws on the later work of Susan Strange, with imperialism indicating a form of power in international relations. However, the idea of sovereignty that is used by Cain and Hopkins has been questioned, as it abstracts from the constitutional arrangements that had pertained to the Dominions. Redish has examined financial imperialism in the inter-war period, in regard to the foreign debt contracts with London bondholders.³¹ The power to deny future loans is one incentive to meet the conditions of the contracts. Redish argues that an imperialist scenario involves the borrower surrendering formal sovereignty, as another form of the commitment to repay. The conditions of the Colonial Stock Act, as a potential sanction against the breach of contract, seem to fit this definition. It is intended as an alternative to the view that equates foreign control of credit with the loss of sovereignty. There could have been a dynamic of formal imperial control, and a form of local autonomy, which had mutual costs and benefits. For instance, a Dominion government that continued to meet its debt payments in London would be able to organize its own system of public accounts autonomously. This was the case for New Zealand's public accounts between the 1880s and the 1930s.

Redish had questioned where Canada fit into the Cain and Hopkins' study, even though it was indebted to London during the depression years. Britain had lost its position as a net

²⁷ Cain, P.J. & A.G. Hopkins, *British Imperialism*, Vol.1, London 1993, p.42.

²⁸ *Ibid.*, p.6.

²⁹ Cain, P.J. & A.G. Hopkins, 'The theory and practice of British Imperialism', in R.E. Dumett (ed), *Gentlemanly Capitalism and British Imperialism*, London 1999, pp.204-5.

³⁰ Cain, P.J. & A.G. Hopkins, *British Imperialism*, Vol.2, London 1993, p.313.

³¹ A. Redish, 'British financial imperialism after the First World War', in R.E. Dumett (ed), p.129.

creditor in general, so imperial policy no longer relied on the promise of repeat loans, as the incentive to make repayments.³² In the inter-war period the British Government made key trade concessions to the Empire borrowers. This would ensure that there were sufficient export earnings to provide for the interest payments in sterling. Yet Cain and Hopkins identify the 1932 Ottawa agreements as a victory for Britain's international interests. The "continued indebtedness of the other Dominions, and their desperate need to earn sterling to pay their annual interest charges, gave London considerable leverage by making membership of the Sterling Area compulsory."³³ Being tied to the fortunes of sterling, the Dominions had monetary policy determined in London. While the Sterling Area was being maintained by the Bank of England, the Dominions were held in Britain's financial, and therefore geo-political, grip.³⁴ Redish observes that the Bank of England had tried to establish clones of itself in the Dominions, by creating 'independent' central banks able to maintain sound finance and avoid debt default.³⁵ But Canada's central bank was not the Bank of England's blueprint. In contrast, "guided by Niemeier, New Zealand created a Reserve Bank in 1933 almost exactly on the lines approved by the Bank of England."³⁶ This situation would confirm the economist's view of sovereignty.

Hawke has stated that the creation of the Reserve Bank had nothing to do with any issue of independence in a constitutional sense, nor does control of the exchange rate indicate greater independence in that context.³⁷ The central bank ensured financial independence from Australia, and this helped debt operations in London. Independence concerning the exchange rate referred to the mechanism of currency management. But despite these claims, Hawke has indicated that the Bank of England and the New Zealand Treasury expected the stabilisation of the exchange rate at parity with sterling. Legislating for this in the Reserve Bank Act would legally tie the currency to convertibility with sterling. Independence could not be then achieved in exchange or in any economic policy sense.

³² *Ibid.*, pp.134-5.

³³ Cain & Hopkins, 'The theory and practice of British imperialism', p.210.

³⁴ *Ibid.*, p.211.

³⁵ Redish, p.130.

³⁶ P.J. Cain, 'Gentlemanly imperialism at work: the Bank of England, Canada, and the sterling area, 1932-1936', *Economic History Review*, 1996, p.343.

A key factor involves the link between the public accounts and the banking system, in the implications for debt management practices of the interest payments made in sterling, or having to buy foreign exchange from trading banks to make repayments in sterling. Up until 1930, the banking system had settled payments in London's money market, and the exchange rate was maintained at parity with sterling. This made the value of sterling loans predictable, and facilitated the transfer of funds to London, with small transaction costs added by trading banks. When economic conditions put the banks' sterling reserves under pressure, control of exchange by the banks became the focus of an economic policy debate. But the debt management practices within New Zealand were forced to change. New Zealand's Treasury was at the centre of these events, yet very little of the material that could be expected to be on policy subject series files has been archived. As relevant policy files exist in later periods, it must be assumed that this decision was deliberate.

This study therefore reconstructs the inter-war period in public finance from other departmental files, the Bank of England's archive, and Ministers' personal collections. The subsequent chapters will examine debt management practices from the perspective of the Audit Office, and in its correspondence with Treasury. It emerges that New Zealand had a distinctive system of statutory accounts for the use of borrowed finance, and why Treasury had its own institutional reasons for changing the public debt system. This coincided with an economic crisis and the influence of the Bank of England, but the public debt system was altered to meet external conditions affecting national solvency.

Chapter 2 examines public borrowing in London and the emergence of the Colonial Stock Act. New Zealand had been instrumental in having the colonial stock issues acquire trustee status in London, with the passing of the 1900 Colonial Stock Act. This had been noted previously, but no New Zealand analysis of the role of the legislation has resulted. Having described the conditions of that legislation, and the role of trustee status in the London market, the link between colonial borrowing and the management of sterling is made. When the Bank of England had decided to return to the gold standard in 1925, this had required it having more control on foreign lending. Dominion governments

³⁷ G.R. Hawke, *Between Governments and Banks*, Wellington 1973, pp.36-8.

continued to borrow to meet interest payments, while trading banks maintained a sterling exchange standard. The system for transferring funds worked in the period of an export surplus, but when export prices fell in the early 1930s the banks lowered exchange rates with London, and maintaining national solvency required the control of sterling reserves.

In chapter 3, the use of the Colonial Stock Act for public borrowing is related to specific debt management practices. The arguments against London's capital exports, and the Colonial Stock Act made in the 1920s, are examined. J.M. Keynes argued against the use of trustee status, especially as the basis for foreign lending. He suggested that certain tests be applied to the borrowing governments, and specific sinking funds be used to effect debt redemption in London. New Zealand's use of sinking funds had been consolidated under the 1925 Repayment of Public Debt Act. Administration of the scheme, however, began to expose fundamental differences between Treasury and the Audit Office over debt management practice. Treasury had sought greater autonomy in the system of statutory accounts, and more control of public works spending. Eventually, the Bank of England official, Sir Otto Niemeyer, advised on the reform of the public debt system.

Having examined the accounting system for the use of loan money, chapter 4 looks at the method of raising the loan money for public works programmes. The funding for the programme was based on domestic sources of finance, including the Post Office Savings Bank's excess deposits. With a drain on Post Office funds, Treasury continued to look to the London market to relieve the local financial situation. However, favourable credit conditions had to be maintained in London so that existing loans, upon reaching maturity, could be converted. As financial conditions worsened, some of its borrowing practices caught up with Treasury. Chapter 5 indicates that New Zealand was on the verge of default by late 1931, and became reliant on the Bank of England and the trading banks for exchange, and cash in New Zealand. Treasury did not adjust its accounting practice for the devaluation of the exchange rates, but looked to the creation of the Reserve Bank as the solution. The Reserve Bank's role did not prevent further problems with default, as chapter 6 indicates. In conclusion, the role of imperial political bonds is located in London's prevention of default, and sovereignty in terms of control of foreign exchange.

2 COLONIAL STOCK ACTS, STERLING EXCHANGE & DOMINION SOLVENCY

2.1 Adding Trustee Status to the Colonial Stock Legislation

“The effect, if not the deliberate intention, of the Crown Agents' system was to facilitate the raising of colonial loans in the United Kingdom and to confer upon United Kingdom industry the chief benefits of the loan expenditure. The self-governing parts of the Empire benefited as borrowers by the trustee status conferred upon their bonds by the Colonial Stock Act, 1900. This status was conditional upon the acceptance of certain obligations, and it by no means carried an imperial guarantee; nevertheless, it gave to borrowing Dominion governments a good mark which was not without influence”¹

Though the consequences of borrowing under the Colonial Stock Act have been ignored by historians, there has been examination of the origins of the practice by New Zealand governments. The Crown Agent was central to New Zealand floating loans in London, prior to the appointment of an Agent-General in the 1870s.² When the former Prime Minister, Julius Vogel, became Agent-General in 1876, he intended to facilitate more borrowing in London. Vogel arranged for the Bank of England to act as the agents for New Zealand loans, on the basis that their administrative role would add confidence to the stock issues.³ He also began the process that culminated in the 1877 Colonial Stock Act, legislation permitting New Zealand to issue ‘inscribed stock’, and enabling banks to transfer these securities once inscribed in the books of the Bank of England. Local legislation was also required, and under the New Zealand Consolidated Stock Act, 1877, all the existing issues of government bonds were converted into ‘inscribed’ stock.

Until 1911, to sell or transfer stock, the bondholder had to “authorize a representative of his broker or his banker to act as his attorney and sign in the transfer books on his behalf.”⁴ The first Colonial Stock Act of 1877 had “enabled the British colonies to obtain the benefit of a specially low composition stamp duty on transfers of their

¹ W.K. Hancock, *Survey of British Commonwealth Affairs*, Volume 2, part 1, Oxford 1942, p.183.

Hancock had a footnote referring to obligations, in Volume 1 of the *Survey*, published in 1937, p.264, n.4.

² R.M. Dalziel, *The Origins of New Zealand Diplomacy: the Agent-General in London 1870-1905*, Wellington 1975, p.54.

³ *Ibid.*, p.57.

⁴ E. Hilton Young, *The System of National Finance*, 3rd edition, London 1936, p.176.

inscribed stocks in London.”⁵ In the form of inscribed stock, and with the cost of stamp duty compounded at 7s.6d. per £100, securities were freely transferable.⁶ The Crown Agents' role had been to offer stocks at a fixed price, and ensure the success of the stock issue with an underwriting operation. The underwriting arrangements were made by private brokers, such as J. & A. Scrimgeour & Co., observing the regulations of the Colonial Stock Act in the marketing of the stock. Underwriting ensured the issue would be taken up, but also “confine it, insofar as possible, to institutions that could be relied upon to hold the bonds until the market could absorb them without breaking.”⁷ J. & A. Scrimgeours would continue to advise New Zealand on its stock in the City of London.

Vogel had also wanted the advantage of colonial stock being added to the list of Trust Fund investments, but recognised that the Imperial Treasury would block this. The British Trustee Acts influenced the preferences of investors to the extent that trust funds were non-specific on the form of investment, and the legislative regulations applied. The Public Trustee was obliged to maintain the estates of deceased individuals in certain securities, but other trustees represented charitable institutions or private investments. Cairncross suggests that, “the great majority of Trust Deeds generally specified the investments that were permissible under them, but when no directions were given, the Trustee was authorized by Statute to invest in only a limited range of securities.”⁸ Before 1889, this legislation appears to have permitted only purchases of British government stock, known as Consols, unless special powers to Trusts were granted.⁹ Inclusion in the list, and achieving trustee status, was seen as prestigious while it remained narrow,¹⁰ but trustees would favour stock from the list without direction.¹¹

⁵ A.S.J. Baster, ‘A note on the Colonial Stock Acts and Dominion Borrowing’, *Economic History*, 2, 1933, p.602.

⁶ J.M. Atkin, *British Overseas Investment*, New York 1977, p.20.

⁷ L.E Davis & R.A. Huttenback, *Mammon and the pursuit of Empire*, Cambridge 1986, p.185.

⁸ A.K. Cairncross, *Home and Foreign Investment 1870-1913*, Cambridge 1953, p.89.

⁹ J.M. Keynes, ‘Foreign Investment and National Advantage’ in D. Moggridge (ed) *The Collected Writings of John Maynard Keynes*, Vol.19, part 1, Cambridge 1981, p.279.

¹⁰ Cairncross, p.89.

¹¹ Atkin, pp.76,118, “trustees would held 33% of all outstanding colonial government issues in 1933.”

Another view of Trustee Act extensions was that it ensured a market for government debt, and that the cachet of trustee status was intended to make borrowing cheaper.¹² It seems that after 1889 the British government's borrowing declined, and with it, an adequate supply of Consols for the increasing volume of trustee funds available for investment. Avner Offer has observed the collapse in the market value of Consols, and this is linked with the extension of the Trustee Act between 1893 and 1900, which set the 'captive purchasers' of Consols free.¹³ As trustees controlled the funds from the disposal of property from estates, "Joseph Chamberlain's Colonial Stock Act of 1900 allowed the proverbial widows and orphans to partake in the imperial investment boom."¹⁴

The question of elevating colonial government stock to trustee status was a political issue that had been pursued by Vogel's successor, F.D. Bell.¹⁵ Colonial governments sought the role of the Consol, ie 'gilt-edged' security status, but did not have the same low risk. This was because Trustees had "legal redress in British courts against the default of listed securities, but Whitehall could not be sure that the colonies would respect this right."¹⁶ Jessop states that the British government would have had to supervise the colonies' public finances, to ensure interest and capital repayments. The question of granting trustee status had been raised at the 1897 Imperial Conference, by New Zealand's premier, Seddon, and by the Canadian government. The Canadians had objected to the previous practice of stamping the stock certificates to state there was no imperial government guarantee.¹⁷

When the new Colonial Stock Act was passed in 1900, the Imperial Treasury had imposed three conditions on the extension of trustee status. These conditions were:

"1. The Colony shall provide by legislation for the payment out of the revenues of the Colony of any sums which may become payable to stockholders under any judgement, decree, rule or order of a Court in the United Kingdom.

¹² D.K. Sheppard, *The Growth and Role of UK Financial Institutions 1880-1962*, London 1971, p.7.

¹³ A. Offer, 'Empire and Social Reform: British Overseas Investment and Domestic Politics 1908-1914', *The Historical Journal*, 26, 1983, p.130.

¹⁴ *Ibid.*, pp.130-1.

¹⁵ Dalziel, p.73.

¹⁶ D. Jessop, 'The Colonial Stock Act of 1900: a Symptom of the New Imperialism?' *Journal of Imperial and Commonwealth History*, 4, 1976, p.155.

¹⁷ *Ibid.*, p.160.

2. The Colony shall satisfy the Treasury that adequate funds (as and when required) will be made available in the United Kingdom to meet any such judgement, decree, rule or order.

3. The Colonial Government shall place on record a formal expression of their opinion, that any Colonial legislation which appears to the Imperial Government to alter any of the provisions affecting the stock to the injury of the stockholder, or to involve a departure from the original contract in regard to the stock, would properly be disallowed.”¹⁸

To acquire trustee status, the loan prospectus of the colony would therefore state its adherence to the Colonial Stock Act. Local legislation, such as New Zealand's British Investors Rights Act 1908, would acknowledge the first two conditions. The third, in establishing an imperial disallowance or veto over colonial legislation, had constitutional implications. A.S.J. Baster had detailed the three conditions, but expressed doubt that the sanctions could be applied, writing in 1933 when the Statute of Westminster had been passed. The Conference on the Operation of Dominion Legislation, convened in 1929, agreed that the power of disallowance, or reservation, vested in the British Parliament, could continue in spite of the Dominions ratifying the Statute of Westminster.¹⁹ The Imperial Treasury had been consistently against the admission of colonial stocks to the Trustee list, if the Dominions would have avoided the third condition of the legislation. The New Zealand Treasury had a similar view: “in so far as Dominion borrowing is concerned it is felt that the retention by the Crown of the Power of Disallowance is of advantage to the Dominion.”²⁰ Treasury's concern was to avoid unnecessarily affecting the raising of London loans, but this was in line with the prevailing political sentiment.

The real question was that of the government guarantee. Baster had emphasized that the colonial government's revenues alone were the security for their borrowing. Later authors have it that the 1900 Act made the British government the guarantor of colonial issues, and the perceived safety made them even more marketable.²¹ The conventional view, that the extension of trustee status to colonial government stocks did not affect the cost of

¹⁸ Baster, 'A note on the Colonial Stock Acts', p.603.

¹⁹ R.F. Holland, *Britain and the Commonwealth Alliance 1918-39*, London 1981, p.62.

²⁰ Secretary to the Treasury/Minister of Finance, 9/4/30, T52/630, and repeated in a memo to the Permanent Head of the Prime Minister's Department, 9/6/30, on EA 159/1/5.

²¹ Davis & Huttenback, pp.79, 169.

borrowing, and stimulate capital exports, goes back to a 1914 study.²² Even in a critique of the statistical analysis of capital exports, there is a potential confusion about the role of the Colonial Stock Act before 1914.²³ But in the inter-war period it seems to be agreed that capital tended to 'follow the flag', with or without an advantage to the colonies of trustee status, over the foreign borrowers. One advantage of that status, according to Platt, was that if the underwriters found themselves saddled with unsold securities they could be sold to trustees, where foreign securities could not be so easily unloaded.²⁴ Compliance with the Colonial Stock Act has been seen as merely meeting the particular formalities that were required to achieve trustee status, and most long-term loan issues in London were floated on that basis. By focusing on trustee status as an incentive for foreign investment, economic historians tend to downplay the role of an imperial government guarantee.²⁵ Atkin has calculated that the trustee status for colonial stocks was worth .5% in interest cost, compared to the rate for foreign governments borrowing on the London market at the same time.²⁶ It is clear that the 'self-governing' Dominions borrowed extensively under the Act, as much as the market could provide. Hawke has suggested that New Zealand's Treasury had a preference for local borrowing, though this is belied by annual loan flotations in London in the 1920s, improvident or otherwise.²⁷

Certainly, the contemporary views suggested that the Colonial Stock Act gave the Dominions an advantage in the London market, and this resulted in over-borrowing, especially by the Australian public authorities. When the Gold Standard had resumed in 1925, this borrowing had further 'congested' the gilt-edged market for British funding operations.²⁸ The Bank of England was able to place an embargo on the issue of foreign loans, but could use only 'moral suasion' when it came to the Dominions. In one

²² C.K. Hobson, *The Export of Capital*, London 1914, especially p.49.

²³ D.C.M. Platt, *Britain's Investment Overseas on the Eve of the First World War*, London 1986, p.95, where Platt refers to the "Colonial Trustee Acts" as a supposed stimulus to Dominion borrowing.

²⁴ *Ibid.* Appendix 1, p.143.

²⁵ An example of this is in the critique of Keynes in D.N. McCloskey, 'Did Victorian Britain fail?', *Economic History Review*, 23, 1970, p.452, which examines other trustee investments in Britain.

²⁶ Atkin, p.77. This is for the period in the 1920s, and assumes that equal standing is calculable.

²⁷ As noted, parenthetically, by Hawke in 'New Zealand and the Return to Gold in 1925', *Australian Economic History Review*, 11, 1971, p.52. Hawke mistook Treasury's view for the government's practice.

²⁸ I.M. Drummond, *Imperial Economic Policy 1917-39*, London, 1974, p.130. The funding operation refers to the process of selling longer-term stock to replace the short-dated, more liquid, Treasury bills.

instance, a request by the Bank of England to New Zealand's High Commissioner, to reduce the sum being borrowed from £7 to £5 million, was declined. Montagu Norman, the Governor of the Bank of England, felt that the time had come to review the capital exports to the Dominions. The problem was the effect of foreign lending on British monetary policy:

“thus under the Colonial Stock Act, the indebtedness of London to Australasia, that is to another economic unit, already considerable, is increasing and is largely needed for the local expansion of credit and currency; it is an immediate menace to our Gold Reserves in practically the same way as would be the case with Foreign loans, were we not able to turn them away under present circumstances.”²⁹

The question of currency management relates to the sterling balances maintained in London, and directly to the Dominion governments need to make interest payments in sterling. The effect of the transfer of sterling into foreign exchange were mitigated by the raising of new sterling loans, while the trustee status made such loans more attractive than on purely economic criteria. As it happened, New Zealand's loan for £7 million was under-subscribed, after Norman's advice was ignored. This did not mean that the market was a sufficient mechanism to curb Dominion borrowing, without political intervention.³⁰ In British financial history, the Colonial Stock Act was the beginning of the geographical concentration on Empire public finance, and this process was accentuated after the gold standard was abandoned in 1931.³¹ The Bank of England wanted to salvage sterling's international settlements role, with a “retreat into the security of the Empire in which it found a ready made banking network in which the use of sterling had a political basis.”³²

Treasury detailed the procedure involved in the raising of New Zealand government stock issues in London for the Minister of Finance, in April 1939.³³ Preliminary negotiations would take place between the High Commissioner and the Bank of England, usually with the Deputy Governor, concerning the amount to be raised for a fresh loan, or whether a

²⁹ Norman/ O.E. Niemeyer, 11/5/25, quoted in D.E. Moggridge, *British Monetary Policy*, Cambridge 1972, pp.206-7.

³⁰ K. Tsokhas, ‘The Australian role in Britain's return to the gold standard’, *Economic History Review*, 47,1, 1994, p.140.

³¹ Sheppard, p.12.

³² G. Ingham, *Capitalism Divided?*, London 1984, p.200.

³³ Secretary to the Treasury/Minister of Finance, 6/4/39, in N2305, 0001-0004.

conversion loan was to be offered with no addition to the national debt. The Bank of England then negotiated with the brokers, Scrimgeours, who would advise on the best terms to offer in the loan prospectus, in the current market conditions. The Bank of England, as the manager of New Zealand's overseas debt, would also consult with the Imperial Treasury as to the purposes of the loan. There was a preference for public works purposes, which would lead to increased spending on British exports of machinery. Treasury made no mention of the borrowing conditions under the Colonial Stock Act.

However, an earlier memoranda for Nash, in 1936, had indicated that prospectuses issued in London since 1925 referred to the Repayment of Public Debt Act. This involved an annual payment from the budget into a sinking fund, to then repay a proportion of debt in London; this was therefore seen as a contractual undertaking that would enhance the Dominion's credit.³⁴ Nash would also receive a note entitled, 'The Colonial Stock Act – British', which set out the conditions prescribed by the 1900 Act, and how the conditions were incorporated into Part 3 of the N.Z. Loans Act 1932. The official, B.C. Ashwin, had noted, after the condition giving 'His Majesty' the right to disallow any New Zealand Act: "the added protection thus given to lenders enables us to borrow at lower rates than would otherwise be the case."³⁵ This may have appeared as a formality to facilitate London borrowing, but like the contractual sinking fund payments it defined a default.

The more informative part of the 'London loans' memo is seen in the section on the 'economics of loan finance'. This described the transfer mechanism of sterling exchange: "The net proceeds of a loan are not transferred to New Zealand in the form of cash, but form part of the Dominion's overseas assets where they are available to meet commitments in respect of debt services or to pay for goods. A London loan thus increases the Dominion's overseas resources and has the same immediate effect as an equivalent increase in the proceeds of our exports....In exchange for the borrowed London funds the Bank supplies a credit to Public Account in New Zealand available for expenditure on the purpose for which loan raised [sic]. This expenditure attracts additional imports which absorb the borrowed sterling. Thus the expending of new moneys raised by the loan has the effect of temporarily raising the national income."³⁶

³⁴ G.C. Rodda/Nash, 9/10/36, N2305, 0489.

³⁵ Note on N2305, 0420-1. The paper includes the change made with the 1934 Colonial Stock Act.

³⁶ Ashwin/Nash, 6/4/39, N2304, 0003-4.

This summary describes the balance of payments situation without the role of banks, assuming that sterling raised in London meant a simple book transfer into £ New Zealand, so the explanation also involves borrowing under a sterling exchange standard.

2.2 The Sterling Exchange Standard: a Nascent National Currency?

“It had never been necessary to inquire whether it was to gold or to sterling that Dominion currencies were primarily attached: attachment to either meant attachment to the other. And the attachment was an automatic one; the little adjustments in which the bankers were well practised were sufficient for their single uncriticized purpose, exchange stability....It would be by pressure of circumstance, rather than by way of deliberate self-assertion, that the Dominions would question the unified and centralized monetary system to which they were by their history bound. They would not aggressively raise the issue of self-determination versus London-determination, so long as London seemed to them to determine efficiently and wisely. But supposing London-determination got them into trouble?”³⁷

After Britain's return to the gold standard in 1925, the management of liquid sterling balances became a problem for the Bank of England, as it tried to prevent the outflows of gold to correct the balance of payments. If part of the Dominions' borrowing in London was not spent in sterling and: “loans were left on deposit, they represented a short-term liability which would threaten Britain's gold reserves”; but “if they were remitted to other countries, they would represent a drain on these reserves.”³⁸ The conventional view of Britain's ‘return to gold’ is that it was flawed in execution, if not conception, due to the high rate (\$US 4.86) chosen for sterling. This raises the counterfactual question of whether countries with exchange rates at parity with sterling had, in effect, overvalued currencies. Moreover, if fresh public borrowing in the 1920s had mirrored interest payments due on accumulated debt, “the predominant role of capital flows to the sterling [denominated] area was evidently to prop up disequilibrium exchange rates.”³⁹ The exchange rate could not be maintained at parity with sterling if these loans ceased.

Pressnell states that New Zealand had implicitly recognised this, albeit too late, when the exchange rate was devalued against sterling in 1930. However, the government and

³⁷ Hancock, *Survey*, Vol.2, p.191.

³⁸ Drummond, *Imperial Economic Policy*, p.131.

³⁹ L.S. Pressnell, ‘1925: The Burden of Sterling’, *Economic History Review*, 31, 1978, p.82.

Treasury officials did not recognise this situation at the time: it was believed that the Australian balance of payments situation was affecting New Zealand's banking system. The exchange rate was simply a decision for the trading banks. Indeed, "the Dominions' international reserves were held by commercial banks but were not known to their governments."⁴⁰ As the Coalition Government would discover in 1933, a 'political' decision to devalue would require the co-operation of the trading banks. If they agreed to devalue, there would be an incentive to err on the side of under-valuation, in that this would lead to accumulating sterling funds. The substantial balances could then "be used to redeem part of the enormous outstanding total of *long-term* debt due to London."⁴¹

The Canadian economist, Plumptre, wrote in 1939 about the new central banks in the Dominions, and of the "latter-day expression of financial imperialism."⁴² The term 'co-operation' was being used by the Bank of England, but the purpose was essentially the same, namely the maintenance of London's control and influence. In 1931, Britain's restoration of the Gold Standard had ended dramatically, as foreigners ran down their sterling balances, and the convertibility into gold could not be sustained. But the sterling balances of the Dominions were still a predictable, if not easily manageable factor, influenced by the Bank of England. Plumptre had therefore observed the on-going interest of the Bank of England in the borrowing activities of the Dominions.

"The interest arises partly out of the large amounts which British financiers have invested there, a good deal of which is in securities that are on the trustee list in London. The Bank is concerned to see that British creditors gain the protection of sound financial policy in the various debtor countries: 'sound' public finance being taken to mean the policy of keeping annual budgets balanced as far as possible, a strict check on the growth of debt, erring on the side of deflation, and an insistence upon the sanctity of contracts."⁴³

This presents the Bank as the creditor's representative, although the Bank of England was also the agent for New Zealand's public borrowing, and managed the London-domiciled debt. The potential conflict between agent and creditor would not be experienced in the settlement of trading receipts and borrowing obligations in the short-term money market.

⁴⁰ *Ibid.* p.69.

⁴¹ A.S.J. Baster, 'A Note on the Sterling Area', *Economic Journal*, 47, 1937, p.573, italics in original.

⁴² A.F.W. Plumptre, *Central Banking in the Dominions*, Toronto 1940, p.193.

⁴³ *Ibid.*, p.192.

However, from 1932, Dominion stock that ranked as trustee securities could not be issued or renewed without the agreement of the Bank of England.⁴⁴ The Bank and the Imperial Treasury were now actively managing sterling with an exchange equalisation account, and had therefore to ration funds in the longer-term money market, where colonial stock issues had previously been left to market conditions. The Bank of England had always acted as New Zealand's agent in the management of its fresh London borrowing. But when export receipts fell, or funds could not be remitted from New Zealand, interest payments had to be met from new borrowing in London. Would the Bank of England facilitate the conversion of loans if the financial situation in New Zealand did not permit sufficient funds to be remitted? New Zealand had borrowed heavily in London during the 1920s, about £6 million per year, and interest payments created a transfer problem.

The transfer problem in paying interest in sterling, and buying exchange from the banks, was apparent to New Zealand's Treasury in 1925, but because it was more concerned with the export surplus.⁴⁵ Due to the fact that interest payments were made from fresh loan proceeds, the prevailing export surplus could not be utilised in New Zealand, other than through increased imports. Treasury officials seemed to think that, if only the government could borrow from the banks in New Zealand, the export surplus could then be shifted. In any case, there remained the political problem of the government securing control of the overseas sterling reserves from the banks. As the Government would discover in 1932, due to low export receipts and the inability to raise any short-term sterling loans, it was forced to borrow from banks in New Zealand. This was to provide sterling exchange, but also the local funds for the interest and sinking fund payments.

The control of foreign exchange reserves was portrayed as a technical problem, and one that would lead Treasury or, at least, B.C. Ashwin, to propose setting up a central bank.⁴⁶ Writing in 1930, Ashwin had analysed the cause of the prevailing exchange rate variation from parity as the consequence of a drain on the banks' London balances.⁴⁷ As there was

⁴⁴ I.M. Drummond, *The Floating Pound and the Sterling Area 1931-9*, Cambridge 1981, p.11.

⁴⁵ B.C. Ashwin's memoranda, 4/3/25, T52/74/6.

⁴⁶ B. Easton, *The Nationbuilders*, Auckland 2001, p.46.

⁴⁷ B.C. Ashwin, 'Banking and Currency in New Zealand', *Economic Record*, 6, 1930, p.197.

no adverse trade deficit at the time, nor had London borrowing been curtailed by the government, it was believed that the drain on the London balances of the banks must have been caused by the Australian exchange situation. The “London credit balances built up by these [Australian] banks from the good trading years in New Zealand have apparently been used to support the Australian exchange.”⁴⁸ The economic question, or that which occupied Treasury analysis, was how to become a separate ‘economic unit’.

Ashwin's remedy was to define the sterling exchange standard so as to fix it into legislation, thus forcing a separation of exchange business from Australia, while the banks “would practically find it necessary to reserve the New Zealand funds for New Zealand business.”⁴⁹ G.R. Hawke has asserted that this analysis of the technical currency problem, and subsequent action by Treasury, led directly to the creation of the Reserve Bank three years later. As the story has been re-told, certain variations on this theme have emerged, including the technical problem being that London financiers confused the Australian and New Zealand economies.⁵⁰ In fact, there was no necessary reason why recognising a sterling exchange standard would require the London-based banks to make a distinction between their sterling balances for exchange purposes. The distinction between the two countries could be made in altering the exchange rates, according to trade and payment relations with Britain. The significance of the exchange standard was that New Zealand's money supply and long-term growth was determined in London.⁵¹

Hawke has made some rather contradictory comments about the policies relating to the exchange rate, in regard to the inception of the Reserve Bank in 1934. He concludes that, when the conventional parity with sterling was disturbed in 1930, New Zealand officials understood and accepted the sterling exchange standard.⁵² But earlier in the same article, Hawke notes that contemporaries didn't distinguish a New Zealand pound from a British

⁴⁸ Ibid., p.199. The claim that New Zealand reserves had been used in Australia was denied by the banks.

⁴⁹ Ibid., p.202. Ashwin recommends a Note Issue board as a new institution, or nucleus for a central bank.

⁵⁰ G.R. Hawke, ‘The Government and the Depression of the 1930s in New Zealand’, *Australian Economic History Review*, 13, 1973, p 77. In his book *The Making of New Zealand*, on page 134, Hawke claims that the problem was London financiers confusing Australia and New Zealand per se. Yet on page 82 of the earlier journal article, Hawke refers to the Reserve Bank of Australia beginning its operations in 1934.

⁵¹ Cain, P.J. & A.G. Hopkins, *British Imperialism*, Vol.1, London 1993, p.245.

⁵² Hawke, ‘New Zealand and the Return to Gold in 1925’, p.58.

pound, as if British gold sovereigns still circulated in New Zealand. He also states that Treasury failed to adjust their accounting practices for exchange rates, apparently treating variation from parity “as an unusual tax levied on payments for pounds in Britain”, at least until 1942.⁵³ Hawke repeats this in his history of the Reserve Bank, and that the “recognition of a clear distinction between New Zealand and British currencies spread slowly.”⁵⁴ But exchange rate variation was immediately a debt management problem.

Indeed, the Audit Office files include memoranda sourced from Treasury that suggest that officials didn't understand, or perhaps accept, the sterling exchange standard at all. In a submission to the Crown Law Office in 1931, signed by B.C. Ashwin, it was asserted that: “the monetary units of Great Britain, Australia, and New Zealand are all based on the sovereign, and therefore are identical at par.”⁵⁵ It seemed that the monetary policy for sterling countries remained unaltered, and allowed for such exchange oscillations; but a political decision to devalue assumed having a distinct currency. The practice was to record transactions in Britain and Australia at par value, and no differentiation was made for exchange rates in the public accounts.⁵⁶ The Audit Office maintained the view that New Zealand had a distinct currency in principle, and parity was a banking convention.

Hawke has suggested that Treasury's accounting practice, of accumulating all exchange purchases into a single account, was advantageous in calculating the extra sterling the government needed at different exchange rates.⁵⁷ Yet it wasn't just within the New Zealand public accounts that it was considered ‘unsound’ to adopt this practice, and to “omit from the budget any reference to exchange when Government borrowing could be used to pay interest in London.”⁵⁸ The Australian-based economist, D.B. Copland, noted that Treasury's practice assumed the New Zealand pound was identical with the English

⁵³ Ibid., p.51. Hawke refers to correspondence in T48/6, a file that has never been archived.

⁵⁴ Hawke, *Between Government and Banks*, p.17.

⁵⁵ Ashwin/Currie (Crown Law Office), 27/10/31, on A29/14.

⁵⁶ Ibid. Brian Easton believes that Ashwin's own views may differ from the official Treasury view.

⁵⁷ Hawke, ‘The Government and the Depression of the 1930s in New Zealand’, p.88.

⁵⁸ D.B. Copland/W.D. Stewart, 26/4/32, Stewart Collection, MS-985-10-1, Hocken. Copland made the same point in a footnote, on page 373, in ‘New Zealand's Economic Difficulties and Expert Opinion’, *Economic Journal*, 42, 1932. Copland explains the Treasury practice of using London loans to pay overseas interest, thereby eliminating the exchange cost of that part of overseas interest payments. He maintains that the amount borrowed in London should show loan receipts denominated in £New Zealand.

pound, to avoid re-calculating loan expenditure, which had increased in local currency due to devaluation. Copland warned that the practice would create future difficulties, unless Treasury and the banks could promptly return the currency to parity. The Minister of Finance, W.D. Stewart, replied that this treatment of exchange had mitigated the imposition of a heavy burden on subsequent budgets, ie conversion of all receipts and payments due in London.⁵⁹ Stewart was more concerned with the recent £5 million loan.

The difficulty of the devalued exchange rate emerged at a time when New Zealand was on the verge of default, in 1932. Stewart's reference to the £5 million loan, secured in early 1932, was significant for it being 'normal' London borrowing. Another loan was arranged, secretly, with the Bank of England.⁶⁰ At the time, export prices had collapsed and, as the financial crisis forced the Bank of England to abandon the gold standard, this had temporarily suspended normal borrowing on the London market. Hawke states that governmental interest payments were consuming about 26% of export receipts at this stage. As the London market began to function again, Hawke has not identified the specific problems that New Zealand's borrowing had caused for the Bank of England. Apparently, "foreign exchange was accumulated during most of the Depression years so that even if there had been profligate government expenditure, much more easily asserted than proved, the interest payments were not an immediate problem in the 1930s."⁶¹

So the balance of payments situation didn't cause the Depression. However, if this was the case in 1932, before the inception of the Reserve Bank, Hawke must be able to prove that New Zealand's foreign exchange was accumulating, even though the banks did not actually differentiate their sterling reserves by country. This must also be misleading unless it can be proved that interest payments were not an immediate problem, due to a lack of exchange in London, and as a budgetary item for the government. Though export prices may have recovered slightly in 1931, the fiscal deficit appeared to be £8 million.⁶²

⁵⁹ Stewart/Copland, 20/5/32, MS-985-10-1, Hocken.

⁶⁰ Hawke, *The Making of New Zealand*, Cambridge 1985, p.135.

⁶¹ *Ibid.*

⁶² A.H. Tocker, 'Public Finance and Depression in New Zealand', *Economic Record*, 7, 1931, p.245.

2.3 National Solvency: with a little help from London trading banks?

"It is untrue to say we hoarded millions in London. We did nothing of the sort. We took over £1 million a month in London from our trading banks from the proceeds of our exports that they handled, and gave them Treasury Bills in New Zealand....

To the extent that we earmarked proceeds in London for our requirements the Banks naturally were restricted in the use of those funds for financing further imports or for other purposes; and as we were restricted by the London market to £5 million of new loan money there would automatically follow a lessening of imports. What happened was the ordinary procedure to maintain a proper balance of external receipts and payments or, in other words the normal procedure to maintain national solvency."⁶³

The former Secretary to the Treasury, A.D. Park, looked back to the 1932 agreement with the banks to organise an exchange pool, and in reply to W.D. Stewart (the Minister of Finance at the time), suggested that it was just a temporary expedient. In fact, this was no ordinary procedure when the Government had to reach agreement with banks to prioritise its interest payments in London over all other exchange transactions. Hawke has claimed that the banks sought legislative backing for this agreement, in a move to secure their control of exchange business through export licensing, preventing an 'outside market' developing.⁶⁴ Nor was it the temporary expedient it seemed: when the immediate exchange crisis was over the banks had already begun purchasing Treasury bills to finance internal public expenditure. The Prime Minister, Forbes, had informed officials that, with the Associated Banks providing the government's borrowing requirements for the financial year, it was necessary to maintain links due to exchange speculation.⁶⁵

This situation, where Treasury control of expenditure had effectively been ceded to the banks, hadn't been caused just by the departure of Britain from the gold standard. This was a more fundamental question of public finance and debt management practices. Condliffe has stated that "the credit of New Zealand was at stake" due to the possibility of default.⁶⁶ The contemporary analysis was based on the practice of government buying exchange from the banks, minus annual loan proceeds, meaning a requirement of £2-3

⁶³ A.D. Park/W.D. Stewart, 24/7/39, MS-985-15-20, Hocken.

⁶⁴ Hawke, *The Making of New Zealand*, p.135.

⁶⁵ Forbes/Controller & Auditor-General, 19/8/32, on A29/14.

⁶⁶ J.B. Condliffe, *The Welfare State in New Zealand*, London 1959, p.35.

million.⁶⁷ Therefore, with interest commitments of up to £8 million, and an issue of Treasury bills in London to be repaid, the foreign exchange requirement was £12 million. Rather than bringing in a policy of exchange control, the banks were being permitted an “effective monopoly over almost the whole of the overseas credit available.”⁶⁸

The process by which the banks came to control the exchange pool is not traceable in Treasury records, other than in a summary for the Minister, entitled the ‘Mobilisation of London Exchange’.⁶⁹ Treasury’s paper pointed to the fact that surplus cash was usually remitted to London to augment loan proceeds, until the banks had ‘raised’ the exchange rate (ie devalued). As this meant that exchange would cost an additional 10%, Treasury took the view that it would be better to borrow in the London’s short-term money market at 2.25%, rather than issue Treasury bills in New Zealand at 5.5%. The Treasury paper does not state why their issue of bills in London had been ‘privately’ placed with new loan agents. But Treasury did record the Bank of England’s displeasure with this practice, and the wider concerns over borrowing. The Bank advised the High Commissioner:

“that New Zealand’s financial position in London is serious beyond all words and that New Zealand’s policy in the past of borrowing on short-dated Treasury Bills had greatly accentuated the present position... [and consequently]...New Zealand should arrange its London finance through all the New Zealand banks operating in London.”⁷⁰

It was the Bank of England that suggested the banks should ration exchange, allocating £1 million per month for Government remittances to meet the £12 million requirement, a policy similar to that which the banks had pursued in Australia, in 1930. Therefore, it was the Bank of England that ensured the banks dictated New Zealand’s public finances.

The Treasury summary indicates officials had suggested alternatives to the Bank of England, including New Zealand’s Reserve Fund securities being sold to raise funds, but the market prices were deemed too low. The Bank of England offered to purchase £4 million of 6-month New Zealand Treasury bills, on the condition that the New Zealand

⁶⁷ A.H. Tocker, ‘Exchange Control in New Zealand’, *Economic Record*, 8, 1932, p. 113.

⁶⁸ *Ibid.* “It was not stated that such control gives them full power to ration supplies of exchange to buyers other than the Government...heavy rationing would be necessary if imports were to be reduced [p114].”

⁶⁹ A.D. Park/W.D Stewart, 8/2/32, MS-985-15-20, Hocken. T44/162/1 file in Archives NZ is not extant.

⁷⁰ *Ibid.*

government refrained from borrowing in London all by itself. The Bank of England's file also indicates that the New Zealand officials inquired whether sinking fund payments could be suspended in 1932, and again in 1933. The sinking fund payments were an item of budgetary significance, with current revenue being used to make capital repayments.⁷¹ These particular payments were legislative enactments, under the Repayment of Debt Act 1925, and reference to the Act and the sinking funds was explicit in the prospectuses for London stock issues. The Bank of England stated that the issue of a prospectus under the Colonial Stock Act meant sinking fund payments were technically a matter of default.⁷² Condliffe has suggested there was manipulation of funds and reserves, and the juggling of accounts to meet interest obligations; but despite the complications of public finance in the Depression, the nation continued to meet its obligations on overseas debt in full.⁷³ However, short-term borrowing in London had been prohibited, and the Bank of England placed an embargo on conversions of existing loans. But according to Hawke, there was a conversion of a substantial loan in 1932, which "coincided with the lowest interest rates to rule in Britain for many years so that for 25 years after 1932 New Zealand benefited from cheap finance."⁷⁴ Fresh London borrowing was actually discontinued after 1935.

In fact, the overseas debt in London would be halved in the period up to 1949. This has been seen as a qualitatively new period in debt management, to those more sympathetic with the financial policy in the later 1930s. Indeed, "it had become painfully clear that borrowing to pay interest, which was all New Zealand had been doing since 1886, could not go on without serious repercussions."⁷⁵ In Rosenberg's analysis, the government did have to tax locals to obtain funds to pay interest, and this use of funds meant new capital works would require borrowing, either locally or overseas. Though it appeared that public works were financed from borrowing, there needed to be an 'artificially large' export surplus to pay the overseas interest. Thus, it was apparent that "New Zealand financed her capital imports out of her own earnings, requiring foreign loans only in

⁷¹ L. W. Holt, 'The New Zealand Budgetary Problem', *Economic Record*, 9, 1933, p.116.

⁷² Bank of England file C40/282 [MS-Coll-20-2925, ATL]. The matter was dealt with in early 1932.

⁷³ Condliffe, *The Welfare State in New Zealand*, p.37.

⁷⁴ Hawke, *The Making of New Zealand*, p.135.

⁷⁵ W. Rosenberg, 'Capital Imports and Growth - the case of New Zealand - Foreign Investment In New Zealand 1840-1958', *Economic Journal*, 71, 1961, p.98, the quote has dashes in the original text.

order to meet charges on loans previous incurred.”⁷⁶ This perspective on London borrowing has been labelled ‘economic nationalism’. In W.B. Sutch's version, not paying off foreign debt put the country farther back into colonial economic status.⁷⁷ An institutional explanation is possible for the inability to repay foreign debt in the 1920s and the Depression era. Rosenberg noted that in this period, the nature of the financial apparatus meant “the payment of interest on foreign debt and the raising of funds for that payment were quite separate.”⁷⁸ A central bank was necessary to facilitate any large-scale loan repayment, through the control of foreign exchange transactions and reserves. The Reserve Bank legislation passed in 1936 facilitated this, by allowing for the control of the transfer of overseas funds, and it was possible to suspend the exchange of Reserve Bank notes into sterling.⁷⁹ Hawke has more recently claimed, without citing a source, that the measure “was introduced into legislation in order to calm Nash's apprehensions that the trading banks might somehow frustrate the guaranteed price for dairy produce,” along with imposing variable reserve asset ratios for cash held at the Reserve Bank.⁸⁰

Sutch certainly believed that the Labour Government had taken the necessary steps to mitigate the effects of a flight of capital. Capital flight would precede the 1938 election, and import and exchange controls subsequently had to be imposed. By suspending the obligation to exchange sterling, the currency had been only conditionally linked to sterling. The 1936 legislation had assumed the sterling exchange standard operated, but had also added the conditions for a national currency to be secured. But the dilemma remained of New Zealand meeting its obligations as a debtor in London, and therefore national solvency was still in question.⁸¹ This will be observed in the 1939 visit of the Minister of Finance, Walter Nash, to negotiate the conversion of loans in London with the Bank of England. Certainly, the Reserve Bank Governor would interpret the loan conversion in terms of default under the conditions of the Colonial Stock Act.

⁷⁶ Ibid p.107.

⁷⁷ W.B. Sutch, *The Quest for Security*, Wellington 1966, p.417.

⁷⁸ Rosenberg, p.107.

⁷⁹ Sutch, *Recent Economic Changes in New Zealand*, Wellington 1936, p.35.

⁸⁰ Hawke, ‘The Evolution of New Zealand Currency’, *VUW Working Papers in Economic History*, 84/1, p.18. Nash was aware of the dangers of capital flight, but was anxious not to actually precipitate it.

⁸¹ W.K. Hancock, *Survey*, Vol.2, Part 1, p.284.

3 PUBLIC DEBT MANAGEMENT WITHIN NEW ZEALAND: TREASURY And The AUDIT OFFICE CROSS SWORDS, 1925-31

3.1 The Dominions' Over-borrowing under the Colonial Stock Act

*"In some cases these loans are becoming dangerously large in relation to the population and the wealth of the borrowing communities. So long as we renew maturing loans when they fall due, and lend in addition twice the amount required to meet the interest on previous loans, the capacity and integrity of the borrowers to meet their liabilities is obviously altogether untested. But this cannot go on for ever. Can we feel perfectly confident in every case that the obligations will be met in their entirety?"*¹

Writing in 1924, J.M. Keynes was troubled by the exportation of capital facilitated by the Colonial Stock Act, and its effect on investment at 'home' - both public and private. In the first place, Keynes was concerned about the security of the lending, and the risk of default. The Dominions' fresh borrowing exceeded the level of interest payments on the previous loans. Although the "motive for repudiation [was] clearly non-existent,"² the problem with an 'artificial stimulus' to foreign investment on such a grand scale was as much the ability of Britain to continue to lend, as the effect of compound interest for colonial public finance. This situation was due to a legislative contrivance: "imperial piety has silenced tongues and criticism; and its results do not receive enough attention."³

Although the legislative contrivance – trustee status – had been extended in 1900 under the Colonial Stock Act, this had been justified at the time because the authorised list of investments was limited and more funds were becoming available. Also, when Keynes was writing, British municipal authorities were not included in the trustee list, and this was rectified the following year in the 1925 Trustee Act. The question in the 1920s therefore, was whether colonial stock issues in London were competing with necessary investment categories at 'home', for public works and utilities.⁴ The matter of debt management was slightly different, given the Imperial Treasury's disdain for public

¹ J.M. Keynes, 'Foreign Investment and National Advantage', 9/8/24, in D. Moggridge (ed), *The Collected Writings of John Maynard Keynes*, Vol.19, part 1, Cambridge 1981, p.281.

² *Ibid.*, p.278.

³ *Ibid.*, p.279.

⁴ *Ibid.*, p.280, "for example, loans for harbour works in New South Wales can be borrowed more cheaply in London than for the Port of London itself, merely because the former, being undertaken by the Government of New South Wales, represent a trustee investment, whereas the loans of the Port of London Authority, although a public body, do not fall within the trustee category."

works programmes, and the practice of redeeming gilt-edged stock. But in so doing, a security with trustee status was made unavailable to the Trust Funds. This then resulted in an automatic foreign investment, in the form of a colonial government stock: “if money is available in the gilt-edged market, and there is no new home investment to take off the surplus funds, they almost certainly find their way into the colonies.”⁵

The Imperial Treasury had actually opposed the extension of trustee status to colonies, at least on the grounds that this would affect the market for gilt-edged securities. Niemeyer, the Controller of Finance, stated in 1920 that, “Treasury would certainly be accused of neglecting its own stocks if it now admitted more colonial stocks to compete with them.”⁶ Nevertheless, the scope of the Colonial Stock Act conditions had been extended to the Crown Colonies, as they were seen to be unable to borrow in London on an equal basis, given the enhanced status of the Dominion inscribed stock.⁷ The Imperial Treasury was aware that the Colonial Stock Act could not validate the continued control of a Colony’s finances. In spite of this, with the granting of trustee status bondholders assumed an informal government guarantee, as the conditions of the Act would prevent default.⁸

Atkin asserts that the “political ties of the Empire appeared, to British investors, to protect their capital from potential default or repudiation.”⁹ Any territory that defaulted would be administered back to paying its way, as the example of Newfoundland in 1933 had appeared to demonstrate. The alternative point of view, was that the Colonial Stock Act facilitated over-borrowing, and this made colonial stocks less safe than domestic trustee securities. Atkin has mentioned the case of Australian over-borrowing, but suggests that the legislation merely facilitated the issue of securities.¹⁰ If colonial stocks were as safe as British consols, an investment of the same risk provided a slightly higher yield than the domestic stocks, developing the market for colonial borrowing. Atkin’s

⁵ Keynes’ evidence in answer to question 4000, ‘Minutes of evidence by Mr Keynes before the Committee on National Debt and Taxation’, 1/10/24, in Moggridge (ed), op cit. p.316.

⁶ Niemeyer quoted in Atkin, *British Overseas Investment 1918-1931*, New York 1977, p.79.

⁷ R.M. Kesner, *Economic Control and Colonial Development*, Connecticut 1981, p.83.

⁸ *Ibid.*, p.85.

⁹ Atkin, p.254.

¹⁰ *Ibid.*, p.84.

analysis is based on trustees providing a regular supply of funds for the colonial stocks, even in the Depression, because this involved the estates of deceased.¹¹

This partly explains why the Dominion governments were able to continue issuing stock on the London market, despite the critics who claimed that the normal curbing on excessive borrowing, in the form of a higher interest rate, was not apparent.¹² Given that the Australians still managed to meet their debt obligations during the Depression, and others had a perfect debt record, Atkin sees the colonial preference in foreign investment as vindicated. He stated that in 1930, New Zealand began to borrow to meet interest and capital repayments. Arguably, New Zealand had been doing this for some time, with the new borrowing providing the exchange to make sterling payments. Though funds still had to be found in New Zealand, the ability to borrow annually remained unquestioned.

Keynes' was perhaps the only analysis to capture the impact of the colonial borrowing, in the effect on public finances in the Dominions, and for Britain's balance of payments. Moggridge has suggested that Keynes had examined the role of capital exports in creating a 'transfer problem' for Britain.¹³ If the loan proceeds were to be remitted to the debtor economy through purchases of imports in third countries, there would be pressure on the exchange rate. Britain's solvency would come to rely on exporting more, though the Dominions were more likely to use British imports. But certainly for New Zealand to pay higher interest costs in London it needed more exports, therefore the British would have to import more to ensure its debts were paid. For Keynes, the ability of a borrowing government to service debt, even without fresh loan issues, should be seen as the first condition on which foreign investment should meet national interest criteria.¹⁴ Keynes also considered it relevant to inquire into the domestic interest rates of the borrowing government, as a disparity indicated the motive for the foreign borrowing. Another specific concern related to the use of sinking funds to repay the capital of the loan, reducing it year by year until extinguished by the due date, rather than a government

¹¹ Ibid., p.195. New Zealand's Public Trust Office had difficulty in realising property sales from estates.

¹² Ibid., p. 84, repeating the views from the *Economist*, 61, 1930, p.578.

¹³ D.E. Moggridge, *Maynard Keynes: An Economist's biography*, London 1992, p.422.

converting the maturing loans. So as “to retain their present position in the list of trustee investments, the Treasury should lay down a regulation prescribing that in every case there shall be a specific sinking fund operating year by year in the market.”¹⁵ The Imperial Treasury had insisted on sinking fund provisions in colonial development in Africa, until the Colonial Stock Act was applied to the African protectorates in 1929.¹⁶

Keynes had criticised the colonial governments’ practice of using only a general sinking fund, for which a certain sum from the budget was applied to debt reduction. This was a “feeble guarantee” for the repayment to a foreign lender, and no substitute for a specific sinking fund attached to individual loans.¹⁷ This kind of imperative had been applied to Imperial government expenditure from the time of the Naval and Military Works Acts of 1901-5, during Asquith’s stint as the Chancellor of the Exchequer.¹⁸ Defence spending had resulted in a ‘deadweight debt’, and henceforth, loan finance was meant to be restricted to projects that could provide a return, so as to finance interest and sinking fund payments. The result was that public works which did not provide a money return would have to be funded ‘above the line’, ie from general tax revenue, or not at all. The British government also maintained two general sinking funds: the ‘old’ sinking fund took an annual revenue surplus and applied it to debt reduction. The ‘new’ sinking fund was to make a fixed annual provision of revenue to allow stock to be bought on the open market. The clear objective in this was to support the price of government stock by maintaining demand, and by reducing the supply.¹⁹ The idea of sinking funds was to reduce the net debt level, which obviously meant no new loan issues, as it was “no use to pay off the debt with one hand while you are creating it with the other.”²⁰ But the sinking fund provisions that were not enshrined in legislation would therefore be ignored in some years, as the British could do under their Sinking Fund Acts, and did in the 1930s.²¹

¹⁴ Keynes, ‘Some tests for loans to Foreign and Colonial Governments’, 17/1/25, in D. Moggridge (ed), *op.cit.*, p.330.

¹⁵ *Ibid.*, p.331.

¹⁶ S. Constantine, *The Making of British Colonial Development Policy 1914-40*, London 1984, p.186.

¹⁷ Keynes, ‘Some tests...’, p.331.

¹⁸ G.C Peden, *Treasury and British Public Policy 1906-59*, Oxford 2000, p.40.

¹⁹ Hilton Young, *The System of National Finance*, 3rd edition, London 1936, p.205.

²⁰ *Ibid.*, p.207. It was therefore better to raid sinking funds if short of revenue, than increase debt.

²¹ Peden, p.518.

But when colonial governments attempted to suspend sinking fund payments it was called default, because the legislation had been specified in stock issue prospectuses.²² A New Zealand loan prospectus issued in London also informed the investor of the actual legislative authority for borrowing, and bondholders could have also traced how their funds were used in the public accounts. The system emphasized accountability, but precision in the method of accounting required detailed legislation and monitoring by the Audit Office. This also happened to constrain Treasury's debt management role.

3.2 Sinking Funds and the Legal Status of Separate Accounts in New Zealand

According to Condliffe, in the 1870s the New Zealand government had been able to set aside sinking funds worth over 7% of the total debt obligations.²³ Then recurrent raids had diminished the ability to redeem outstanding loans, until the 1910 Public Debt Extinction Act was passed, and 'extinction' was calculated over a timeframe of 75 years. The problem with this legislation was that it did not result in any debt actually being redeemed or cancelled. In fact, the sinking funds were used to invest in government securities in the public sector, providing funds for the State Advances Department and the Public Trust Office. A new scheme had been drafted for legislation every year since 1922, and was finally passed in 1925. The scheme consolidated existing sinking funds into a Public Debt Redemption Fund, while interest earned on the previous investments would be retained by the Consolidated Fund. The new element was that the Consolidated Fund would be obliged to put .5% per annum of the value of the public debt into the Redemption Fund, plus a figure of 3.5% on debt redeemed, to represent interest that would have been paid. The total amount would be used to purchase stock in London for cancellation. Henceforth, the "credit of the Dominion in the London market will be maintained, and the rapidly increasing indebtedness of the Dominion held in check."²⁴

The unanimity between the Audit Office and Treasury over the details of the scheme did not last long. The difficulty seems to have been caused over a question of the use of loan

²² R.M. Kindersley, 'British Overseas Investments in 1932', *Economic Journal*, 44, 1934, p.369.

²³ Condliffe, *The Welfare State in New Zealand*, London 1959, p.191.

finance being distributed between separate accounts and involved both the 'recouping' of the required revenue from each account, and the sharing of interest relief from each debt cancellation between the separate accounts. According to Treasury, "an account where debentures have been redeemed will under present circumstances escape liability for interest to that extent, all of which is inequitable and absolutely unsound from a commercial point of view."²⁵ Only two accounts had sufficient revenue to cover a transfer of revenue, and Treasury wanted no recoupment made until the legislation was amended. In fact, the idea of the 3.5% recoupment had been to establish a uniform rate for the interest charge on all debt that was redeemed, no matter what the actual interest rate on a cancelled debenture had been. The analysis in the Audit Office was that the "3.5% charged against the separate account does not represent the interest which would have accrued on an invested sinking fund as [Treasury] suggested (which would be a receipt) but represents interest chargeable against that account which has been redeemed under the Repayment of Public Debt Act."²⁶ Treasury, it seems, had not adjusted to the idea that the loan accounts were not making actual investments from the allocated loan money, but had liability for interest reduced 'in lieu' of the amount previously payable, as interest on the securities which were redeemed. It was "clear that the effect was exactly the same as if each separate account contributed to a separate sinking fund," on the same basis as under the 1925 Act.²⁷ Treasury's method would require profit in each account.

The Audit Office version involved the possibility of calculating the interest obligations of separate accounts, but only recouping interest or sinking fund contributions where surplus money existed. Treasury preferred to abandon the practice of recouping debt repayment charges, and thus drafted section 22 of the Finance Act, 1926. The clause was intended to have the separate accounts "charged full interest on the whole of the capital sunk in the respective undertakings irrespective of whether the corresponding part of the public debt has been redeemed by the Consolidated Fund or not."²⁸ Audit's view remained that the system had the flexibility, "to relieve separate accounts of the necessity of paying off

²⁴ Controller & Auditor-General/Minister of Finance, 17/6/25, A23/49.

²⁵ Secretary to the Treasury/Controller & Auditor-General, 13/4/26, on A23/49.

²⁶ Control Branch Officer (R.M. Sunley)/Controller & Auditor-General, 4/5/26, A23/49.

²⁷ Ibid.

their loan liability unless by some good fortune they chance to be in a position to do so.”²⁹ The new system, however, appeared to relieve the accounts of making any sinking fund contribution. The effect on departmental balance sheets seemed to be neutral, unless revenue “not set apart by law for some particular purpose,” was used to redeem debt and write-off any losses.³⁰ All that section 22 appeared to do was change the nature of the loan liability, from that of a loan account to the debenture holder, to then being secured on the Consolidated Fund. The Auditor-General sought the opinion of the Solicitor-General: to be assured that the separate accounts which were not wholly funded by loan money would not use their loan money to pay interest, or for the sinking funds.³¹

The Audit Office’s principle of maintaining a continuity of interest on the loan liability, represented by the 3.5% contribution to be made from the Consolidated Fund, became redundant. This occurred first in the actual practice of debt redemption. Treasury would purchase securities for redemption before there was the authority from the Minister of Finance to effect cancellation. This problem had emerged when Treasury decided that it need not adopt the ‘roundabout method’ of purchasing the securities before the date of cancellation, and had sought a legal opinion to support a short-cut method.³² The Solicitor-General appeared to complicate matters by offering an opinion on whether the calculation of interest was still relevant, once the purchase of the security was made, due to the obligation to keep the accounts in a particular form. The situation appeared to be the temporary investment by a separate account, although technically it was a case of the purchase by the Crown of its own securities. However, “the raising of a fresh liability to the Consolidated Fund in place of the liability redeemed therefrom imposes an obligation to keep accounts recording the position of two separate entities.”³³ The Solicitor-General did not appreciate Audit's view of the legal standing of separate accounts, nor the formal accounting point, of preventing a break in interest calculation before the interest became the (notional) liability of the Consolidated Fund when the actual security was

²⁸ Secretary to the Treasury/Controller & Auditor-General, 22/10/26, T40/16/1, on A23/49.

²⁹ Sunley's note on 22/10/26 memo, A23/49.

³⁰ Controller & Auditor-General/Secretary to the Treasury, 6/4/27, A23/49.

³¹ Controller & Auditor-General/Secretary to the Treasury, 23/7/27, A23/49.

³² Secretary to the Treasury/Solicitor-General, 4/5/28, included with a Treasury memorandum to the Controller & Auditor-General of 27/6/28, T44/92, on A23/49.

cancelled. But it was necessary to provide validating legislation for delayed cancellation, when no interest on the loan was being paid nor sinking fund contribution being made.³⁴

Though this instance was representative of the administrative technicalities in debt management, it was also indicative of the different perspectives between Treasury and the Audit Office in regard to separate loan-financed accounts. As it happened, the amendment to the Repayment of Debt Act, under section 22 of the 1926 Finance Act, had required further amending, in section 18 of the Finance Act, 1927. This appears to have been an attempt by Treasury to tidy up where funds were transferred from the accounts under previous legislation, now part of the Public Debt Redemption Fund, which had included investments by the Public Trust Office. In section 18, “the Minister is to decide whether interest shall be charged or not, and if charged may direct payment of same from an account other than that which has the liability.”³⁵ Audit saw this as having potential for the accounts to be misleading. The intention was to equate the interest earned from previous investments with the rate on the liability to the Consolidated Fund, on the stock redeemed by the sinking fund; to be “equitable the rate must be the same either way.”³⁶

Unfortunately, it then emerged that the interest rates were not intended to be the same, either way. Treasury thought it more “equitable that compound interest should now be allowed on the sinking funds of the separate accounts,” while “simple interest only has been calculated on the amount of securities redeemed from the date of cancellation.”³⁷ Audit then objected that this was inequitable under the new scheme, and the Crown Solicitor advised that the Act did not authorise compound interest. Therefore, Treasury drafted further amendments to the 1925 Act, to reflect the adjustment for the amounts contributed to sinking funds prior to the new scheme, to restore the original intention. Under continued objection from Audit, Treasury abstained from the technical debate, in suggesting the transactions were merely adjustments between accounts. This was now

³³ R.M. Sunley's notes, 4/7/28, on Treasury memo of 27/6/28, on A23/49.

³⁴ Solicitor-General/Secretary to the Treasury, 7/8/28, included with a Treasury memorandum to the Controller & Auditor-General of 14/8/28, T44/92, on A23/49.

³⁵ R.M. Sunley/Controller & Auditor-General, 28/3/28, A29/55.

³⁶ Assistant Secretary to the Treasury/Controller & Auditor-General, 16/4/28, T40/16/1, on A29/55.

³⁷ Assistant Secretary to the Treasury/Controller & Auditor-General, 12/7/28, T40/16/1, on A29/55.

“purely a technical question of financial administration, which is entirely the function and responsibility of the Treasury,” and Treasury’s decision in such matters had to prevail.³⁸ The Auditor-General attempted to explain Audit’s position to the Minister of Finance, emphasizing the extra strain being placed on the Consolidated Fund. But the Minister agreed with the ‘small technical amendment’, as “no liability to the Consolidated Fund can accrue until the investment assets on which interest is being compounded have been extinguished.”³⁹ The result of this was another amending clause in a Finance Act, but the position of Treasury had hardened, and it could count on the support of the Minister.

As the debate continued, the Audit Office pointed out that the idea of sinking funds was to set-off revenue against a loan liability; whereas Treasury reversed this, and “set off against the investments arising out of sinking fund contributions, as and when such liability accrues.”⁴⁰ It seemed that Treasury wanted to preserve the idea of sinking funds that were actual investments, with the Public Trustee retaining the interest calculated on past contributions. As the Public Trustee had actually made interest payments in cash to the previous scheme, Treasury offered to meet Audit’s objection with a continuation of the practice of interest calculation.⁴¹ It seemed impossible to reconcile giving full credit for past contributions to the old sinking funds, and maintaining the same rate of interest on the sinking fund assets as the rate calculated on liability to the Consolidated Fund for separate accounts.⁴² The technical points continued to be viewed as mere formalities by Treasury, while the Auditor-General wrote disapprovingly of the situation in his 1930 Annual Report. There still remained questions of whether all the public debt was covered by the 1925 scheme, as some loans were not raised on the security of the public revenues, such as under the Rural Advances Act 1926. The Repayment of Public Debt Act would then not embrace loans raised for rural advances, and this required further amendment. As this section (10) of the 1929 Finance Act mistakenly exempted other loan categories from the 1925 Act, another draft clause was required for the 1930 Finance Act.⁴³

³⁸ Secretary to the Treasury/Controller & Auditor-General, 3/9/28, T40/16/1, on A29/55.

³⁹ Minister of Finance/Controller & Auditor-General, 5/10/28, A29/55.

⁴⁰ Assistant Secretary to the Treasury/Controller & Auditor-General, 21/3/29, T40/16/1, on A29/55.

⁴¹ Assistant Secretary to the Treasury/Controller & Auditor-General, 13/6/29, T40/16/1, on A29/55.

⁴² Controller & Auditor-General/Secretary to the Treasury, 14/10/29, A29/55.

⁴³ Secretary to the Treasury/Controller & Auditor-General, 7/11/30, note by Sunley, 14/11/30, on A23/49.

By this stage, however, Treasury had decided to reform the procedures for the public debt system as a whole, irrespective of whether the loan accounts were excluded from the operation of the repayment scheme or not. This was to be ‘codification’ of the procedure for raising loans in general, and meant consolidating the 1908 New Zealand Loans Act and the 1917 New Zealand Inscribed Stock Act and subsequent amendments, into one statutory borrowing authority.⁴⁴ This was more than just a consolidation when securities were issued under one authorising Act, as the statutory accounts would then not have individual borrowing authorities. The reaction of the Audit Office to Treasury’s proposal to alter the public debt system was that the necessity for amending clauses in Finance bills had been Treasury’s inability to effect its own intentions, not any systemic failure.⁴⁵

3.3 The Constitutional Role and Powers of Treasury Re-defined?

Treasury had obviously been frustrated by the amendments to the 1925 Repayment of Public Debt Act, and decided that it should no longer be restrained by the need to seek validating clauses in annual Finance Acts to modify accounting practices. The Law Draftsman, J. Christie, saw these clauses as merely technical points, and thus not of the ‘slightest importance to anyone’, except the Audit Office.⁴⁶ Christie’s primary example of a technical point involved the Repayment of Public Debt Act, and concerned whether the amount paid on a redeemed debenture was divisible into interest and capital, in terms of the 1925 legislation. In that case, it had been Treasury seeking the Solicitor-General’s opinion on when accrued interest on the security affected its selling price, and how this should be accounted for in a sinking fund. It seemed to Christie, “absurd to suggest that special authority is necessary to enable the Treasury to make such analysis, and to keep the accounts accordingly.”⁴⁷ Christie had taken the liberty of drafting a clause for the next Finance Act, which gave Treasury the authority to have its way in questions relating merely to matters of accounting, and prevented Audit withholding its approval of the

⁴⁴ Secretary to the Treasury/Controller & Auditor-General, 5/5/30, T40/16/1, on A23/49.

⁴⁵ Sunley’s note of 9/5/30, on Treasury memo of 5/5/30, T40/16/1, A23/49.

⁴⁶ J. Christie/Secretary to the Treasury, 22/9/28, on T40/510.

⁴⁷ *Ibid.*, “Under the present system the Statute book may well be mistaken for a textbook on the art of book-keeping.”

accounts just because statutory authority did not exist for an adjustment in any particular account. Thus the clause sought to define the separate functions for Treasury and Audit.

The Auditor-General took immediate exception to Christie's proposed clause, as it appeared to give permission to supplement one account from another without specific authority. This was also expressed in constitutional terms, if seen as undermining the authority of Parliament. Hence, the idea "that the Treasury should have the power to act on its own initiative in the absence of specific legislative enactment to the contrary, undermines one of the main principles of Parliamentary control."⁴⁸ Treasury already had control over the form of the published accounts, while the statutory basis of separate accounts remained. Parliament specified a purpose, or earmarked the use of loan money.

Christie's reaction to the Audit criticism was to reiterate that the clause would not involve payments of money outside the public accounts, but authorised "the methods used by Treasury in recording and disclosing the true financial position."⁴⁹ Treasury explained to the Minister that the clause involved the 'administrative acts' necessary to keep the accounts on a commercial basis. Transactions between accounts for sinking fund payments were only book-keeping matters, these could be authorised by a "general clause in lieu of a never ending stream of detailed authorisations and validations."⁵⁰ But Treasury also responded to the Auditor-General's constitutional point, concerning the impairment of Parliamentary control. Apparently, "far greater powers than are contained in these proposals are conferred upon the British Treasury constitutionally without any express legislative provisions."⁵¹ To prove this, Treasury attached extracts from the texts of British authorities on the system of public finance; Audit would also quote some of the same authorities to buttress their arguments. But one significant point, in the extract from Sir Josiah Stamp's *Problems in Finance and Government*, was that in matters of financial administration a Treasury must have power to take autonomous 'Executive acts'.

⁴⁸ Controller & Auditor-General/Minister of Finance, 27/9/28, on T40/510.

⁴⁹ J. Christie/Secretary to the Treasury, 28/9/28, on T40/510, copy annotated by Sunley on A19/5/1.

⁵⁰ Secretary to the Treasury/Minister of Finance, 28/9/30, T40/510.

By using the concept of an Executive act, Treasury constructed an answer to the constitutional question, rather than rely on arguments concerning administrative efficiency. Treasury did refer to the complexity of commercially-based accounts, and the inability of Parliament to judge the merits of technical clauses validating accounting practices. But the “constitutional position of the Treasury should be sufficient authority for all such administrative or executive acts,” and there had actually been no need for the proposed clause, if only Audit would accept this view.⁵² Audit maintained that legislative clauses were required to control cash transactions in a system of earmarking money raised for particular purposes in separate accounts, which were not constructed on a commercial basis. Without authority for transfers: “it is clear that to pass on to the Executive the power to transfer moneys from one statutory fund to another would virtually have the effect of rendering ineffective all the statutory financial machinery which has been built up to control such transactions.”⁵³ The Auditor-General suggested that the problem was actually in the reliance on permanent statutory appropriations.⁵⁴

Treasury's file on the control of the form of public accounts gives some indication of the type of situation it was actually concerned with. Control over the expenditure of loan moneys was seen to be lacking in the current system, especially in areas of public works. Treasury apportioned available loan money each year for specific purposes, but the actual commitment of funds was spread over several years. Any given project was approved, and a “comparatively small amount placed on the estimates one year to start a large undertaking, usually without any definite consideration as to the effect on the finances in succeeding years when expenditure becomes heavier.”⁵⁵ The annual loan programme was tied to ‘huge commitments’, and proceeded without effective Treasury control.

Treasury was looking to overhaul the loan finance system at this point in early 1929, and the relevant example was the system in New South Wales, rather than being British. In

⁵¹ Ibid. Sunley's note on a copy of the memo provided to Audit, suggests that only 4 or 5 questions of legality arose each year, and Treasury did not distinguish between expenditure votes and loan accounts.

⁵² Secretary to the Treasury/Controller & Auditor-General, 30/10/28, T40/510.

⁵³ R.M. Sunley's memo 2/11/28, commenting on Treasury memo of 30/10/28, on A19/15/1.

⁵⁴ Controller & Auditor-General/Secretary to the Treasury, 10/11/28, A19/15.

⁵⁵ Secretary to the Treasury/Controller & Auditor-General, 10/4/29, T52/35, on T40/510.

the meantime, Christie's clause increasing the power of Treasury, had been drafted as section 14 of the 1929 Finance Act. Christie's explanation referred to the Repayment of Public Debt Act 1925, and the construction placed on previous amendments in the 1927 Finance Act (#2), which had to be re-drafted because of a variation in the language used from the principal Act.⁵⁶ If the function of Treasury was defined as selecting the method of public accounting practice, the technical disputes with Audit wouldn't affect statute law, and Parliamentary control would be retained through the Auditor-General's reports. An amendment to the Public Revenues Act ensured a commercial basis for the accounts.

But the clause extending Treasury power to adjust the accounts resulted in an appearance before the Statutes Revision Committee of the Legislative Council, in November 1929, by the Secretary, A.D. Park, and assistant, B.C. Ashwin. The Treasury submission stated that the necessity for clause 14 emerged from new methods of accounting introduced in 1922, on the recommendation of the National Efficiency Board. Treasury stressed that the pursuit of appropriate accounting practice had been hampered, when technical omissions were pointed out by Audit just because a technique was not specifically prescribed in statute. Treasury was being unnecessarily restricted, if "all its accounting transactions were first to have a basis of specific law before any action could be taken."⁵⁷

The result was that after the intervention by members of the Legislative Council, clause 14 was withdrawn, on the basis that the authority of the Audit Office was reduced and it could not object to the transactions within Treasury accounts. The press report of the situation was based on the views of a "gentleman who takes a close interest in the country's finances."⁵⁸ The 'gentleman' was quoted at length on the role of Audit in representing Parliament, and he emphasized the links to the system in the 'Old Country' for ensuring control of the public accounts. The report quoted the legislative ideal that 'silence was not consent', ie that an action could not be taken even though not expressly forbidden by law. Treasury's perspective seems to have been put across in April the

⁵⁶ J. Christie/Hon. Mr Forbes, 7/11/29, on T40/510.

⁵⁷ 'Precis of Treasury views', submission on section 14, Finance Bill 1929, 8/11/29, T40/510.

⁵⁸ 'Public accounts, principles of control, necessity for audit, dropped clause', *Evening Post*, 11/11/29.

following year, in a statement made by the Prime Minister, Sir Joseph Ward.⁵⁹ This press report's quotes appear to be derived from the Treasury submission to the Legislative Council and other memoranda to the Minister of Finance. But the *Herald* editorial, 'Powers of the Treasury', found it "remarkable that this explanation was not given in Parliament, in either chamber, and still more remarkable that the clause was reserved for inclusion in a bill presented two days before the session closed."⁶⁰

Two aspects of the internal Audit commentary on the Prime Minister's explanation, are significant. Audit had noted that Treasury's emphasis on technical details being involved in accounting practice was disingenuous. When instances of administrative adjustments were identified, as in the writing-off millions of pounds under the Repayment of the Public Debt Act, it was essential to identify transactions in appropriate accounts. If such transactions between statutory accounts were necessary, new legislative enactments would have to be made under the existing system. Sir Francis Bell, a member of the Statutes Revision Committee of the Legislative Council, was credited with criticizing the Treasury view that such enactments were unnecessary.⁶¹ The analysis also focused on the functions of the Controller and Auditor-General being questioned, especially in regard to Parliamentary 'control'. The control function permitted the Audit Office to scrutinize accounting transactions before they were finalised, a practice of 'pre-payment audit' of vouchers before being passed as correct. Under the New Zealand legislation, the Controller and Auditor-General "has therefore the power to *control* the entries made in the public accounts, but under the proposed legislation he would lose this power of control."⁶² Treasury was thus seeking to change the public debt system and Audit's role.

These points suggest the system that had evolved in New Zealand was not derivative of the British system, for all the references to the British texts. Indeed, having had a unique system of public finance, Treasury would then seek advice from British authorities on the proper 'powers of Treasury', and about reforming the public debt system on imperial

⁵⁹ 'Treasury's Powers, Prime Minister's explanation', *New Zealand Herald*, 26/4/30.

⁶⁰ 'Powers of the Treasury', *New Zealand Herald*, 26/4/30, on T40/510.

⁶¹ R.M. Sunley's notes on Prime Minister's explanation (26/4/30), 5/5/30, A19/15/1.

⁶² *Ibid.* This assumed that clause 14 was intended to make Treasury 'sole judge' of accounting practices.

lines. The advice was sought from Sir Otto Niemeyer of the Bank of England, who had embarked for Australia on a mission to resolve their balance of payments crisis. Though his advice on central banking and currency matters is well known, Niemeyer had also been the Controller of Finance in the Imperial Treasury up to 1927. In September 1930, the Prime Minister, George Forbes, had “desired to consult him, as a former Treasury official, concerning administrative powers and relative position of the Audit Office.”⁶³ Niemeyer had already responded in August to a long Treasury paper on New Zealand's banking and currency system, when his opinion was sought on the methods of debt management accounting. The Acting Prime Minister's letter explained the draft clause in the 1929 Finance Act, and how previous legislation was not found anywhere else in the world.⁶⁴ Niemeyer was also sent a paper on simplification of the public debt system.

The Treasury paper on the public debt system contains more information on Treasury's view of the system of separate statutory funds than would otherwise be available. The focus was upon the legislative authority for the borrowing of specific amounts, which then remained available for separate accounts until the sum was exhausted. The borrowing authorities and thus the specific loan purpose could be identified in the system until the debt was redeemed, and this meant retaining separate records for each loan. The stock certificates were issued bearing “the name of the particular authorising Act and as a result the individuality of these securities is preserved in the debt records so long as such securities are outstanding.”⁶⁵ The proposed change would be to identify securities only by the interest rate and maturity, rather than the borrowing authority, as that was all that investors in London were interested in. After the consolidation of the existing legislation, government securities would be issued under a new Loans Act, and the individual borrowing authorities would not appear in a loan prospectus. Treasury seemed to think that the loan money raised could still be applied to separate accounts ‘if need be’, but “the perpetuation of the separate authorities in the debt records [was] unnecessary.”⁶⁶

⁶³ Forbes cable is on T52/645; while the version sent to the High Commissioner, and on to the Bank of England, was finally received by Niemeyer on the 'Cathay' ship on 4/7/30, Bank of England, OV59/15.

⁶⁴ E. A. Ransom/O.E. Niemeyer, 9/9/30, on T40/510.

⁶⁵ Notes on Public Debt System, on T40/510.

Niemeyer's initial response to the public debt precis, was that control of expenditure from loan monies by the Controller and Auditor-General was irrelevant.⁶⁷ He observed that separate loan authorities need involve only the process of the apportionment of funds from the Consolidated Fund, and with the money raised under a general authority, rather than the citing of a specific purpose. Breaking the link between the securities issued and the separate loan accounts appeared to apply to sinking fund payments, depending on the loan prospectus. On the subject of Parliamentary control, Niemeyer had met with the Controller and Auditor-General, G.F.C. Campbell, and received a long memorandum.⁶⁸ Colonel Campbell tried to explain how the method of control differed from that in England, due to a complicated system of statutory accounts, when the British had a statutory consolidated fund and spending votes. The focus on the withdrawn clause from the 1929 Finance Act, allowed for an explanation of the 'pre-audit' nature of control. The large number (at least 40) of separate statutory accounts, and the need to ensure permanent appropriations were only applied to a specific purpose, meant that the Audit Office had inspected vouchers for certain transactions. As the borrowing authorities specified the purpose of loan, the statutory accounts required the strict form of control.

Sir Otto may have been rather bemused by his encounter with Campbell, the latter a former Secretary to the Treasury, but one result was more analysis of Treasury's role in the public debt system. In the follow-up, Treasury described being 'short-circuited' in its ability to control loan expenditure.⁶⁹ A system with so many separate accounts funded by loan money allowed departments to incur heavy expenditure on capital projects with Cabinet approval, but without Treasury control. Treasury wanted to reduce the 40 separate loan accounts to prevent further legislative enactments, and to prepare the accounts and departmental balance sheets on an entirely commercial basis. Treasury also wanted the changes to lead to a better use of cash balances, and all in one bank account.

⁶⁶ *Ibid.*, ie when loan money was spent it didn't matter for what purpose any particular stock was issued.

⁶⁷ O.E. Niemeyer/A.D. Park, 18/9/30, T52/645.

⁶⁸ G.F.C Campbell/O.E. Niemeyer, 19/9/30, on A19/15/1.

⁶⁹ Undated notes, September 1930, on T52/645.

Niemeyer's report on the public debt system was read in Parliament in October, and parts were reported in the press.⁷⁰ Not surprisingly it supported the Treasury view, and the context for the Parliamentary debate was whether the withdrawn clause from the previous year's Finance Act would be restored. Niemeyer claimed that he had the Auditor-General's agreement that the clause had not been a threat to Audit's role, and also that unnecessary attention was paid to the detail of public finance. In fact, the pre-payment checking of vouchers and the existing system was being rejected. This would reflect the British practice, which did not have detailed legislation in financial administration. The question of whether a pre-audit system was necessary for the 'control function' of Audit seems to have been obfuscated by comparisons with the British system. There were other aspects of Niemeyer's report that were not publicly reported upon, but were seen by the Audit Office. Once again, Niemeyer endorsed the Treasury proposals for the public debt system, and for removing the references to an authorizing Act on debt securities issued.

It seems that the Audit Office was not consulted about the changes to the public debt system.⁷¹ Niemeyer had proposed a 'central fund' to pool all government borrowing into one account, this being the complete opposite of the New Zealand system of separate statutory accounts. This advice was based on the British local loans account, used to fund capital works for local bodies too small to have the ability to borrow individually. A Public Works Loans Commission was established to allocate the money from Local Loans Stock issues, and the legislation limited the amount re-lent to local authorities, but with a central government guarantee for the interest payments to investors.⁷²

The Audit Office appear to have recognised the implications of a 'central fund', in that loans would no longer be raised for specific purposes. Indeed, "as the loans are 'pooled' it is impossible to allocate interest on particular loans to particular accounts, and some more or less arbitrary system of allocating the interest charge must be adopted."⁷³ As the expenses on the raising of loans were also affected by the removal of specific borrowing

⁷⁰ 'Public Accounts, Part of Niemeyer Report, Authority of Parliament', *Dominion*, 21/10/30, with Sunley's annotations on A19/15/1.

⁷¹ Controller & Auditor-General/Acting Prime Minister, 17/10/30, A19/15/1.

⁷² Hilton Young, p.189. The central government was therefore not prepared to guarantee the capital.

authorities, it was not just the present loans legislation that would be comprehensively changed, but the entire system of borrowing authorities for the separate statutory funds.⁷⁴ The changes to be made to the public debt system were finalised in the 1932 Loans Act.

There was a notable post-script to Niemeyer's visit, and a change in the pattern of the battle between Treasury and Audit. The Secretary to the Treasury, A.D. Park, had written to Niemeyer in Sydney in early October, and indicated that he hoped as a result of his public platform, "to obtain a further move forward insofar as Treasury control is concerned."⁷⁵ Meanwhile, the Controller and Auditor-General had decided to consult with his British equivalent, Sir Malcolm Ramsey, via the Audit officer in London. Sir Malcolm had then informed Niemeyer, in January 1931, that he was being drawn into a conflict between the New Zealand Treasury and Audit Office. Niemeyer replied that he would have a word with Ramsey about the situation, and especially the personality of Colonel Campbell.⁷⁶ He would also inform Park of the Auditor-General's latest move:

"For your very confidential ear, I hear friend Campbell has been trying to draw our C. & A.G. here through one Hore, I suppose for ammunition against you. Our C. & A.G. will politely indicate that he can only express opinions if asked by the New Zealand government (and in fact would, I have reason to know; take much the view I do)."⁷⁷

Following the intervention of Niemeyer, what had seemed to be an endless dispute over technicalities and legislative clauses, became a question of interpreting the British system of public finance for constitutional precedents. Even minor disputes between Treasury and Audit could re-emerge, after October 1930, in the apparent imperial context.

3.4 Emulating the System of National Finance at 'Home'

Late in the 1930 Parliamentary session, Treasury sought to introduce a clause in the Finance Act to validate the practice of issuing 'sight drafts'. A system of sight drafts had

⁷³ R.M Sunley, 'Notes on report of Sir Otto Niemeyer', p.5, 17/10/30, A19/15/1.

⁷⁴ *Ibid.*, p.6. Here Sunley misread the version of the British system in his standard source, A.J.V. Durell's 'Parliamentary Grants', p.459. Durell had referred to the use of separate loan accounts ending in 1905.

⁷⁵ Park/Niemeyer, 6/10/30, on Bank of England, OV9/24.

⁷⁶ Niemeyer/Ramsey, 22/1/31. B.of E., OV9/24. Niemeyer added, "I'm very pressed at the moment, with one leg in Brazil and the other cut off in Australia."

⁷⁷ Niemeyer/Park, 23/1/31, T52/645.

been introduced in 1929, and appears to have entailed district Treasury officers effectively using an overdraft with the Bank of New Zealand to make payments. The draft limit for each office had been increased in early 1930, when Treasury found that the Bank of New Zealand would guarantee only £1.5 million in exchange remittances to London for redeeming the Treasury bills that were maturing there every three months.⁷⁸ This meant that district offices would be negotiating with the private firms in London that wanted to remit money to New Zealand; while, being exchange transactions, there would still be some scrutiny from the Audit Office in Wellington.

Under Treasury's proposed clause, it appeared to Audit that "payments on Government Account could be made without reference to the Controller and Auditor-General, who could not therefore exercise any control."⁷⁹ Again, the emphasis was on the potential use of the clause, in permitting Treasury officers to make payments prior to the issue of funds allocated from the public account. This was a perceived threat to Audit's control function: "[enabling] Government to effect payment without first drawing on the Exchequer, is opposed to the constitutional principles on which the system of National finance is based, for in effect it avoids the Control of Issues."⁸⁰ The phrase, 'control of issues', was one that had been used by Niemeyer. The Audit Office's reference to this particular terminology used in the British context, could be counterproductive. The Auditor-General suggested to the Minister of Finance that, as with previous clauses affecting the 'control function', the current draft clause should also be dropped.⁸¹ From the Minister's reaction, the practice of Audit passing vouchers prior to payment, the pre-audit or control function, now appeared to be in jeopardy. The Acting Minister had simply repeated Niemeyer's view: "Audit is essentially a post-mortem on the acts of executive authority," and the Auditor-General should have the fullest powers of independent examination and criticism; but "obviously his powers of criticism are impaired in respect of any transaction to which he has been a party before expenditure is

⁷⁸ R.M. Sunley/Controller & Auditor-General, 27/1/30, A29/47.

⁷⁹ R.M. Sunley/Controller & Auditor-General, 9/10/30, A19/15/2.

⁸⁰ Ibid. "The Public Revenues Act precludes the Government from making any payments save from money issued from the Public Account, such issues can be made only under the countersignature of the Controller and Auditor-General, who controls on behalf of Parliament."

⁸¹ Controller & Auditor-General/Acting Minister of Finance, 11/10/30, A19/15/2.

incurred.”⁸² Niemeyer therefore suggested that the role of audit as a post-mortem was potentially impaired by the pre-audit, control function; an argument that had been intended to undermine the Audit idea of accountability for the ‘control of issues’.

But based on constitutional grounds, the Minister had a more straightforward case for dismissing Audit Office objections. Treasury had simply followed the example of the imperial authorities, upon which the New Zealand system of control was apparently based. The “New Zealand Treasury is now applying for similar powers that have existed at Home for a very long period and any charge that such a proposal is contrary to constitutional principles cannot be sustained.”⁸³ It was time to follow the British Treasury manual. The Auditor-General replied that the substance of Niemeyer's arguments confused the control of issues, which would only refer to final figures, with the detailed pre-audit of individual transactions in statutory accounts. Campbell also pointed out that it was he, when in ‘control of Treasury’, who had negotiated the 1914 Banking Agreement that allowed for sight drafts for exchange transactions.⁸⁴ But instead of emphasizing the point that the New Zealand system was fundamentally different from the British, the issue was again confused by references to the British ‘standard texts’.

Treasury was able to pass the validating clause into legislation (section 12 of the Finance Act, 1930 {#2}), and sent extracts of the British Treasury ‘Note-book’ to the Audit Office.⁸⁵ The Minister of Finance thought it necessary to get an expression of opinion from the Imperial Treasury in regard to Audit's control function. This rather narrow legislative issue was actually obscuring the point, that this question involved the relationship between the public accounts and the banking system. The comparative question was concerned with ‘economising cash balances’ held for the government, but in a number of different bank accounts in New Zealand, where the British system had only one Exchequer account.⁸⁶ An obvious difference with the imperial authorities was

⁸² E.A. Ransom/Controller & Auditor-General, 16/10/30, A19/15/2.

⁸³ Ibid. “Your statement that the proposed legislation ignores the English Exchequer and Audit Act is apparently under a misapprehension, as section 10 of that Act expressly covers payments by orders.”

⁸⁴ G.F.C. Campbell/E.A. Ransom, 20/10/30, A19/15/2.

⁸⁵ Secretary to the Treasury/Controller & Auditor-General, 25/11/30, T40/15.

⁸⁶ Sunley's notes on extracts submitted by Treasury, 9/12/30, on A19/15/2.

the short term borrowing possible in the London money market, when necessary. By contrast, "Treasury habitually borrows millions long before the money is required."⁸⁷ The issue can be identified as debt management, not the ability to fund short-term debt.

The views of the Imperial Treasury had been sought to support Niemeyer's contribution, so the Audit Office thought for some balance they might include the view of the imperial Auditor-General. In a letter to Audit's London officer, the Auditor-General's explanation of events focused on the clauses in Finance Acts and their effect on the 'control function'. The Auditor-General told of how he had lobbied politicians to get the offending clauses withdrawn.⁸⁸ There was only brief mention of the public account investments and the intention of achieving 'economy' in the use of cash balances. The London Audit Officer relayed the imperial Auditor-General's opinion in May 1931, but the report is not included on the Audit file with the covering letter. The covering letter does give some indication that the report was based on standard texts, emphasized co-operation with the Imperial Treasury, and also endorsed New Zealand's Treasury having greater power in controlling the programmes of the 'spending departments'. Thus, "instead of making your Treasury a mere instrument of finding money, it should be in a position to turn down proposals, the execution of which might place an undue strain on the National Exchequer."⁸⁹ The clear difference in the system of public finance was actually in debt management, not the terminology used to describe what were thought to be similarities.⁹⁰

Treasury received the report from the British Treasury, confirming the practice of payment by sight drafts. In the context of making more economical use of public money, Treasury promised to inform Audit of any further changes to the Public Revenues Act.⁹¹

⁸⁷ Ibid. Sunley suggested temporary borrowing which is then to be incorporated in a long term loan.

⁸⁸ Controller & Auditor-General/A. Hore, 16/12/30, A19/15/2.

⁸⁹ Hore/Controller & Auditor-General, 13/5/31, A19/15/2.

⁹⁰ Hore refers to the 'appropriations-in-aid', used by the spending departments in "relief of issues out of the Exchequer." This would be the equivalent to the 'control of issues', that the Audit Office were concerned with in terms of Treasury's allocation of loan money. Hore included a report from Sir Malcolm Ramsey on 'appropriations-in-aid', for the British Public Accounts Committee, in April 1930. It includes a reference to criticism of the practice, in the second edition of Hilton Young's text. The third edition of *The System of National Finance*, refers to the report, and how the effect is to "remove the gross sum estimated for a Vote from the control of Parliament [p.50]" Only net expenditure was formally controlled.

⁹¹ Secretary to the Treasury/Controller & Auditor-General, 15/8/31, T40/15.

The Imperial Treasury noted that finance acts had never been used to amend the principal Act in the United Kingdom, and their Comptroller and Auditor-General had never had the role assigned to him as in the Dominion. Indeed: "My Lords are satisfied that it would be impossible to maintain in the United Kingdom a pre-payment audit check on State transactions comparable in its completeness of detail to that under the [NZ] Public Revenues Act."⁹² The Imperial Treasury report includes an appendix, with a clause-by-clause comparison of the Public Revenues Act with the 'Imperial procedure'; but the Audit Office concentrated on the points of difference, especially the apparent pre-audit function, as well as trying to find some support for its view in the imperial report.⁹³

The Minister of Finance declared that the imperial authorities, "are of the opinion that the procedure might have been regarded as within the authority of the Public Revenues Act."⁹⁴ In any case, a system of sight drafts had been evident for many years at 'Home'. The Minister's memorandum went to the Solicitor-General, and it became clear that Treasury's victory was a hollow one. The Solicitor-General pointed out that the imperial authorities had not been informed of section 44 of the Public Revenues Act, for it had been this that Audit had objected to.⁹⁵ The Auditor-General's view had been deemed correct, but the amending legislation had already been passed. The Audit Office sought another legal opinion about the new clause on sight drafts, and confirmed that section 44 of the Public Revenues Act could be held to prohibit overdrafts from a private bank.⁹⁶

The Auditor-General's objection to the clause in the 1930 Finance Act, concerning sight drafts, was put to a new Minister of Finance, in April 1932. The ability to maintain control was still under threat, when made "effective only after the claims are paid by Government, and therefore inherently weaker than the system set out in the Public Revenues Act, under which control is effected before the claims are paid."⁹⁷ Though the scope of the drafts was still in question, the argument concerning the role of repayments

⁹² R. V. Nind Hopkins, F.12359, 7/5/31, on T40/15.

⁹³ R.M. Sunley, notes on Treasury memo (15/8/31) and enclosed reports, A19/15/2.

⁹⁴ Forbes/Attorney-General, 19/8/31.

⁹⁵ Solicitor-General/Attorney-General, 26/8/31, on T40/15.

⁹⁶ Solicitor-General/Deputy Auditor-General, 11/12/31; and Sunley's notes, 5/4/32, on A19/15/2.

⁹⁷ Controller & Auditor-General/Minister of Finance, 21/4/32, A19/15/2.

to a bank without the appropriate checks had now received the Solicitor-General's support. The immediate result, in recognition that the form of the sight drafts was not prescribed, was an Order-in-Council being prepared for the Prime Minister's approval. Treasury had wanted to make this provision retrospective, to come into force from October 1930, but the Crown Law Office considered that this could be challenged as invalid.⁹⁸ Treasury, in place of the Minister, assured the Audit Office of its responsibility for arrangements with the trading banks, and the measures that would be taken in the context of an appropriation that had been exceeded at a bank's own expense.⁹⁹

By 1932, Treasury was certainly dealing with all the banks, due to the crisis in public finance. In fact, the Secretary to the Treasury was already in negotiations with certain imperial authorities, especially the Bank of England, over questions of trade and public finance. The focus of historians has been on the form of imperial guidance that led to the creation of the Reserve Bank. But Niemeyer's advice, to endorse the overhaul of the public debt system, was central to legislative change earlier than in the Reserve Bank Act. A new Loans Act was passed in late 1932, and created another round of technical disputes between Treasury and the Audit Office. Treasury was well prepared, having traced the pre-audit payment system back to 1844.¹⁰⁰ The imperial view had been opposed to pre-audit, was then linked to the constitutional 'powers of Treasury', and Treasury being enabled to take responsibility for 'acts of executive authority'. The immediate impact of this was in the borrowing in London to fund statutory accounts, but fundamental changes would be apparent in the public debt system itself and in the relative constitutional roles of Treasury and Audit. But ensuring that there were the proper British practices in debt management was less important than the substantive imperial links in financial and constitutional terms. This is clear in the analysis of the annual issues of government stock in London under conditions of the Colonial Stock Act.

⁹⁸ Assistant Crown Solicitor/Secretary to the Treasury, 21/6/32, on T40/15.

⁹⁹ Acting Secretary to the Treasury/Controller & Auditor-General, 23/8/32, T40/15.

¹⁰⁰ 'Report and Notes on Development of Pre-Audit System in New Zealand', Treasury 28/6/32, T40/15.

4 LOOKING TO LONDON FOR LOAN RELIEF, 1925-31

"As regards Governmental finance, apparently the Treasury was hard pressed for money. The cream had been skimmed off the local market by domestic issues, and recourse was had to Overseas lenders. I think that in an emergency, or whenever markets are unfavourable, it is always preferable to sell Treasury Bills rather than issue long dated securities at prices which might not be consistent with New Zealand's credit. The necessity for disposing of Stock other than through the normal channels will not arise again. This, however, does not mean that the Government has no further use for temporary expedients, and the Treasury Bill is the instrument par excellence for meeting awkward exigencies, as it...can be renewed again and again, until markets are suitable for the issue of more permanent securities."¹

The London-based Audit officer, Arnold Hore, was in early 1928 reporting a favourable trade balance. It seemed an opportune moment to borrow in London without using the official channels, under the usual conditions. This would be an unusual move: selling government stock inscribed in Wellington, and privately placed by Australian brokers (Norris Oakley). Hore had suggested that the usual brokers, Scrimgeours, had thought that such private sales would lead to subscriptions for the public issues being adversely affected.² Though these comments were from a routine financial commentary on the London market, they also observe a turning point. Treasury would circumvent the official channels again soon after this, setting a precedent for the future use of emergency short-term borrowing in London. But in the normal course of events, New Zealand's annual appeal to the British bondholders was necessary to the extent of the shortfall in the domestic sources of finance, from the Public Trust Office and the Post Office Savings Bank's excess deposits available for investment. Treasury were engaged in a complex process of manipulating cash balances in New Zealand and borrowing fresh money in London, to maintain public works spending programmes and make debt repayments.

High Commission officials and Treasury were aware of the need to maintain New Zealand's credit in London. The main concern was with £29 million in loans maturing in 1929, and the expected conversion stock issue. The Audit officer in London ensured that the Audit Office was informed of the fortunes of the government's stocks in the City.

¹ Arnold Hore (Audit's London officer)/Controller-Auditor-General, 20/2/28, on A29/4.

² Ibid. "I suggest that advantage should be taken of the privilege very sparingly, as many of the large Investors place limits on the amount they are prepared to sink in any one Government's securities [p.6]."

This commentary tended to be perhaps too up-beat, for instance stating that New Zealand held the premier position amongst the Dominions' credit ratings. Its good reputation had been "acquired through a long succession of surpluses, steady debt redemption, and a frank and voluntary exposition of its trade figures."³ The steady debt redemption was interpreted as maintaining the government stocks' market price and availability, in relation to other securities with Trustee rank, colonial and British local body stocks. Ensuring an active market in trustee securities was preferable to just reducing debt:

"The New Zealand Government has already discovered that when a borrower uses sinking funds for the cancellation of securities, the market price advances, each subsequent operation becoming less profitable, and that is the main reason why lenders prefer Issues, the sinking funds of which are consistently used for redemption purposes, as the prices of the stocks are always maintained at high levels through the borrower's support of the market."⁴

The point seems to be that redemption rather than the cancellation of stock, was a process of supporting the overall prices of government stocks. It seemed that the trustee securities offered by large British municipal corporations were more attractive, if new issues.⁵

But things were not all they might have been in New Zealand's relations with the London Loan Agents. Certainly from the Audit Officer's point of view, the institutions involved were a source of irritation. There had been a long-standing question over the level of management charges on New Zealand government stocks domiciled at the Bank of England. The Bank managed one other government, the State of Queensland, which had less loan expenses on a lower level of inscriptions than from New Zealand's business.⁶ Hore complained of similar difficulties in dealing with the London Discount Houses and the Bank of New Zealand, over obtaining acceptable fees for the deposit of London cash balances for short terms. Indeed: "much of London's financial business is transacted with a casualness which would horrify most people dealing with Trust funds."⁷ The New Zealand government's brokers, Scrimgeours, were not seen as always useful in their advice to the High Commission; they invariably erred on the conservative side, offering

³ A. Hore/Controller & Auditor-General, 18/5/27, on A29/43.

⁴ Ibid. "Comparing this Issue with contemporary Australian flotations, eg New South Wales 5.25% at 99, I repeat that the Government has every reason to be proud of its high standing in the City."

⁵ Hore/Controller & Auditor-General, 20/5/25, on A29/19.

⁶ Hore/Controller & Auditor-General, 21/11/27, on A29/5/1.

⁷ Hore/Controller & Auditor-General, 26/8/27, on A29/49.

platitudes about how the continual borrowing undermined New Zealand's credit rating. Hore felt that the exigencies of government were ignored: "if the Treasury must come to London, they do not want a financial sermon on the dangers of overborrowing, but the best advice as to how to get the money."⁸ Even the underwriters weren't blameless: in examples such as the May 1925 loan failure, when 85% of the stock issue was left unsubscribed. The "underwriters only offer such terms as will ensure to them a reasonable percentage of profit, and they cannot afford to have large lines of Government stocks on their hands for indefinite periods."⁹ The under-subscription of the 1925 loan was due to the underwriters having made the stock too dear. They had "apparently under-estimated the results that would flow from such an important announcement as the resumption of the gold standard."¹⁰ It was clear that London's lending capacity was going to diminish.

4.1 Finding the 'Ways and Means' for the Loan Programme in New Zealand

In 1925 Treasury informed their Minister that, given the outlook for future London loans, the funding of accounts that had relied on loan money could not be maintained. The sources of loan finance or 'ways and means', were no longer available; and the projected £6 million London loan was above what had hitherto been regarded as the standard borrowing amount.¹¹ To compensate for the lack of loan money available, the tax revenue surplus had been transferred to public works expenditure in recent years. But the ways and means accounting system emphasized the lack of Treasury control over loan moneys. Treasury was not informed of projects before Cabinet approved them. In fact: "as things are at present large commitments appear to be entered into and the first that Treasury hears about it is when they are suddenly asked to provide the money."¹² The rate of expenditure appeared to have gotten ahead of the ability to absorb it profitably.¹³

⁸ Hore/Campbell, 24/1/28, A29/4a, "an extra half million or so in this market makes little difference."

⁹ Hore/Controller & Auditor-General, 20/5/25, on A29/19.

¹⁰ Ibid. Hore wrote "New Zealand was fortunate in being the first Overseas Government to appeal to the market before the gold standard became fully effective." Later foreign borrowers fared even worse.

¹¹ Secretary to the Treasury/Minister of Finance, 29/7/25, T40/6, on T52/77.

¹² Ibid. Departments were unable to comply with reductions due to actual expenditure already incurred.

¹³ Secretary to the Treasury/Minister of Finance, 18/8/25, T52/77, only some projects created revenue.

The Government had insisted on a £7 million loan in 1925, even though Scrimgeours had recommended a £5 million issue; but it had accepted the reduction in the issue price, from 95 to 94.5, for underwriting purposes. The prospectus was issued, the declaration under the Colonial Stock Act, 1877, was made: but only 1996 applications were placed, for £1.05 million, and so £5.95 million had to be allocated to the 415 applications by the underwriters.¹⁴ The London press had not reacted favourably to the loan amount; but it had only been possible to issue stock because foreign loans were embargoed. Hore also advised that trustees preferred to avoid the broken six-month interest payment on stock.¹⁵

By July 1925, the Bank of England had received £4.3 million to credit to New Zealand's public account. Although the stock was still at a discount, maturing Australian stock had faced a higher discount on a large conversion.¹⁶ But the broking expenses of the 1925 issue had meant significant costs, and the loss in loan proceeds had to be recouped from a private sale of stock for £600 000, inscribed at the Bank of England to an insurance company. It seemed that Scrimgeours had managed to overcome objections to such sales in the gilt-edged market, as the loan was not offered on a prospectus under the Colonial Stock Act.¹⁷ Despite 1925's loan failure, Treasury still proposed a London loan of £6 million in 1926, and assumed expenses of £200 000. Treasury were aware that this figure could impair the country's credit, and also estimated that only 60% of capital invested could be assumed to pay interest on the capital cost. Moreover: "unless a halt is called we will draw on us the reflections now made in London on overborrowing by Australia, which we have been at pains to avoid."¹⁸ Australia had obtained only £5 million in London the previous year, and had then sought £15 million in New York. At the same time the New Zealand Treasury was also borrowing in Australia at a higher rate, 5.5%.

¹⁴ Hore/Controller & Auditor-General, 20/5/25, A29/19, ie underwriters were left with 85% of the loan.

¹⁵ Hore/Controller & Auditor-General, 5/6/25, A29/19. On 30/7/25, Hore wrote, "the reason Trustees dislike securities whose first interest payment covers a broken period is to be found in the opposition of beneficiaries with a life interest in estates. They are not so much concerned in the actual investment as with the return derived from it, and they favour stocks with a full dividend", on A29/19.

¹⁶ Hore/Controller & Auditor-General, 16/7/25, A29/19.

¹⁷ Hore/Controller & Auditor-General, 23/2/26, A29/19. Hore suggests that a private sale in the future could bypass Scrimgeours, and the need to pay brokerage, though the stock would lack a quotation.

¹⁸ Secretary to the Treasury/Minister of Finance, 2/8/26, T52/77.

New Zealand's 1926 loan was for £6 million of 5% inscribed stock, issued at the discount price of 98 to ensure success, or a substantial amount not being left with the underwriters. Hore initially reported an unqualified success, the issue being regarded as "particularly welcome at the present time because there is a scarcity of Colonial trustee securities yielding over 5%."¹⁹ But despite a 'critical tendency' evident among London investors towards colonial borrowing, it was then felt that the price was too low, as the loss of a whole percentage point on the issue price was significant. Scrimgeours had insisted on a low price to obtain underwriters (including the Bank of New Zealand for £250 000), and the Bank of England had endorsed the price due to the desirability of success.²⁰ The issue price caused extensive 'staggering' operations, due to speculators assuming the price would rise once traded; and with the price rising 1.5%, the final quotation was exactly at par, 5%. It seems that the Bank of England had lent £600 000 in advance, if it did fail.²¹

Loan requirements for 1927 totalled £7.7 million, but it was assumed that the local stock issue and the Post Office Savings Bank would contribute £1 million to the 'ways and means', leaving the London loan at £6 million again. Treasury were now confident of arranging for the underwriting in London, but were concerned at the terms, given the failure of a London County Council issue of 4.5%, at 93.5.²² On this occasion it seems New Zealand's timing on the London market was fortunate as, despite competition from other trustee securities, the 5% inscribed stock issue was oversubscribed, at 99.5. Stock prices were still at a premium, but the small discount in offer price appealed to traders, given the number of applications.²³ The strong demand for long-dated stocks had been due to a gilt-edged market recovery, after the Bank of England eased the 'Bank' rate.

Despite the apparent success in London that year, Treasury ruled out further borrowing there, as 'ways and means' problems emerged later in 1927. Instead of having surplus deposits from the Post Office Savings Bank, there had been a net withdrawal since May. This reduced ways and means funding by £1 million, and with no increase possible in the

¹⁹ Hore/Controller & Auditor-General, 31/5/26, on A29/38.

²⁰ Hore/Controller & Auditor-General (#52), 4/6/26, on A29/38.

²¹ Hore/Controller & Auditor-General (#51), 4/6/26, on A29/38.

²² Acting Secretary to the Treasury/Minister of Finance, 31/3/27, T52/77.

local loan stock issue beyond £700 000, the only other borrowing option was at 5.5% in Australia.²⁴ By November, over £1 million in cash had been used to meet the withdrawal of savings, with Treasury forced to liquidate the Post Office Savings Bank investments in government stock. This situation meant that the entire Public Account was down by £2 million compared with the average year, a position sustained only by an unusual revenue surplus of £3.5 million.²⁵ Besides the curtailment of public works, the initial move was to ensure that the financial departments of government, and the Public Trust Office, ceased any lending and instead purchased Treasury bills.²⁶ A higher interest rate was offered on local inscribed stock, and a separate issue of rural advances bonds to fund State Advances could also be issued overseas. Overall, £3.5 million cash had to be found: £2 million for the Post Office, and £1.5 million for maturing war bonds. It was not desirable to increase the deposit rate for the savings bank, because Treasury saw traders rather than ordinary savers as causing the drain, and interest costs would still increase.²⁷

Treasury's temporary expedient was to transfer London loan proceeds to New Zealand, to be replaced by the end of the financial year to make interest payments, and with local securities being converted into 'redemption' Treasury bills for sale in London.²⁸ This quick-fix could only last to December, when the Post Office Reserve funds would have to be sold. Moreover, land tax usually obtained through the Post Office would not be available to relieve the Ordinary Revenue Account, which meant selling more 'revenue' Treasury bills.²⁹ The situation also caused Treasury to question the need to maintain the sinking fund agreement with the Public Trust Office, under the 1925 Repayment of Public Debt Act. Of the Public Trust's £20 million of investments in 1927, only 6% was held in government stock. Treasury viewed this as a failure to recognise obligations, or the sense of responsibility that came with administering a State-guaranteed account.³⁰

²³ Hore/Controller & Auditor-General, 18/5/27, on A29/43.

²⁴ Secretary to the Treasury/Minister of Finance, 30/6/27, T40/135, on T52/77.

²⁵ Secretary to the Treasury/Minister of Finance, 7/11/27, T52/77.

²⁶ Secretary to the Treasury/Minister of Finance, 22/11/27, T52/77.

²⁷ *Ibid.* Notes attached preceding memo on file T52/77, point #2.

²⁸ *Ibid.* Points #7 and 8.

²⁹ *Ibid.* Points #3 and 9.

³⁰ *Ibid.* Point #13.

The Public Trust Office observed that it was obliged, in the interest of the estates being managed, to pursue investments earning more than the inscribed stock rate (5.25%).³¹

In the late 1920s, debt management became complicated by a manipulation of cash balances, which required numerous transfers between different accounts. The Audit Office had referred to the appearance of a 'system of overdrafts' within the public accounts; and Treasury were also defending London borrowing, which seemed to be required for immediate cash demands rather than for the purpose of the loan authorities.³² By the end of the financial year, Treasury could point to increased funds from the 5.25% local stock issue, and from 'special inducements' for the public to invest in Post Office Investment Certificates, as well as the government departments' contributions mitigating internal transfers. With pressure on cash balances, due to a war loan redemption, Treasury had accepted the offer from the Australian broking firm to sell 5.25% securities in London, adding £500 000 to the loan programme in December 1927.³³ Now that private sales had been accepted, the official brokers could make similar arrangements, to sell stock as the money was needed. Treasury felt that it could not take the risk of not accepting the money when offered, rather than wait for better borrowing conditions. The Audit Office analysis suggested that Treasury were struggling for cash to meet the redemption; and when loans had been used for 'immediate current needs', it was unclear why they were not raised directly for the purpose for which they were required.³⁴ Audit's query was part of a debate over the interest rate used on the transfers between accounts.

In December 1927, Cabinet decided to form a committee to make recommendations on reducing public works spending, including the unemployment relief programmes. The spending estimates had come in at £7 million, well over the previous London loan figure. With local loan stock funding the State Advances Department, the only alternative for the public works programme was to use tax revenue. If it "were known in London that loan money is used to provide work for unemployed, there would be criticism adverse to our

³¹ Prime Minister (Coates)/Minister of Finance, 21/12/27, on T52/77.

³² Assistant Secretary to the Treasury/Controller & Auditor-General, 11/4/28, T40/240/25/4, on A29/12.

³³ *Ibid.*, "at this time it was not known that the Stock Exchange would allow the sale of private issues of Consolidated Stock on the same terms as the prospectus for the £6 million loan of May, 1927."

credit.”³⁵ It was proposed to reduce the London loan to £5 million, because of the £29 million of stock maturing in 1929. This 4% stock required such a large conversion issue, that obtaining favourable terms seemed unlikely.³⁶ In February 1928, Treasury decided that the subsidies from the Consolidated Fund, which had been transferred in cash to different superannuation schemes by the Public Trust Office, would instead be invested in government inscribed stock. The desired reduction in the London loan to £5 million could be achieved only “by our taking some risk in connection with the money that will have to be raised locally, the principal source of which is the Post Office excess of deposits, and sales of our 5.25% inscribed stock.”³⁷

In April 1928, it became necessary to decide the amount to be borrowed in the annual London loan, to keep close to the £5 million figure. There was a determination to reduce the railway construction costs for the year, although the Rotorua to Taupo line did commence, at a cost of £2 million. This meant that public works would rely on the local loan funding, unless recourse was again had to London later in the year.³⁸ But another appeal to London was ruled out because of the likely effect on the huge conversion loan coming up in 1929. Treasury were satisfied that a “good atmosphere in high credit” was established in London, but also had to realise that the High Commissioner negotiated with the brokers to take ‘our turn’ on the market.³⁹ The brokers had determined that in conjunction with the annual loan, an early conversion loan for the 1929 maturity should be offered, provided the market was favourable.⁴⁰ Apparently this would help with the remaining £22 million actually maturing in 1929, or at least give an indication of the best terms to offer for the conversion, on the assumption that the interest rate must increase. The concern with the interest rate was shared by the Arnold Hore in London, who observed that the brokers tended to underestimate market sentiment, or were able to convince the High Commissioner to accept a price on the low side.⁴¹

³⁴ R.M. Sunley/Controller & Auditor-General, 26/4/28, A29/12.

³⁵ Secretary to the Treasury/Minister of Finance, 9/12/27, T52/77.

³⁶ *Ibid.*, “an increase in interest is inevitable, but to save even a quarter % means £75 000 per annum.”

³⁷ Secretary to the Treasury/Minister of Finance, 16/2/28, T52/77.

³⁸ Secretary to the Treasury/Minister of Finance, 18/5/28, on T52/77.

³⁹ *Ibid.*, and Secretary to the Treasury/Minister of Finance, 19/4/28, on T52/77.

⁴⁰ *Ibid.*, 19/4/28.

⁴¹ Hore/Controller & Auditor-General, 6/2/28, on A29/5/1.

Hore had made a comparison of the terms offered to British municipal corporations, which had trustee status, but also had the issuing houses competing for their business. The High Commissioner indicated that the brokers had decided to offer a conversion loan at a higher rate, 4.5%, and at a discount price. If this discounted offer was effective, it would be a substantial step towards lowering the current interest rate, “and constitute a break in the 5% rate which has so long prevailed on the London market.”⁴² The first question about the loan issue’s terms concerned underwriting: given the fact that interest rates were being lowered, making 5% stocks less common, there was an ability to offer a higher rate on the conversion offer, without a discount. Otherwise the stock issue opened at a discount, and the price rose when trade began, depending on the preferences of the underwriters. Even if the price fell, the underwriters earned a fixed rate of 1% in any case, and this seemed to be a very substantial buffer. Given market competition:

“Issuing Houses pride themselves on the skill with which the securities have been marketed, but the truth is that there has always been a continuous and ever increasing demand for Trustee Stocks, and that unless the market is glutted beyond its powers of absorption, an unusual happening in normal circumstances, Underwriters run very little risk of losing money.”⁴³

The key point was that the trustee stocks were able to be ‘unloaded’ on a gradual basis, ensuring profitability. The big ‘City’ firms with large resources, when lumbered with stocks at a heavy discount, could ‘nurse’ the stock pending the return of better times.⁴⁴

After the terms of the £7 million loan conversion offer became known to the Audit Office a legal question cast doubt over the prospectus. It seemed that the NZ Loans Act gave discretion to the Loan Agents (ie the brokers) in regard to the terms of a conversion, but it had not envisaged an alteration in the capital value because of the offer price. The legal question was whether a borrowing authority could be extended in a ‘renewed’ stock, as opposed to a redeemed security, and whether a new security was being issued in either case.⁴⁵ Treasury maintained that a stock renewed with the same investor, irrespective of the terms on the security being offered, was a renewal, because it did not require

⁴² Secretary/Minister, 19/4/28, this combined loan figure was approved in Cabinet on 20 April, 1928.

⁴³ Hore, 6/2/28. Hore enclosed an Australian loan prospectus, 47% of which was left with underwriters.

⁴⁴ Ibid. Hore made comparisons to Stoke-on-Trent’s issue that wasn’t discounted, and had lower expenses.

⁴⁵ Controller & Auditor-General/Secretary to the Treasury, 26/3/28, A29/41.

repayment at maturity.⁴⁶ However, if the terms of the conversion offer were different, it could be seen as a new loan, so as to effect redemption (rather than a renewal). This point emerged at the culmination of another debate between Treasury and Audit over the use of loan money approved for particular purposes in separate accounts. A clear example was seen in the use of the receipts from the 1928 London loan. Rather than being put on deposit in London until required by the separate accounts, the loan proceeds had been used to redeem outstanding Treasury bills in London.⁴⁷ To achieve this, the relevant accounts had been issued debentures, in return for the use of their loan proceeds. But the debenture rate for a transfer was 4%, which was below the interest cost of the loan at 5%, and the current deposit rate in London. The failure to match rates had been questioned by Audit for some time, initially in terms of the rate on Post Office investments, which were held at 4%. The Audit Office had suspected that the funds in the loan accounts were in fact being used to meet the demands of cash for Post Office Saving Bank withdrawals. Accounting for cash balances became more significant after the 1929 loan conversion.

4.2 Uncovering the 'Loans' between the Treasury Accounts and Post Office Investments

The use of cash balances in the public accounts was complicated by the temporary investments of the Post Office Savings Bank, and other government departments, in long-term stock that would have to be liquidated if cash was needed in that account. A similar process was used for the cash balances transferred to London, which were put on short-term deposit until being required for interest payments. In March 1927, the Audit Office referred to Treasury a request for information as to how the recently revamped Public Revenues Act was being used to permit 'loans' between separate accounts. It seemed that a section had been added to the principal Act, to distinguish between the temporary advances between accounts, and the long-term investments by an account. Of the two clauses involved, the Solicitor-General had been concerned with the "effect of a construction confining investments under section 39 to investments of the more

⁴⁶ Assistant Secretary to the Treasury/Controller & Auditor-General, 12/4/28, T44/143, on A29/41.

⁴⁷ R.M. Sunley/Controller & Auditor-General, 24/5/28, A29/12.

permanent nature on the administration of [Treasury].”⁴⁸ It appeared to the Audit Office that temporary investments were being made under section 39, “though usually in the guise of investments for a considerable term,” and that the loan accounts would require the funds being used for the temporary ‘loans’.⁴⁹ The Auditor-General’s initial query to the Solicitor-General had observed section 39 as being exercised because of the need for cash in the borrowing account, rather than to obtain an investment for the account that had been advancing the money.⁵⁰ Treasury had promised to offer a history of the practice, to show why investment was temporary, but long-term securities were used.⁵¹

The practice of making temporary ‘loans’ had emerged during the First World War, when money could only be raised for war expenses, and the funds were lent to other accounts. Section 38 of the 1910 Public Revenues Act (an earlier version of section 39) allowed the proceeds of exports and London loans to be used as investments in Imperial Treasury bills and stock, and then were remitted to New Zealand as required.⁵² From 1920 the annual London loan was secured early in the financial year, and the proceeds would be ‘lent’ from the statutory loan accounts, with fresh government securities being issued for the purpose. When the tax revenue ‘swelled’ late in the financial year, and as the loan proceeds were expended, these securities were taken over temporarily by the Ordinary Revenue Account.⁵³ The amount of such securities in Treasury accounts, at over £11 million in 1922, was reduced by sale to the Post Office Savings Bank and government bodies outside the public account. The public account only came to hold more securities if the Post Office withdrawals exceeded deposits, and therefore cash had to be found.⁵⁴ So section 39 was used for accounts that already had investments to be realised, or for on-sale to other accounts with spare funds. Treasury stressed that it was not desirable to realise securities until the cash was needed, and the system of transferring investments between accounts minimised the need to hold the cash in the system.⁵⁵ By contrast,

⁴⁸ Solicitor-General/Controller & Auditor-General, 2/3/27, on A29/17.

⁴⁹ Controller & Auditor-General/ Secretary to the Treasury, 4/3/27, A29/17.

⁵⁰ Controller & Auditor-General/Solicitor-General, 17/2/27, A29/17.

⁵¹ Assistant Secretary to the Treasury/Controller & Auditor-General, 27/6/27, T40/240/25/4, on A29/17.

⁵² *Ibid.*, ‘Loans Between Treasury Accounts’, para.3.

⁵³ *Ibid.*, para.s 4-5.

⁵⁴ *Ibid.*, para.8, the other situation for increased securities involved redeeming stock held by the public.

⁵⁵ *Ibid.*, para.12. Examples of the Imperial practice were also attached to the memo.

section 40 of the Public Revenues Act was used for accounts with an unexhausted borrowing authority. The borrowing authority meant that temporary transfers could be repaid, once new money was raised, by a 'book transfer' rather than with securities' sale.

The Audit Office had been critical of these practices for some time. In regard to section 39, Audit was concerned with the 'loans' between Treasury accounts as part of a wider question, the investment of the cash balances of the Public Account as an entity. Audit would have preferred that advances be made under section 40, which prescribed a one-year period for transfers, but the effect would have been to permanently reduce the borrowing authority.⁵⁶ The immediate concern with section 39 was that accounts with investments still found it necessary to raise further loans on the market. This resulted in the diversion of a loan raised for one purpose to fund other accounts over an extended period. It also resulted in a situation, long associated with Post Office investments, of the transfer being made at lower rates of interest than the prevailing market borrowing rate.⁵⁷

Pooling of cash balances within the public accounts, for the purpose of temporary investment, had been effected under section 28 of the 1920 Finance Act. That particular clause had been passed to facilitate investments by the High Commissioner in London when there was a surplus of funds from borrowing; and to avoid remittance, and the costs of exchange, from Wellington.⁵⁸ In 1925, the Audit Office had queried the use of loan proceeds paid into the public account, when £150 000 had been immediately placed on fixed deposit. The first question was whether such loan money was in fact cash in the Public Account: it had been credited to separate accounts in full, and yet part of the total amount had also been credited to the Cash Balance Investment Account.⁵⁹ This appeared to deprive the separate accounts of the interest on the investments that the loan money was used for. While Treasury had acknowledged that the investments were from the loan proceeds, it was stressed that cash (from any source) that was lodged in London, was

⁵⁶ R.M. Sunley/Controller & Auditor-General, 4/7/27, A29/17.

⁵⁷ *Ibid.* Treasury suggested that Post Office purchases under section 40 cancels the borrowing authority.

⁵⁸ Secretary to the Treasury/Controller & Auditor-General, 1/6/25, T43/25, on A29/17.

⁵⁹ R.M. Sunley/Controller & Auditor-General, 21/5/25, A29/17.

viewed as then available for the High Commissioner's London requirements.⁶⁰ The Audit Office analysis ignored the remittances to London, and concentrated on the balances of cash available, given that a payment had been made from the Public Account. The key factor was that the 'ways and means' account indicated the balance available for issue.⁶¹

In the following year a decision was made, after a Solicitor-General's opinion on section 38 of the Public Revenues Act identifying the practice of temporary transfers between accounts was received, that a new clause be drafted to legitimate the practice.⁶² In the Treasury version of the clause, all the temporary investments of cash would be pooled, and separate accounts not identified.⁶³ This affected the limitation placed on the 1920 amendment, and thus removed any restriction on matching the investments against the separate accounts and making the necessary interest calculations.⁶⁴ Audit claimed that it was a similar effect to abolishing the separate accounts, with a view to saving work. Moreover, the ways and means account, which showed the cash in all the loan accounts, would not be accurate when payments were made into a fixed deposit investment. The Solicitor-General's opinion had been interpreted to refer to the book transfers, without the issue of new securities, while the Cash Balance Investment Account would be retained for fixed-term deposits.⁶⁵ Treasury had said that allocating investments to separate accounts meant a separate cash margin for each; and therefore preferred that there be only one margin of cash across the accounts to ensure the closest investment of balances.⁶⁶ Book entry and transfer would then replace the issue of formal long-term securities.

The Audit Office maintained a distinction between legislative authority for investments in fixed deposits and Imperial Treasury bills, which were made from surplus cash balances, and inter-departmental transfers within the public account. If Treasury saw the ways and means account as 'credits' representing separate cash balances, the Audit view

⁶⁰ Treasury memo, 1/6/25.

⁶¹ R.M. Sunley/Controller & Auditor-General, 2/6/25, A29/17.

⁶² Solicitor-General/Controller & Auditor-General, 30/4/26, on A29/37.

⁶³ Secretary to the Treasury/Controller & Auditor-General, 13/5/26, T40/15, on A29/17.

⁶⁴ R.M. Sunley/Controller & Auditor-General, 18/5/26, A29/17.

⁶⁵ Ibid. "The bulk of investments...have no bearing on the investment of surplus cash in the Public Account, as they do not affect the balance of the Public Account, but are internal transfers only."

⁶⁶ Secretary to the Treasury/Controller & Auditor-General, 7/6/26, T40/15, on A29/17.

was that there was only one cash account in any case, but the way and means account was being altered by the investments of loan moneys from accounts with distinct statutory purposes.⁶⁷ This was another occasion when Treasury quoted the British practice from textbooks, and the Audit Office pointed out how the 'ways and means' practice differed materially in the New Zealand system. Audit had stressed the urgency of amending the Public Revenues Act to meet the need for inter-departmental transfer, and making a separate provision for investment in British Treasury bills and fixed deposits, rather than pursuing Treasury's proposed clause.⁶⁸ When the amendments to the principal Act were passed, section 39 was not specific on investments being credited to separate accounts.⁶⁹ Treasury had decided certain accounts would not be allocated interest from investments.

In early 1927, Treasury looked to place surplus cash on fixed deposit in London, with the Bank of New Zealand providing security through holdings of British government stock. Treasury had been "anxious to remit very large balances for employment on the short loan market, but profitable operations of this nature require favourable exchange rates, and the difficulties of arranging transfers at a satisfactory figure have apparently proved insuperable."⁷⁰ Nonetheless, in March 1927, the Bank of New Zealand agreed to pay 2.5% interest on fixed deposit, and £1 million was remitted to London. The rate was set below the going deposit rate, and this appeared to counter the agreement to pay interest on public account balances of up to £400 000 at the brokers' 'notice rate' of 3.25%.⁷¹ The Bank of New Zealand had arranged for 32 deposits between April 1926 and March 1927, to be placed with Discount Houses or shared with Joint Stock Banks.⁷² The BNZ then decided to charge .5% on the interest accruing from all the deposits, due to the work involved in receiving and exchanging securities as the collateral for the deposits. This was a reaction to the practice, initiated by Treasury, of keeping public account balances

⁶⁷ Controller & Auditor-General/Secretary to the Treasury, 9/7/26, A29/17.

⁶⁸ *Ibid.*, this appears to be the other instance of Treasury pursuing a single clause to increase their powers.

⁶⁹ R.M. Sunley/Controller & Auditor-General, 7/10/26, A29/17, the Act authorised Treasury discretion.

⁷⁰ Hore/Controller & Auditor-General, 22/2/27, on A29/47. "It is assumed that under circumstances of this kind the Treasury, before remitting, always obtains a firm quotation for the return of the money to Wellington." Sunley has added "no quotation for the return of these moneys to NZ has been obtained."

⁷¹ Hore/Controller & Auditor-General, 24/3/27, on A29/47.

⁷² Hore/Controller & Auditor-General, 1/9/27, on A29/49.

low to earn more interest on the short-term money market.⁷³ The Discount Houses offered a form of security in earmarking certain securities as collateral on the deposits.

This form of cover was ordained in an agreement with the Bank of New Zealand. An Order-in-Council authorised investment with three Discount Houses, who offered a deposit receipt as security. Alternatively, the pledge of certain securities could have been accepted by the government, in lieu of a deposit receipt, so the High Commissioner could step in and remove the securities at any time.⁷⁴ The effect of the BNZ's action was to hinder the role of the Discount Houses, who had to transfer the securities to banks, and limit the deposit business to the banks' quotations. Arnold Hore advised retaining the business of the Discount Houses: "we must not overlook the fact that their eagerness to buy New Zealand Treasury bills has raised the price to the level of Imperial bills."⁷⁵ This offer to lend to the government on Treasury bills meant not having to remit cash.

Treasury would pursue Hore's strategy in 1928, and seek acceptance of British government securities as collateral for a fixed deposit, instead of a fixed deposit receipt. Audit and the Solicitor-General were opposed to changing the existing Order-in-Council for an investment of cash balances, because to do so infringed section 39 of the Public Revenues Act. In fact: "the Crown would not be in a position of an absolute proprietor of such securities with the rights of sale and conversion set out in section 39, but would only be the mortgagee thereof."⁷⁶ It was unclear to the Minister of Finance whether receipts were obtained or not, but no change was made in 1928.⁷⁷ This situation was replayed in 1929, when the High Commissioner was offered favourable terms by a new player in the market, but without offering a deposit receipt in addition to the collateral of government securities.⁷⁸ The Crown Solicitor declined an alteration to the Order-in-Council, if the deposit receipt was not present. Subsequently, the Crown Solicitor relented, on the

⁷³ Hore/Controller & Auditor-General, 4/10/27, on A29/49.

⁷⁴ Hore/Controller & Auditor-General, 26/8/27, on A29/49.

⁷⁵ Hore's memo, 1/9/27. Of course, Imperial Treasury bills were the premier short dated security.

⁷⁶ Crown Solicitor (Currie)/Assistant Secretary to the Treasury, 16/3/28 [Copy to Sunley], on A29/17

⁷⁷ Secretary to the Treasury/Controller & Auditor-General, 29/8/28.

⁷⁸ Secretary to the Treasury/Solicitor-General, 22/6/29, T45/10, on A29/17.

proviso that all discount houses adopted the same form of collateral, ie being limited to categories of British trustee stocks.⁷⁹ A fresh Order-in-Council was then issued.

4.2.1 Post Office Savings Bank Investments

In August 1925, the Audit Office had alerted the Minister of Finance to the effect of reducing the rate of interest on government stock issued to the Post Office Savings Bank. The immediate problem was £15 million of securities already held by the Post Office, part of a total of £26 million covered by a decision in the previous year.⁸⁰ These 4.5% securities were being replaced before maturity, and 4% stocks were to be issued in their place. With the loan accounts at the time using borrowed money at the rate of 5%, it appeared that the Post Office was being short-changed, in favour of other departmental balance sheets. Indeed, “the result of the transaction is that the sum (1% of £15 510 556) which is actually earned by the Post Office Savings Bank funds, will be used to increase the profits of the various accounts which have borrowed the money at a low rate.”⁸¹ Not only was manipulation of interest rates bad accounting practice, it was also considered illegal under the Post & Telegraph Act, 1908. It seems that the idea had been to use the profits to benefit the Consolidated Fund, but the effect of the conversion was to actually reduce the Post Office profits, and prevent its reserve being bolstered.⁸² The Minister could direct an interest rate change, if Cabinet had been unaware of the problem.

The Minister of Finance then stated that the Post Office Savings Bank had not been established to make profits, and its investments need only cover its interest obligations and expenses.⁸³ In fact, Cabinet had been aware of the effect of the conversion, and intended to eliminate any further accumulation in profits, reverting to a rate established before an unfortunate increase in the deposit rate. In terms of Post Office investments, “the fact that the reduced rate may favour some accounts is not inconsistent with the

⁷⁹ Crown Solicitor/Secretary to the Treasury, 24/6/30, under Treasury memo to Controller & Auditor-General, 27/6/30, T45/10, on A29/17.

⁸⁰ Controller & Auditor-General/Minister of Finance, 24/8/25, A29/12.

⁸¹ R.M. Sunley/Controller & Auditor-General, 19/8/25, A29/12.

⁸² *Ibid.* It seemed Treasury were not aware that the effect of the reduction was a £40 000 loss in revenue.

⁸³ Minister of Finance (Nosworthy)/Controller & Auditor-General, 1/9/25, on A29/12.

policy of enabling the State to have the use of money at the lowest rates.”⁸⁴ The Auditor-General also accepted: “that the intention of the Act was in the opposite direction and that it was intended that the Post Office should lend to the Treasury at a moderate rate.”⁸⁵ The Audit Office would re-examine the situation, however, in light of the Solicitor-General's opinion of April 1926, which reflected on the rate for the ‘loans’ between accounts. The relevant part of the opinion referred to a variation in the interest rate between accounts that were investing, compared with those borrowing at the market rate. In this case: “such a purchase [amounts] to the grant of a subsidy by way of gift from the special account to the Department from whom the stock is purchased and so is obviously improper and irregular.”⁸⁶ Whether or not the market rate was above or below the rate for the investment of funds by the Post Office, the fact remained that the Minister of Finance set the rate for both the lending and borrowing accounts. The Auditor-General suggested finding instances where a loan account on-lent its funds at a lower rate.⁸⁷

When the Post Office required funds, and therefore its 4% securities had to be sold to Treasury accounts, the Audit Office could claim that the Post Office was being gifted the difference between the 4% rate and the current borrowing rate of 5.25%. The transaction could be questioned because the Post Office was outside the public accounts, and not covered by section 39 of the Public Revenues Act, which was designed for loans between Treasury accounts.⁸⁸ Treasury referred the question to the Solicitor-General, and emphasized that the Post Office would not have accepted 4% securities if they were not assured that these would be re-purchased at par. Moreover, if calculated at the market rate, the entire assets of the Post Office would be worth only 80% of deposits.⁸⁹ The Solicitor-General stated that the opinion from April 1926, on which the Audit view was based, referred to long-term investments, not those that could be re-purchased at call.

⁸⁴ Ibid. “The fact that the Post Office might be able to find investments at 5% was fully recognised.”

⁸⁵ G.F.C. Campbell's note, 11/9/25, on Sunley's memo, 3/9/25, A29/12.

⁸⁶ Solicitor-General's opinion, 30/4/26, on A29/37, quoted in Sunley's memo, 14/7/26, A29/12.

⁸⁷ Campbell's note, 19/7/26, on Sunley's memo, 14/7/26, A29/12.

⁸⁸ Deputy Controller & Auditor-General/Secretary to the Treasury, 22/12/26, A29/37.

⁸⁹ Acting Secretary to the Treasury/Solicitor-General, 14/1/27, T45/8, on A29/37.

Treasury clarified the situation, by seeking the approval of the Minister of Finance for the practice concerning the Post Office, under section 39, despite that account's status.⁹⁰

The only problem with this was that the Post Office's £44 million worth of investments in government stock were not at call; the practice was to actually sell long-term government securities.⁹¹ At the time, the Solicitor-General was still awaiting Treasury's clarification of loans between accounts under section 39, as opposed to book transfer under section 40.

The Audit Office continued to find transactions involving the Post Office investments that appeared to infringe on the limited intention of section 39. In April 1927, Treasury had decided to use the revenue surplus to redeem debt, specifically, the war securities held by the Post Office. The proposal was to exchange these securities for others held in Treasury accounts, but Audit could find no authority for this transaction under section 39, or elsewhere in the Public Revenues Act.⁹² Treasury believed that this was the same form of transaction as that authorised in 1925, when the £15 million of securities had been replaced by stock with a lower rate of interest, with an exchange on a cash basis.⁹³ As it turned out, the transaction had not been treated in the Treasury accounts as an exchange, but as a redemption of securities under a separate clause in a Finance Act, with the issue of the new securities made under the Loans Act, citing the authorising Acts.⁹⁴

By December 1927, there was a clear instance of loans between accounts under section 39 appearing to gift a lower interest rate to the Post Office, as it had been defined by the Solicitor-General in April 1926. This occurred with the proceeds of the issue of 5.25% stock inscribed by the Treasury, but payable in London free of exchange, in the private sale situation. Although the loan had been raised under separate borrowing authorities, £100 000 was immediately used to fund the Post Office. The Electric Supply Account and the Railway Improvements Authorisation Account both had £50 000 of the loan proceeds, raised under their borrowing authorities at 5.25%, but then used to purchase

⁹⁰ Acting Secretary to the Treasury/Minister of Finance (W.D. Stewart), 21/2/27, T45/8, on A29/37.

⁹¹ R.M. Sunley/Controller & Auditor-General, 10/3/27, A29/37.

⁹² R.M. Sunley/Controller & Auditor-General, 12/4/27, A23/96.

⁹³ Acting Secretary to the Treasury/Controller & Auditor-General, 14/4/27, T44/140, on A23/96.

⁹⁴ R.M. Sunley/Controller & Auditor-General, 15/11/27, A23/96.

securities from the Post Office at 4%.⁹⁵ The loss being credited to these accounts had been unintended, but indicated an expedient to cover for the withdrawals of deposits at the Post Office. It was also considered in the Audit Office that, at the time the 5.25% loan was raised, it would have been possible to make an issue of Treasury bills at 4.5%.⁹⁶ The Auditor-General's query to Treasury concentrated on the use of the loan proceeds to fund the redemption of war debt, with the £2 million loan maturing in November 1927. As with the funding of the Post Office, 4% debentures were purchased by accounts that had just been authorised to borrow at 5.25%; but some accounts already had enough loan money to meet their expenditure needs, or otherwise had cash invested in stock.⁹⁷

Treasury's specific response to the point about the Post Office investments being taken up by loan accounts was that these accounts had the advantage of low rates from the Post Office, while the raising of money to meet cash shortages was denied them.⁹⁸ But a similar situation occurred again, this time with the 1928 London loan when, instead of being put on fixed deposit, loan proceeds were used to redeem Treasury bills maturing in London. To effect the redemption, debentures were being purchased by accounts with loan proceeds, so once again Railways Improvement and Electric Supply assumed the investments at 4%, using money borrowed at over 5%.⁹⁹ The present operations in the London market had been devoted to the 1929 Loan Conversion offer, a minor fiasco.

4.3 The 1929 Loan Conversion and the Assertion of the Bank of England's Control

Preparation for the 1929 loan conversion had begun in 1927 when the Minister of Finance, W.D. Stewart, sent a cable to the Bank of England seeking their advice. The High Commissioner and the Finance Officer visited the Bank in July 1927, and were advised to seek an early and brief test of the market after the holiday season.¹⁰⁰ The Bank advised against anything longer than a three-week offer, and with no 'private' sales

⁹⁵ R.M. Sunley/Controller & Auditor-General, 20/12/27, A29/12.

⁹⁶ R.M. Sunley/Controller & Auditor-General, 21/12/27, A29/12.

⁹⁷ Controller & Auditor-General/Secretary to the Treasury, 29/12/27, A29/12.

⁹⁸ Treasury memo, 11/4/28, T40/240/25/4, on A29/12.

⁹⁹ R.M. Sunley/Controller & Auditor-General, 25/5/28, A29/12.

¹⁰⁰ Notes of meeting, Deputy Governor and Chief Cashier, 20/7/27, Bank of England, C40/282.

thereafter. The High Commissioner, Sir James Parr, remained somewhat dubious of the need for early conversion offers of small amounts, given that interest rates might fall.¹⁰¹ Parr also pointed out that £33 million of new stock had been inscribed at the Bank of England since 1922, when management charges had been decreased, and the higher total debt justified a lower rate. There were separate charges for new issues and conversions.

The charges could not be easily compared to another government, as the Bank of England was not managing a similar portfolio, other than Queensland's. Audit's London officer, having been a critic of the management charges, noted that Queensland now had the same charges as New Zealand, and secured them in 1913 on the condition that all issues of stock were made through the Bank.¹⁰² The condition lasted for 15 years: when the same offer had been made to New Zealand in 1922 it was initially declined, due to it having a 25 year restriction; but then the restrictive condition was withdrawn. Sir James Allen, the High Commissioner in 1923, had complained that the Bank were overcharging, and threatened to remove the existing stocks from the Bank of England register.¹⁰³ As well as the management charge, a reduction was sought on the charge for each new issue, and a refund on the charges made above the level offered since 1913. The Governor of the Bank of England subsequently met with the Prime Minister, Massey, in December 1923. Massey explained that the trouble had been caused by Allen, as he was Finance Minister when the Bank's 1913 offer had been declined, and now wanted to recover lost ground.¹⁰⁴

Indeed, it appeared that the Bank of England treated "applications for management reductions as an irritating interruption of the more important business of controlling the currency."¹⁰⁵ Hore noted that, with a £107 million debt, the New Zealand government would have been better off without the flat fee offered in 1922, and with a return to the previous scale of charges. Besides the management charges, the issue of making private

¹⁰¹ Memorandum, Parr's meeting with Deputy Governor and Chief Cashier, 4/4/28, B.of E., C40/282.

¹⁰² Hore/Controller & Auditor-General, 21/11/27, on A29/5/1.

¹⁰³ Memorandum, meeting with Parr, 1/5/23, B.of E., C40/214.

¹⁰⁴ Memorandum, meeting with Massey, 14/12/23, B.of E., C40/214. The notes of the meeting also record discussion of a central bank in New Zealand, based on the 'injustice in the exchange' being experienced by New Zealand, because of the banking links to Australia, and thus to the Australian financial policies.

¹⁰⁵ Hore's memo, 21/11/27. Hore added sarcastically: "an Institution so satisfied with its own generosity in making one long overdue concession, that it can blandly ask a customer for 25 years immunity."

sales was also relevant to both parties. Hore was encouraging the Finance Officer in the High Commission to offer New Zealand Treasury bills to more Discount Houses, as the need for cash did not mean being limited to the quotations of the Joint Stock Banks.¹⁰⁶ He suggested that Treasury prepare for an 'onslaught' on the Bank in 1928, as the conversion of large loans in 1929 should carry a lower charge, due to the amount.¹⁰⁷

In 1927, Treasury was in fact defending the management charges, at least the method of accounting for them under the Loans Act. Since 1922, the Audit Office had suggested that the separate accounts contribute an amount to the management charges on their loans.¹⁰⁸ In response, Treasury appears to have greeted this suggestion as yet another example of Audit seeking new legislation for a technical accounting practice. Audit saw this as a question of law, given that loan money was earmarked for specific purposes, and Treasury appeared to be advocating discretion for adjustments after the primary transaction.¹⁰⁹ It seems that the practice of recouping the charges needed specific legal authority, and this required an amendment to the Loans Act.¹¹⁰

From the Audit Office perspective, getting the interpretation of the Loans Act correct also applied to the conversion loans being offered in London before maturity, in 1929. The Bank of England had encouraged the High Commissioner to issue a £5 million conversion offer in the spring of 1928. Hore was not party to the preparation of the loan prospectus, and had not subsequently noticed that it was invalid, it "being left to the 'eagle eye' of Mr Sunley to discover it."¹¹¹ Unfortunately, as the officer in charge of the Control branch, R.M. Sunley was not aware of the conversion offer until it had already taken place. The problem was with the terms in the conversion prospectus, which raised the interest rate from 4 to 4.5%; moreover, the conversion loan was to be offered at a premium price, which increased the capital liability of the new stock.¹¹² The 1908 Loans Act seemed only to envisage that the capital liability changed because the interest rate

¹⁰⁶ Hore/Campbell, 28/11/27, A29/4a. Hore linked this with the deposits taken by the Discount Houses.

¹⁰⁷ Hore/Controller & Auditor-General, 22/12/27, on A29/5/1.

¹⁰⁸ R.M. Sunley/Controller & Auditor-General, 5/9/27, A29/5/1.

¹⁰⁹ Treasury memo, 16/9/27, T48/25/2; and Sunley/Controller & Auditor-General, 4/11/27, on A29/5/1.

¹¹⁰ Assistant Secretary to the Treasury/Controller & Auditor-General, 13/12/27, T48/25/2, on A29/5/1.

¹¹¹ Hore/Campbell, 21/9/28, A29/4a.

was reduced, by making the conversion to a new security. But the government was paying more because of the offer price on the conversion, and the effective interest rate was over 5%. In fact: "as the old loan had still 18 months to run this would mean an increase of nearly 1% per annum on £5 000 000 for 18 months, equal to an additional cost over and above the cost of the old loan during the same period."¹¹³ Beside the question of the merits of the advice being offered, the legislative authority was also dubious. Loan Agents in London had the delegated authority of the Governor-General, and as it was solely a London stock issue, such a delegation excluded the Minister of Finance. The Audit Office sought the Solicitor-General's view on the legal question, given that the Minister did not have the authority to approve the terms of the loan offer. In an initial opinion, the Crown Solicitor agreed that the conversion terms did not come within the exceptional case built into legislation.¹¹⁴ Informing Treasury, the Auditor-General suggested the conversion was contrary to the legislative authority, but as the loan contract had already been completed by the Loan Agents it could not be repudiated.¹¹⁵

In September 1928, the High Commissioner reported back the advice of the brokers, Scrimgeours, that the government should buy any 1929 4% Stock being offered in the market, and provide the funds for this through private sales of new stock.¹¹⁶ Parr appeared to favour that view, and asked for an authorising Act for the £1 million issue, though he could not accept advice to clear the way for the 1929 conversion through an early loan for new money. When Parr's cable was presented for auditing, the Audit Office once again sought an opinion on whether the transactions were covered by legal authority. The problem with the contract was that because of a discounted price (also affected by accrued interest), the debt burden and the effective interest cost on the capital liability were being increased on the conversion.¹¹⁷ Moreover, the Loans Act did not give the Minister the power to effectively increase the debt burden through a conversion.

¹¹² R.M. Sunley/Controller & Auditor-General, 12/7/28, A29/20/2.

¹¹³ *Ibid.*, "it is clear that the actual charge for interest alone will show an increase of £52 687."

¹¹⁴ Crown Solicitor/Controller & Auditor-General, 2/8/28, on A29/20/2.

¹¹⁵ Controller & Auditor-General/Secretary to the Treasury, 9/8/28, A29/20/2. Audit included the point about the additional cost of the conversion, but omitted the questioning of the terms that were accepted.

¹¹⁶ High Commissioner/Secretary to the Treasury, 10/9/28, T44/142, on A29/41.

The real point was with the maturity date in 1929, and “the increase of the debt before such increase becomes necessary, there being a contract...by which the Government may retain the money at only 4%.”¹¹⁸ The Solicitor-General's subsequent opinion appeared to over-rule the Crown Law Office's initial response. This second opinion stated that the Minister, High Commissioner, or Loan Agents, did have the discretion to repay loans before maturity, and to vary the terms of the loan.¹¹⁹ The Audit Office maintained their view of the impropriety of conversion before maturity, and the confusion with the delegated authority to loan agents in London; and then also added the point about the charges for loans being brought on separate accounts.¹²⁰ The Crown Solicitor suggested that while the Loan Agents may not have the power to effect the terms of the conversion, the Minister did, and so he just needed to confer this authority on them.¹²¹ The conversion transaction was to be subsequently re-defined as a fresh issue of securities.

The Bank of England also had cause to question the September transactions, and the intention was to not encourage the private sale of stock. The Chief Cashier wrote to the High Commissioner, based on what had been agreed in April 1928, to see if this would be an isolated transaction or part of a programme of dealing with the 1929 maturity.¹²² The Finance Officer, E. Toms, was interviewed on the matter, and stated that the private transaction was due to the specific offer made, not part of a programme. Toms was sent a confidential letter, reminding him to seek from the High Commissioner the government's requirements.¹²³ The Bank of England was aware that financial decisions were affected by the 1928 election, although it expected the incumbents to win. While it had been preferable to offer a conversion loan in the autumn, the High Commissioner was urged to make a £10-15 million conversion offer in early January, along with the usual loan.¹²⁴ The terms for the conversion loan were decided by December 1928, with a £12.5 million offer of 4.5% stock. The Bank of England were aware that a risk was being taken on the

¹¹⁷ Controller & Auditor-General/Solicitor-General, 12/9/28, A29/41.

¹¹⁸ Ibid. “Treasury desires to have the matter finalised today.”

¹¹⁹ Solicitor-General/Controller & Auditor-General, 14/9/28, on A29/41.

¹²⁰ Controller & Auditor-General/Crown Solicitor, 18/9/28, A29/20/2.

¹²¹ Crown Solicitor/Treasury, 20/9/28, and Treasury/Audit, 10/10/28, T44/162, on A29/20/2.

¹²² Chief Cashier/High Commissioner, 14/9/28, B.of E., C40/282.

¹²³ Chief Cashier/Toms (private and confidential), 15/10/28, B.of E., C40/282.

¹²⁴ Memorandum, meeting with Parr and Toms, 24/10/28, B.of E., C40/282.

stock being traded at a discount, as in May 1928, given a greater amount at stake.¹²⁵ The conversion offer was not underwritten, and continued the practice of stock being sold at a premium price to receive all of the maturing capital, but by increasing the public debt.¹²⁶

Meanwhile, the loan for £7 million new cash was offered at the discount price of 95, ensuring it was oversubscribed, and even went to a premium on trading. However, the price went back to par (95), after an Australian loan issue at 98 had been mostly left with the underwriters, which depressed the gilt-edged market.¹²⁷ From early 1929 then, the market had decided that Australia had been overborrowing, though this had not initially affected New Zealand stock. The offer of a loan at a discount price meant that, for the £7 million that was nominally added to the public debt, the actual indebtedness was greater. When the calculations were made at the end of the financial year, 31st March 1929, the Audit Office found that for the £5 million of loan proceeds received, actual indebtedness was over £5.3 million.¹²⁸ There would subsequently be concern with the expenses of the 1929 cash loan in particular, with a final total of £7.5 million stock issued, the expenses were £170 000, ie charges of 2.5%.¹²⁹ The brokers commission was worth £25 000, and since this was avoided on private sales of Treasury bills, Hore recommended these be sold to Discount Houses; or short-dated bonds be issued rather than long term loans.¹³⁰

In August 1929, the High Commissioner approached the Bank of England to obtain advice for dealing with the remaining £10 million of 4% stock, still to reach maturity in November. The Governor stated that previous advice had not been followed, in regard to increasing the amount being offered, and the matter had been left to a late date.¹³¹ The High Commissioner said that due to market conditions the government was considering a short-dated bond issue combined with the conversion offer. The Governor of the Bank of England suggested that a 5% bond issue would have to be heavily discounted, or the

¹²⁵ 'New Zealand Conversion Loan', 21/12/28, B.of E., C40/282.

¹²⁶ Minister of Finance (Ward)/Controller & Auditor-General, 15/1/29, T44/142, on A29/59.

¹²⁷ Hore/Controller & Auditor-General, 23/1/29, on A29/59.

¹²⁸ R.M. Sunley/Controller & Auditor-General, 23/4/29, A29/59. The figure involves multiplying the loan figure and interest cost, and dividing this by the offer price (95). Treasury used the £7 million figure.

¹²⁹ 'Stock and Debentures issued 6 months to 30/9/30', W.D. Stewart Collection, MS-985-10-9, Hocken.

¹³⁰ Hore/Controller & Auditor-General, 15/2/29, on A29/4. The conversion charge was £1000 per million.

¹³¹ 'New Zealand', 26/8/29, B.of E., C40/282.

interest rate raised to 6%.¹³² The Finance Officer then wrote to the Chief Cashier, in regard to charges for the conversion, given that £500 000 would be redeemed from sinking funds.¹³³ The reply indicated that the charges remained the same, irrespective of the source of redemption money. Toms then worked on a proposal to avoid a new conversion issue, and as an alternative to the heavily discounted long-term stock or short-dated bonds. Besides the sinking fund sums, cash balances would be used to repay the maturing stock, and more loan money remitted from New Zealand depending on the exchange rate.¹³⁴ This would also require that NZ Treasury bills be sold in London.

When Toms met the Governor in September, he was informed that Treasury bills were a last resort and should be saved for a rainy day, therefore a conversion offer should be made.¹³⁵ The Governor was assuming that New Zealand could finance itself for six months, and that the brokers would advise only on underwriting the conversion loan. Montagu Norman had met with Scrimgeours, and had complained that his advice was usually sought, but seldom heeded; also, the schemes New Zealand usually adopted were inadvisable.¹³⁶ H.C. Scrimgeour had recommended a larger stock offer, priced at 97, with New Zealand underwriting £5 million, whereas the Bank favoured a smaller offer at a higher price, consistent with underwriting. The result was a £5 million stock issue at 98, without an offer of additional stock to trustees. It turned out that the Governor's view had been more accurate, with 30% of the loan being taken up by underwriters.¹³⁷

New Zealand also had lower cash, or sterling balances, in London than had been expected. In March 1930, Scrimgeour met with the Bank of England to discuss the next £7 million loan, due to be raised in April, after the budget. The figure was considered too large, as there were local loan maturities to also be funded at the time, although New Zealand had usually 'got away with' considerable amounts in fresh London borrowing.¹³⁸ The Bank subsequently discovered that the three big discount houses held £2.3 million of

¹³² *Ibid.* The 5% bonds would have to be priced at 90, 5.5% at 98, and a 2-3 year bond at least 6%.

¹³³ Toms/Chief Cashier, 27/8/29, B.of E., C40/282.

¹³⁴ 'Summary of proposals', 30/8/29, B.of E., C40/282.

¹³⁵ Memorandum, 'New Zealand', 3/9/29, B.of E., C40/282.

¹³⁶ Memorandum, 'New Zealand 4% Stock 1929', 5/9/29, B.of E., C40/282.

¹³⁷ Norman/Parr, 3/10/29, on B.of E., C40/282. Norman requested that in future he be contacted earlier.

New Zealand Treasury bills, and more were expected to be placed.¹³⁹ The explanation offered to the Governor was that the Treasury bills were being issued only because of the difficulty of remitting money through the trading banks, and sufficient cash was held in Wellington to meet the expenditure. There would be numerous sales of Treasury bills during 1930, albeit at a relatively favourable rate.¹⁴⁰ A £7 million loan was still sought, but the loan market had become difficult, and the figure was reduced by two million.¹⁴¹ The new High Commissioner, Sir Thomas Wilford, queried the brokers' advice as to a discounted price; but the Bank of England did reduce charges on issues and conversions.

The High Commissioner had become aware of the pressure on government finances through maturing loans, and excess withdrawals from the Post Office Savings Bank. The loan programme had been framed with a view to receiving £1.7 million from the Post Office, but the actual position was a shortage of £3 million, to be met in cash.¹⁴² During September there was a further issue of 5% stock, to raise £700 000 to cover the expenses on previous stock issues and the conversion offers. Treasury acknowledged this to the Minister in November 1930, but stated that London market conditions were favourable; while £6 million of local maturing stock was redeemed.¹⁴³ Local stock issued at 5.5% was being relied upon for cash needs, since the Treasury accounts had to be relieved if the cash was required for spending commitments. In December, it emerged that Treasury had attempted to make secret sales of Treasury bills in London, after the 'City Editors' latched on to the story.¹⁴⁴ Hore considered this unfortunate, given the terms that could be secured in the market, and as he had been responsible for getting the business of the Discount Houses. By early 1931, on the brokers' advice, the short loan market was still being used to meet cash requirements, but bills were sold without having the option of renewal. The practice of selling Treasury bills in London was becoming unsustainable.

¹³⁸ Memorandum, 'New Zealand', 24/3/30, B.of E., C40/282.

¹³⁹ Memorandum, 'New Zealand', 27/3/30, B.of E., C40/282.

¹⁴⁰ Hore/Controller & Auditor-General, 6/2/31, on A29/4.

¹⁴¹ Memorandum, 'New Zealand', 8/5/30, B.of E., C40/282.

¹⁴² Acting Minister of Finance/High Commissioner, 4/11/30, T48/9, on T52/77.

¹⁴³ Secretary to the Treasury/Acting Minister of Finance, 25/11/30, T48/9, on T52/77.

¹⁴⁴ Hore/Campbell, 9/12/30, A29/4a.

5 HOBSON'S CHOICE: LOAN DEFAULT Or CONTROL BY THE TRADING BANKS, 1932-33

5.1 The Reform of Borrowing Practices Imposed by the Bank of England

“The Governor, after reading out the cable, remarked that the [NZ] Government still seemed unable to appreciate the difficulties into which their recent financial policy of borrowing short and lending long had led them, but he reminded Sir Thomas [Wilford] that the dangers of such a policy had consistently been made apparent by the Bank of England to the Government’s representatives in London. Sir Thomas concurred. The Governor further stated that within the last few days he had been informed by the New Zealand Government brokers in London that it was quite impossible to make any issue of New Zealand Stock either short or long and pointed out that the effects of recent policy were that at the present moment the Government were unable to borrow at all and were faced with default both on bills and interest payments.”¹

By the end of 1931, New Zealand’s credit in London had collapsed, and the government was completely reliant on the Bank of England for maintaining the Dominion’s solvency. The Bank’s Governor, Montagu Norman, certainly blamed the recent financial decisions made by the New Zealand Government, and specifically the private sales of Treasury bills from December 1930. Apparently: “the High Commissioner’s office used to telephone to half a dozen people to place with them surreptitiously as many Bills as each could manage.”² From the Bank’s point of view, New Zealand was part of an economic unit in Australasia, and the Australian financial crisis also affected New Zealand stocks. Whether the perception of an exchange crisis was accurate, this was the reaction to the 1930 exchange rate depreciation by the banks.³ Treasury had ceased making remittances to London for interest payments. In the depths of the Depression, Treasury appeared to flounder, as retrenchment was the apparent course of action with no signs of relief internationally. Trading banks offered the only source of cash, at a very high price. The Reserve Bank would emerge from within the public controversy over exchange rates.

The High Commissioner, Sir Thomas Wilford, had notified the Bank of England in April 1931, that all the government’s interest commitments in London for the next year would

¹ Memorandum, ‘New Zealand’, 4/12/31, B.of E., C40/282.

² Notes, Governor’s meeting with Downie Stewart in London (15/9/32), 17/9/32, B.of E., G1/335.

³ Sinclair, K. & W.F. Mandle, *Open Account*, Wellington 1961, pp.190-1.

be covered by means of fresh borrowing, amounting to £9 million.⁴ At the time there were already £4 million worth of Treasury bills outstanding, although these could have been re-funded through a new issue of long term stock, enabling another issue later in the year. In May, Wilford was interviewed at the Bank, and had stated that with rates on Treasury bills at just over 2%, this method of financing “appealed very forcibly” to the government.⁵ The Governor favoured an issue of short-dated (2-3 year) bonds, as an experiment, to repay the outstanding bills. The main factor for the High Commissioner was the net cost of borrowing, given the stock prices and interest rate, and he mentioned the approach from a firm of stockbrokers suggesting a favourable issue price.⁶ Apart from the Australian situation, and a growing reluctance to invest in overseas securities, the London gilt-edged market was being manipulated to facilitate British conversion operations.⁷ The critiques of Australian borrowing now referred to the effect of the Colonial Stock Act, where the idea and the extension of trustee status were questioned, with the Australian situation sufficient reason to remove its stocks from the Trustee list.⁸

The Bank of England’s experimental issue of short-dated bonds was significant, if the prospectus was issued without a declaration under the Colonial Stock Act, 1900. An analysis by the Imperial Treasury indicated that the proposed bearer bonds could not be considered an authorised investment under the 1925 Trustee Act, without a declaration under the Colonial Stock Act.⁹ It seems that Scrimgeours had attempted to offer the bonds or long-dated trustee securities in the same prospectus. The Governor suggested that this had wasted time, and impressed upon Mr Scrimgeour the need to proceed with the bond issue, not Treasury bill sales.¹⁰ By June, Scrimgeours had concurred with the Bank on the short-dated bond issue, and a £5 million loan was underwritten, priced at 99. The result was a failure, as underwriters took up 68% of the issue, and with the trading price falling to a discount. Hore noted that Trustees had been debarred from investing, but the ‘floater’ was a better bet in the conditions, more so than the permanent investor in

⁴ Memorandum, ‘New Zealand’, 29/4/31, B.of E., C40/282.

⁵ Memorandum, ‘New Zealand’, 5/5/31, B.of E., C40/282.

⁶ Ibid. The firm based in London, Mortons, had actually approached the government in Wellington.

⁷ Hore/Controller & Auditor-General, 14/5/31, on A29/4. Hore refers to New South Wales’ repudiation.

⁸ ‘Overseas Loans in London’, *The Economist*, 27/9/30, in W.D. Stewart papers, MS 985-10-9, Hocken.

⁹ Solicitor/Secretary to the Treasury, F.759.017, 19/5/31, on B.of E., C40/282.

Dominion stocks.¹¹ There was a 1% loss on the issue price to the government, which was considered good even if it was too dear for the market.¹² The broking expenses of £144 000 included £50 000 lost on the issue price, and the same amount was also paid to the underwriters. The Audit Office questioned the form of the prospectus, as one of the authorising Acts indicated an account not covered by the 1925 Repayment of Debt Act.¹³

By October 1931, “if recent monetary conditions get worse in London, the Government might experience some difficulty in the near future, or indeed find it impossible to discount Treasury bills.”¹⁴ Within a month, substantial sums would have to be remitted from New Zealand, or penal rates of interest (over 6%) paid to renew Treasury bills. There was more than £1 million in interest due in December, and £2.5 million worth of Treasury bills maturing during the month. The High Commissioner appealed to the Bank of England in late November, but “they could not at so late a date give him any advice on the matter.”¹⁵ On 1st December 1931, with an election in New Zealand on the following day, public finance began to slip into the abyss as the treasury benches were vacated.

This was the point at which the New Zealand Government was directed by the Bank of England to obtain information on the sterling funds of the trading banks in London. The Governor stated that New Zealand was now unable to borrow in the market, and would have to compel the banks to hold at their disposal at least £1 million London funds per month.¹⁶ The Bank would not be prepared to assist unless the private sales of Treasury bills in London permanently ceased. Temporary accommodation on Treasury bills was to be sought from the trading banks in New Zealand. The banks would have to provide the sterling exchange for repaying current short-term debt and the usual interest payments. The High Commissioner sought advice on the sale of Reserve Fund securities, or

¹⁰ Memorandum, ‘New Zealand’, 29/5/31, B.of E., C40/282.

¹¹ Hore/Controller & Auditor-General, 15/7/31, on A29/64.

¹² Hore/Controller & Auditor-General, 12/6/31, on A29/64.

¹³ Controller & Auditor-General/Hore, 25/1/32, A29/64. The Bank of England required identical bonds.

¹⁴ Quote from High Commissioner, in Minister of Finance/Minister of Public Works, 8/10/31, T52/77.

¹⁵ Note of telephone conversation with Wilford, 27/11/31, B.of E., C40/282.

¹⁶ Memorandum, ‘New Zealand’, 1/12/31, B.of E., C40/282.

receiving a short-term advance from the Bank.¹⁷ The Bank of England underwrote an issue of £4 million Treasury bills, after claiming that a bill issue could break the market.

When the Reform Government was returned in the election, W.D. Stewart cabled the High Commissioner to pass on his view of Wilford's meeting preceding the election. The Minister seemed rather dismayed at the permanent embargo on use of the short term market, and was concerned about being excluded from the annual long term London loan. Stewart did not think that it would be necessary to compel the banks to provide exchange for the government, and appeared to believe that their agreement would prevent a further depreciated exchange rate.¹⁸ The High Commissioner informed the Bank of England that the government had acquiesced in the embargo, and negotiated with the banks to repay outstanding debt. Subsequently, on 15 December 1931, *The Times* reported a statement from Stewart, in which he said 'new external factors' made further reductions in public expenditure absolutely necessary.¹⁹ Wilford then wrote to Montagu Norman, expressing his embarrassment at the government defeatism, and chagrin at Stewart's 'bombshell'.²⁰

The key development in the new scenario was that, as London commitments now had to be met from remittances from New Zealand, the London-based trading banks were in a pivotal position. In arranging the exchange pool to meet London commitments, there emerged a curious positioning movement between the banks. The Bank of New Zealand approached the Bank of England and offered to show them their confidential figures on sterling funds; the Deputy Governor indicated that the Bank did not desire to see such figures.²¹ The Bank of England also obtained a copy of a lengthy cable from the Bank of New South Wales' General Manager to his Board, from mid-December 1931. The cable advocated the exchange pool as part of a wider policy package, including budget cuts and a reduction in interest rates linked with the government's financial organisations.²² The Bank of New South Wales had insisted on a further devaluation, to a discount of 25%,

¹⁷ Memorandum, 'New Zealand', 4/12/31, B.of E., C40/282.

¹⁸ Stewart/High Commission, 4/12/31, on B.of E., C40/282.

¹⁹ 'New Zealand Finances', *The Times*, 15/12/31, on B.of E., C40/282.

²⁰ Wilford/Norman (personal), 16/12/31, on B.of E., C40/282.

²¹ 'New Zealand', 8/12/31, B.of E., C40/282.

²² Cable from General Manager to the Board, 15/12/31, on B.of E., OV59/15.

before joining the exchange pool. The other five banks had formed a united front on the present exchange rate, at the 10% discount, on which the exchange pool would be based. It seems that Cabinet had prepared an emergency Order-in-Council to take over all of the proceeds of New Zealand exports, but a system of export licensing was secured by the banks, and the exchange rate was held.²³ The National Bank had sought the opinion of a Bank of England official, R.N. Kershaw, to help publicly oppose further devaluation.²⁴

Kershaw was more concerned with the impact of devaluation on the budget, as there was no provision made for the increase in external debt servicing. The extra cost of overseas debt could lead to more Treasury bills being sold to the banks. In January 1932, New Zealand's long-dated stock was trading at the price of 86, and with devaluation making debt servicing more difficult, the more remote would be the date when fresh London borrowing could relieve the Treasury bill issues.²⁵ In February, the High Commissioner received advice from Wellington that, in view of the 'sudden cessation' of the London borrowing and with revenue falling, temporary relief from fixed charges was being sought. The proposal was to suspend the sinking fund payments, under the Repayment of Public Debt Act, for two years. Advice from the Bank of England was sought; while the British Treasury were asked if objection could be raised under the Colonial Stock Act.²⁶ The Repayment of Public Debt Act had appeared in every loan prospectus since 1925.

Within the Bank of England it was thought that this move would break contracts and harm credit rating, but the sinking fund payments were not fixed amounts applied solely to debt redemption in London every year.²⁷ Kershaw noted that Australia had not suspended sinking fund payments, as other countries had, because of the conditions of the Colonial Stock Act. As the transfer of the payments for debt redemption were no longer in question, it was merely a budget problem for the Finance Minister, but one that would affect future borrowing. It seemed that the suspension of sinking fund payments would

²³ R.M. Campbell has claimed that the Secretary to the Treasury misled Cabinet over the role of holding the exchange rate at 10% in the negotiations. Campbell/W.B. Sutch, 30/9/71, MS-1900-15, ATL.

²⁴ 'New Zealand', 22/12/32, B.of E., OV59/15; and 26/1/32, OV59/16.

²⁵ 'New Zealand', 14/1/32, B.of E., OV59/16.

²⁶ Finance Officer/Chief Cashier; Finance Officer/Secretary to H.M. Treasury, 8/2/32, B.of E., C40/282.

²⁷ 'Suspension of sinking fund on New Zealand debt', 8/2/32, B.of E., C40/282.

undoubtedly see New Zealand stocks removed from the Trustee list.²⁸ The Bank of England advised that suspension of sinking funds was a default, making a consolidation of short-term debt and fresh borrowing impossible. The High Commissioner cabled the Bank's view to Wellington, emphasizing the repercussions of being the "first British Dominion" to default under the Colonial Stock Act.²⁹ The Minister of Finance replied that with no maturities in London for two years, the cost of remittance could be avoided, especially given large local loan maturities.³⁰ Stewart also noted that imperial sinking fund charges had been suspended in 1931. The Bank of England's reply stated that these were not contractual commitments, whereas New Zealand had legislated for a fixed provision from revenue, and this was how the default condition was being interpreted.

The Bank's analysis of the Colonial Stock Act conditions was written by the Deputy Chief Cashier, Leslie Lefeaux, who became the first Governor of the Reserve Bank in New Zealand. The focus was upon the condition giving the imperial authorities the power of disallowance over colonial legislatures. Lefeaux noted that the sanction did not necessarily apply to the failure to make sinking fund provisions.³¹ A precedent had been set by the Australian example in January 1931, when the Imperial Treasury had determined that the power of disallowance was only optional, and was not obligatory on behalf of bondholders. It remained open to doubt whether the power of disallowance could be exercised preceding default, or if the only sanction was the removal of colonial stocks from the Trustee list, after an actual default.³² Lefeaux also studied previous New Zealand loan prospectuses to find references to the allocation of sinking funds to debt redemption in London. Meanwhile, the Imperial Treasury view was that the condition referring to disallowance could be invoked, if the failure to make the appropriations specified in the prospectus was indeed a 'departure from the original contract'.³³

²⁸ 'I agree with Mr Kershaw', O.E. Niemeyer, 9/2/32, B.of E., C40/282.

²⁹ Wilford/Stewart, 10/2/32, on B.of E., OV59/16.

³⁰ Stewart/Niemeyer, 11/2/32, on B.of E., OV59/16. The Economy Commission had made the proposal.

³¹ 'Colonial Stocks', 12/2/32, B.of E., C40/282.

³² *Ibid.*, "although in the case of New Zealand the constitutional right to veto presumably exists as that Dominion contracted out of the Statute of Westminster."

³³ Waterfield/Harvey, F.12830, 16/2/32, on B.of E., C40/282.

The Bank of England was troubled by the fact of being New Zealand's agent, while also simultaneously obligated to the bondholders. Though the safeguards afforded under the Colonial Stock Act had not been tested, the Bank would have to advise His Majesty's Government on invoking sanctions in any situation that arose.³⁴ The key relationships therefore, were between the Bank of England and New Zealand on the one hand; and the Bank as His Majesty's Government advisors on the other. This meant that a political decision would have to be made to assist a Dominion to avert a loan default. The High Commissioner felt shamed by the matter even being raised with the Bank, and couldn't understand suggestions of a breach of contract, "especially when one realises the enquirer is a barrister."³⁵ Wilford was mortified at the question of default having arisen, and felt his government had lost its sense of direction in its desire to balance the budget.³⁶

5.2 Public Debt Management without the Control of Exchange Remittances?

The Bank of England seemed to have resolved the transfer problem, at least by ensuring that there were sterling funds to meet London commitments, while the trading banks had mitigated the domestic budgetary crisis. In the agreement for the exchange pool, or the 'Mobilisation of Foreign Exchange', the New Zealand Government would issue Treasury bills to cover the payment of London funds, and for the exchange on the transfer (or remittance). The Chairman of the Associated Banks, J.T. Grose, confirmed a discount rate of over 5% on Treasury bills, an apparently 'low rate' suggested by Park, which afforded the Associated Banks only a 'trifling profit'.³⁷ The banks' saw the situation as a question of meeting 'National Liabilities', given that Treasury could no longer borrow abroad, but stated that the deal would end if borrowing resumed without the Associated Banks' concurrence. Initially, Grose was hostile to Treasury's continued requests for information on the banks' reserves or sterling funds, and refused to supply the totals of debits and credits to London balances.³⁸ Treasury was concerned that raising London loans be accepted as desirable for maintaining the public works programme, and this need

³⁴ Norman/Wilford, 16/2/32, B.of E., G14/282.

³⁵ Wilford/Norman, 25/2/32, B.of E., C40/282.

³⁶ *Ibid.*, "a deficit is not a proof of incompetency but merely a symptom of the economic condition."

³⁷ J.T. Grose/Forbes (PM), 28/1/32, copy on A29/27.

not have any impact on exchange requirements. The Prime Minister, Forbes, insisted that the Government have a complete understanding of the international trading position as a whole, and this required the information on the relative position of exchange resources.³⁹ The Minister of Finance, Stewart, had received an analysis of the combined banks' net sterling funds, with their assets exceeding liabilities by £9 million and with gold reserves added, the total figure was £20 million.⁴⁰ The banks secured their dominance in the exchange market with the ability to allocate the government's exchange needs.⁴¹

An indication of the position of the banks, and their perspective on New Zealand business, was that the Treasury bills issued to them would be domiciled in Melbourne, with the Government having the option to repay in Wellington. This was immediately altered at some of the banks' request, to give them the option to require payment in Wellington.⁴² The Audit Office questioned both this and having to complete Treasury bill transactions before the sterling funds were remitted (by cable) to London, and the sterling lodged on behalf of the Government, given that this reversed the usual practice. The Minister explained that, "under the present financial position in which the Government is placed there is no alternative but to agree to the procedure demanded by the lenders."⁴³ The Audit analysis suggested that, when the January instalment of £866 667 had been remitted, the High Commissioner had then invested £950 000 on fixed deposit.⁴⁴ This indicated that the money remitted was not actually needed for at least a month, and a high interest cost was involved, with the Treasury bill rate higher than deposit rates.

In February 1932, papers were prepared for the Economy Commission, which was to consider the areas of government requiring retrenchment.⁴⁵ Treasury had concentrated on

³⁸ Grose/Forbes, 14/1/32, copy on A29/47.

³⁹ Forbes/Grose, 20/1/32, copy on A29/47.

⁴⁰ A.H. Tocker/W.D. Stewart, 10/2/32, Stewart Collection, MS-985-10-13, Hocken.

⁴¹ Minister of Finance/Controller & Auditor-General, 29/1/32, on A29/47. Two banks, Union and Australasia missed their respective payments (£83 333 and £50 000) in the first £1 million remitted.

⁴² Minister of Finance/Controller & Auditor-General, 3/2/32, on A29/47.

⁴³ Minister of Finance/Controller & Auditor-General, 19/2/32, on A29/47.

⁴⁴ R.M. Sunley/Controller & Auditor-General, 2/2/32, A29/47. See note 41 above, to clarify the figures.

⁴⁵ E.P. Neale, 'The Crisis in New Zealand', *Economic Record*, 8, 1932. The 'Economy Commission' was in fact named the National Expenditure Adjustment Commission; the result was the National Expenditure Adjustment Act passed in emergency parliamentary sessions in 1932, to cut wages, rent, and interest rates.

reductions in interest payments. On the subject of compulsory reduction, Treasury had indicated potential repercussions for future borrowing, and also stated that no advantage would come from reducing rates for Treasury accounts or the Post Office.⁴⁶ It appears that Treasury made a subsequent submission, in which they suggested that interest could be saved by abolishing the system of separate statutory accounts. Treasury gave one example of when it was necessary to “borrow £200 000 in London at short notice, even though the money was not immediately required, and there was more than sufficient cash in the Public Account in the bank.”⁴⁷ The inference to Treasury’s view seemed to be that, having separate accounts with a cash margin prevented the close investment of the cash balance across all accounts. Despite section 39 and 40 of the Public Revenues Act, the system would have to change. In fact, Treasury continued its practice of raising Treasury bills under one account’s authority, and using it to make interest payments in London.⁴⁸

Charging the costs of remittance to separate accounts was difficult before the exchange pool commenced, and Treasury’s method of dealing with exchange had been questioned. Under the new method of remitting money during 1932, it was impossible to “ascertain for the purpose of what account the remittances are used.”⁴⁹ On the one hand, funds were now definitely remitted, where before there had been internal transfers between the public account in Wellington and London, treated as investments even if the money was intended for interest payments. Uniformity now emerged in the monthly remittance of £1 million being treated as investments of cash balances. The Audit Office had questioned the exchange cost of remittances when transfers were made to cover the 1929 London loan maturity, if treated as an investment, though the funds were then used for interest or sinking fund payments.⁵⁰ If it was not an investment made from cash balances and a borrowing authority being utilised, there must be an allocation of the cost of exchange to a particular account. Exchange costs were always incurred on the remittance to London.

⁴⁶ Park/Chairman, National Expenditure Commission, 11/2/32, T52/702.

⁴⁷ Quoted in the Audit draft, ‘Separate Accounts’, February 1932, A35/34/1.

⁴⁸ R.M. Sunley/Controller & Auditor-General, 5/3/32, A29/13.

⁴⁹ R.M. Sunley/Controller & Auditor-General, 3/2/32, A29/14.

⁵⁰ R.M. Sunley/Controller & Auditor-General, 4/12/30, A29/14.

But remittances involved more than a transaction cost once the exchange rate had been devalued, because all foreign receipts and payments were affected. The only proper method of treating exchange costs, with the rate depreciated by 10%, was “by converting all receipts or payments in foreign currencies to New Zealand currency for the purpose of the New Zealand accounts.”⁵¹ The necessity for currency conversion was not accepted by Treasury: its view was that the currency was still based on the gold sovereign, and a payment in £NZ was the same in sterling “regardless of what the rate of exchange may be at the time.”⁵² The London loan issue for £5 million was a debt of £NZ 5.5 million, but that amount had not actually been received in New Zealand for the accounts to disclose.

The effect of the exchange rate on debt management had emerged with the redemption of securities in Australia, under a favourable exchange rate, as this saved exchange costs on the remittances. The effect was similar to repaying stock with a market price at a discount, but under the Repayment of Public Debt Act, the exchange that had been saved was legislatively tied to the loan redemption account.⁵³ With Treasury’s treatment of remittances, the debt would have remained at the figure before the exchange rate had changed, rather than show the actual exchange cost of redeeming the securities; and the Public Debt Repayment Account was to be ‘debited’ for the difference, termed a profit. The Audit Office sought a legal opinion from the Crown Law Office on the practice. After reviewing Treasury and Audit’s positions, the Crown Solicitor saw no reason to debit the account for a nominal debt figure. In this legal opinion the correct transaction method meant: “a liability in an overseas country to be discharged in the currency of that country [is] to be recorded in the Public Accounts according to New Zealand currency.”⁵⁴ Statutes did not expressly differentiate a New Zealand currency from sterling, but gold was not in circulation and it could no longer be exported to make payments. The local currency differed in value from sterling, so public debt must be interpreted in that light.⁵⁵

⁵¹ Sunley’s memo, 3/2/32, A29/14.

⁵² B.C. Ashwin/Currie, 27/10/31, copy on A29/14.

⁵³ R.M. Sunley/Controller & Auditor-General, 27/8/31, A29/41.

⁵⁴ Currie/Controller & Auditor-General (Urgent), 27/10/31, on A29/14.

⁵⁵ *Ibid.* Mr Currie’s opinion was that, even with a common monetary unit, the term parity was redundant.

The Attorney-General, W.D. Stewart, preferred Treasury's view, unless the Crown Law opinion was somehow proved to be correct.⁵⁶ The fact that the question of currency conversion had been addressed by the Crown's legal authorities, and the Attorney-General had still endorsed Treasury's position, may be explained by the fact that Stewart was also the Minister of Finance. The legal position could be made right with validating legislation, but the accounting practices would remain, and exchange remittances were central to interest payments in London. The analysis in the Audit Office was not always clear on exchange, unless it was based on the assumption of one-way transfer, with the government always having to remit money to London over and above loan proceeds. Audit's analysis seemed to find an exchange premium in loan proceeds to be used by the loan accounts for expenditure after its remittance.⁵⁷ But there was no actual remittance of loan proceeds while there was interest to be paid in London, all the sterling stayed put.

In December 1931, W.D. Stewart (as Attorney-General), had made an interim ruling under the Public Revenues Act 1926, transferring any costs of exchange on remittances to the Consolidated Fund.⁵⁸ This decision also affected the unusual exchange premium with Australia, when its exchange rate had depreciated against sterling further than the New Zealand rate on sterling. In early 1932, there was also an example of exchange costs having to be paid on remittances within the public accounts: the Post Office held government stock which was domiciled in London, and being inscribed on the London register meant that Treasury paid the interest there, so exchange costs would be incurred on remittance. By retaining the interest payment in London, Treasury avoided exchange costs on remittance, and deprived the Post Office of the profit in New Zealand currency.⁵⁹ Audit's point was that this could not work the other way around: payment made in London for the Post Office would see the exchange costs recouped from its account. Treasury proposed the transfer of the stock to the New Zealand register, and with its low market value, the "change would be useful for window dressing purposes."⁶⁰ The

⁵⁶ Secretary to the Treasury/Controller & Auditor-General, 13/11/31, on A29/14.

⁵⁷ R.M. Sunley/Controller & Auditor-General, 19/11/31, A29/14. There were no remittances in this case.

⁵⁸ B.C. Ashwin/Controller & Auditor-General, 18/12/31, T47/290, on A29/14.

⁵⁹ R.M. Sunley/Controller & Auditor-General, 16/2/32, A29/14.

⁶⁰ D.A McCurdy/Secretary to the Treasury, 21/3/32, T15/22/19, copy on A29/14.

permission of the Bank of England would have to be sought, but given the exchange situation, it would be better for such securities to be domiciled locally.⁶¹

By April 1932, Treasury had asked the Minister to reconsider the interim ruling he had made (as Attorney-General) on the accounting for overseas transactions, being now urgent with the end of year accounts held up by the Audit Office.⁶² In late 1931, the Law Draftsman, J. Christie, had also addressed the issue of the exchange profits on Australian transactions. Christie contended that no essential change in law had occurred from the exchange situation, whereby a distinction could be made between the £NZ and £Australian, and the question was not one of a separate currency value rather than a transaction cost on exchange.⁶³ The point was directed at the Crown Law opinion favouring Audit's view, but he still criticized the Audit Office for treating separate accounts as if they were independent entities with rights as individuals, that had led to unnecessary legislative amendments since 1929.⁶⁴ Christie also suggested that as no legal question had been identified by the Crown Solicitor's opinion Treasury need not allocate exchange costs to separate accounts. But Treasury also sought the advice of 'public' accountancy firms on the exchange transactions. One firm considered the Post Office investment in London, and appeared to be closer to Audit's view, but noted that the effect was to question the accounting method for all overseas transactions.⁶⁵ If this applied to London loans, Treasury could still claim that cash was not remitted, though it was later used in London to pay interest. Treasury might also apply the same principle to interest payments on loans in Australia. The other firm concurred in the view that it was not a question of 'currency exchange', sterling was sovereign, and 'temporary fluctuation of remittance exchange rates' was simply a phase.⁶⁶ Thus the "pound Australian and New Zealand are, apart from exchange fluctuations, identical;" this being the basis for Treasury advice to the Minister on the method of treating exchange in the accounts.⁶⁷

⁶¹ G.C. Rodda's note, 24/3/32, on McCurdy's memo. He had stated that exchange was being paid twice.

⁶² Secretary to the Treasury/Minister of Finance, 9/4/32, copy on A29/14.

⁶³ J. Christie/Attorney-General, 5/11/31, copy on A29/14.

⁶⁴ *Ibid.* Legislation "regarded by Sir Otto Niemeyer, as a grotesque example of a waste of mental energy."

⁶⁵ Clarke, Menzies, Griffin & Ross/Secretary to the Treasury, 31/3/32, copy on A29/14.

⁶⁶ Ernest Hunt, Turner & Heslop/Secretary to the Treasury, 7/4/32, copy on A29/14.

The 'pound-sterling must be pound-NZ fallacy', was embedded in Treasury's thinking, according to R.M. Campbell, and this may have been deliberately ignored by the historian of the Reserve Bank, G.R. Hawke.⁶⁸ Though no Treasury files remain as the witness to this, it is obvious from correspondence with the Audit Office. In 1932 there were practical examples of the use of currency conversion in the public accounts, such as in the payment of imperial pensions by the British Government, which were remitted from London to Wellington.⁶⁹ Beyond the intricate accounting system, the real reason for maintaining that a pound was a pound irrespective of location was the fiscal impact of revaluing public debt. W.D. Stewart attempted to defuse the question of exchange by referring the case for a legislative amendment to Sir Francis Bell. Bell took the view that it was hopeless to expect agreement about the currency conversion question, and thus simply excluded it in drafting a clause to deal with each exchange transaction as a separate event.⁷⁰ Section 55 of the 1932 Finance Act gave the Minister of Finance the power to debit or credit any account, when the result of a transaction was an exchange cost (or profit). The Audit Office claimed that the proposed section robbed statutory funds of any independence, even when they had separate bank accounts, and meant that certain exchange losses could be ignored.⁷¹ The rights of individuals receiving imperial pensions were already affected, despite the arbitrary use of Ministerial power.

The result was that the exchange premium on debt redemption in Australia, even under the Repayment of Public Debt Act, would be transferred to another account under section 55.⁷² The difficulty then was not that exchange premium was to be dealt with separately, but that the Treasury's practice was to record it as part of the cost of making the payment in Australia.⁷³ The Treasury method was as if to make a nominal payment in sterling, and then deduct the difference in exchange rates, rather than record the actual transaction cost. Treasury maintained that exchange rates had no bearing on the payments of cash held overseas, but did make an exception for the payment of imperial pensions to

⁶⁷ Treasury memo, 9/4/32. Treasury relied on the absence of currency law, and the fiscal deficit concern.

⁶⁸ R.M. Campbell/W.B. Sutch, 16/8/73, MS-1900-15, ATL. Hawke had adopted a "pro-Treasury line."

⁶⁹ R.M. Sunley, 'Notes on reports...in respect of transactions involving exchange', 18/4/32, A29/14.

⁷⁰ F.H.D. Bell/Controller-General[sic], 29/9/32, on A29/14.

⁷¹ R.M. Sunley/Controller & Auditor-General, 6/5/32, A28/30/32.

⁷² Secretary to the Treasury/Controller & Auditor-General, 13/5/32, T47/290, on A29/14.

individuals, claiming that the dispute was only over which account to use for exchange transactions.⁷⁴ Audit pointed out that payments in Australia were remitted, as cash was not held there. Likewise, the imperial pensions were remitted from London, and the actual cost to the British in sterling differed, so the individual in New Zealand received a greater sum in New Zealand currency.⁷⁵ Treasury stated that Audit was introducing the idea of currency conversion into the accounts, when the issue was only the exchange on individual remittances.⁷⁶ The currency conversion would have affected all transactions.

Treasury therefore saw the wider implications of currency conversion. Thus, if “overseas transactions were revised and 10% added to all the amounts paid in Great Britain, the effect would be to increase the deficit for the year by a substantial amount.”⁷⁷ The Audit Office later realised that section 55 had been enacted primarily to avoid the budget deficit being increased.⁷⁸ Treasury had reason to be concerned with the wider fiscal impact in May 1932, as it sought to borrow in London to fund the maturing Treasury bills, arranged by the Bank of England. Meanwhile, the Audit Office sought another legal opinion from the Solicitor-General regarding payments in Australia. Treasury was able to submit some points on the topic, and it was suggested that cash was remitted to augment receipts in London, and treated as a temporary investment, even though all remittances were used to pay interest.⁷⁹ But Treasury also insisted that its officer, the second Assistant Secretary, B.C. Ashwin, advise the Crown Solicitor on the question. Ashwin appears to have maintained the artificial distinction between payments made in another country from existing funds, and payments made through a remittance, as if the existing funds had not been remitted.⁸⁰ Treasury subsequently told the Minister that it was impossible to say whether payment in London was made out of cash remitted or out of cash received, as the transfer from New Zealand was for the net amount required.⁸¹ All payments in London

⁷³ Controller & Auditor-General/Secretary to the Treasury, 16/5/32, A29/14.

⁷⁴ Secretary to the Treasury/Controller & Auditor-General, 18/5/32, T47/290, on A29/14.

⁷⁵ Controller & Auditor-General/Secretary to the Treasury, 19/5/32, A29/14.

⁷⁶ Secretary to the Treasury/Controller & Auditor-General, 21/5/32, T47/290, on A29/14.

⁷⁷ Secretary to the Treasury/Controller & Auditor-General, 26/5/32, T47/290, on A29/14.

⁷⁸ R.M. Sunley/Controller & Auditor-General, 27/5/32, A29/14.

⁷⁹ Assistant Secretary to the Treasury/Solicitor-General, 2/6/32, on A29/14.

⁸⁰ Crown Solicitor/Controller & Auditor-General, 22/6/32, on A29/14.

⁸¹ Acting Secretary to the Treasury/Acting Minister of Finance, 4/7/32, copy on A29/14.

would be dealt with at face value, without reduction because of exchange rates. The Audit Office's analysis suggested that currency conversion was actually occurring on all other exchange transactions, except for the remittances to Britain.⁸²

The Prime Minister again sought the advice of Sir Francis Bell, as the Crown Law opinion appeared to support Audit's case, with the logical result appearing to be the complete recasting of the public accounts.⁸³ As it happened, Bell agreed with Audit's case for the form of the Treasury accounts, but not for currency conversion.⁸⁴ Treasury did explain its position on the Crown Law Office opinion, which had maintained that the £NZ was different to both the Australian currency and sterling. Treasury believed that this was merely a 'theory', or a contention that it did not have to accept. Thus, "the par of exchange remains pound for pound irrespective of whether Great Britain is on or off the gold standard."⁸⁵ With no alteration in currency laws, the rates of exchange oscillated around par, now with a discount on remittances. Treasury did follow the logic of exchange costs, knowing a £5 million loan in London added £NZ5.5 million in debt.

5.3 The Return to London Borrowing and Modifying the System of Accounts

The Bank of England officials, Niemeyer and Kershaw, were also concerned with the exchange rate question, and wanted to assist Park and Treasury avoid another exchange devaluation. As early as February 1932, Park had cabled the Bank about the possibility of converting the £4 million in Treasury bills into inscribed stock, when they matured in June. Niemeyer felt it was important to indicate it was possible to raise money, "and that the sooner we could encourage Park with that hope, the better."⁸⁶ Under the exchange pool agreement with the Associated Banks, any loan would reduce the monthly exchange quota in proportion, and a loan would have to be advertised as for the repayment of bills. In March, the Finance Officer met with the Governor, who felt that it was then an

⁸² R.M. Sunley, 'Notes on Approval of Minister dated 4/7/32', on A29/14.

⁸³ Forbes/Bell, 19/9/32, T47/290, copy on A29/14.

⁸⁴ F.H.D. Bell/Prime Minister, 3/10/32, copy on A29/14.

⁸⁵ Acting Secretary to the Treasury/Controller & Auditor-General, T47/290, on A29/14.

⁸⁶ Niemeyer (Paris)/Kershaw, 11/3/32, B.of E., OV59/16.

opportune moment to place a £4 million stock issue.⁸⁷ Toms had been keen to borrow an extra £1 million as a fresh loan for public works. The Governor then suggested to the High Commissioner, “that the New Zealand Government should be very thankful at the prospect of being able to extricate themselves from the very difficult situation into which they had fallen.”⁸⁸ The matter of enlarging the loan was directly related to the finance from the banks, and reducing their Treasury bill accommodation for exchange. If a loan increased public works spending, the banks still provided the same level of funds.⁸⁹

In early April 1932 then, it appeared to be back to the normal borrowing, with a stock issue for £5 million at 98.5. When the Audit Officer in London got to see the papers involved, it was clear that the brokers had wanted a heavily discounted price, but the Governor of the Bank of England considered the figure too low. A delayed issue, in hope of the market improving, proved unfortunate. When the issue opened with the market reeling from the “Krueger defalcations”, 47% of the stock was left with underwriters, though still inscribed in the name of Scrimgeours.⁹⁰ The underwriters were still quite happy while the stock traded at a small discount. But then “on the news of the riots in New Zealand the Scrip fell away to a 3% discount.”⁹¹ The Chairman of the Bank of New Zealand was also concerned at ‘riotous occurrences’ affecting the country’s credit.⁹²

By May, the Government’s transfer of funds for the interest payments and maturing debt until December seemed assured, and various proposals were being made for the banks to switch their funding to domestic spending. However, the exchange pool had been under continuous pressure due to the export licensing system. The Bank of England were concerned that, with the government’s exchange requirements resolved, an end to the pool would allow for exchange depreciation. The National Bank had suggested that, “if the licensing system were brought to an end an attempt would undoubtedly be made by the Bank of New South Wales to depreciate the New Zealand pound and that the other

⁸⁷ Memorandum, ‘New Zealand’, 10/3/32, B.of E., G1/335.

⁸⁸ Memorandum, ‘New Zealand’, 15/3/32, B.of E., C40/282.

⁸⁹ Notes on figures provided by Willis of the National Bank, R.N. Kershaw, 5/4/32, B.of E., OV59/16.

⁹⁰ Hore/Controller & Auditor-General, 20/5/32, on A29/65.

⁹¹ Ibid. “With the advent of cheaper money and the improvement in the gilt-edged market the scrip rose.”

⁹² ‘Banks and public, adverse criticism’, *Evening Post*, 17/6/32.

banks would be unable to resist the downward movement.”⁹³ A concern about the depreciation was with accumulating sterling balances not being used in New Zealand.

In June 1932, with the success of the London loan, the exchange pool was abolished. Prime Minister Forbes said there was no justification for assuming that the exchange rate would fluctuate; but ‘London opinion’ assumed that the pool would be required again in the future.⁹⁴ By contrast, Professor Belshaw of Auckland University was quoted as saying the exchange rate would go up when the pool was abolished, though depreciation by at least 30% was needed to counteract the policy of deflation. Meanwhile, politicians and officials departed for the Imperial Economic Conference, in Ottawa. The New Zealand contingent, including A.D. Park, W.D. Stewart, and Gordon Coates, were expecting to discuss an ‘Empire currency’, and the role of an Imperial chain of central banks.⁹⁵ But the substantive currency discussions were to be held afterwards in London, where R.N. Kershaw had supervised the drafting by J. Christie of the Reserve Bank bill in 1931. The Bank of England was particularly keen for the bill to be finally introduced.

G.R. Hawke has claimed that the Bank of England did not initiate discussions with Treasury over the Reserve Bank bill, and advised Park in London on countering the opposition of trading banks.⁹⁶ It was apparently not until March 1933 that Niemeyer expressed concern about the drift on the legislation, according to Hawke. It was clear at the time that Niemeyer and the Bank of England required a central bank that maintained convertibility of the internal currency with sterling, and that sterling was expected to be returning to the gold standard.⁹⁷ Gordon Coates had cabled to Wellington from Canada to proceed with the Reserve Bank bill on the lines of the existing draft, Park adding that his second assistant (Ashwin) could handle matters.⁹⁸ Meanwhile, Park and Stewart would arrive in London for meetings in August 1932. Park’s prior cable had sought any

⁹³ ‘New Zealand’, R.N. Kershaw, 4/5/32, B.of E., OV 59/16.

⁹⁴ ‘The Credits Pool’ and ‘London opinion’, *Evening Post*, 16/6/32.

⁹⁵ M.E.R. Bassett, *Coates of Kaipara*, Auckland 1996, p.187.

⁹⁶ G.R. Hawke, *Between Governments and Banks*, Wellington 1973, p.42.

⁹⁷ A.H. Tocker, ‘The Development of Central Banking’, *Economic Record*, 15, 1939, p.46; and Tocker, ‘The Reserve Bank of New Zealand’, *Economic Record*, 10, 1934, p.90.

⁹⁸ Park/Rodda, 11/8/32, T52/717.

news from London about converting the short-dated bonds issued in 1931.⁹⁹ When Park arrived in London, the High Commission could inform him that nothing had been borrowed from the banks since the abolition of export licensing. Sir Thomas Wilford also informed Stewart that he would arrange for him to meet with Montagu Norman about the borrowing, but it would be a few months before a loan could be raised to replace existing debt.¹⁰⁰ The focus of negotiations would be to reduce interest payments on the government's previous war borrowing, and the 'funded' debt was subsequently frozen. Park was also informed by cable that the Prime Minister had approved of his review of the London Audit officer's operation, but the Auditor-General had objected.¹⁰¹

W.D. Stewart had a preliminary discussion with Montagu Norman at the Hotel Metropole on 15 September 1932. The Governor of the Bank of England explained that he could meet Stewart because his government were customers of the Bank, while certain officials of other governments were rebuffed; and that while New Zealand would be free to issue bills for revenue purposes again, no Treasury bills were to be sold in advance of long term stock issues.¹⁰² The New Zealand government was not in the formal position of the British government, and any decisions on Treasury bill issues would be made through the Bank of England. Stewart reported: "to enable me to advance discussion in relation to short term market facilities and details of co-ordinating machinery required... will be glad to know if you have decided to go ahead with legislation for central bank as suggested by me from Ottawa."¹⁰³ The use of London's short term market would allow cash to be remitted to Wellington, to repay Treasury bills costing over 5% in New Zealand. Park arranged with the BNZ earmarked sterling funds, so the transfers could be safeguarded.¹⁰⁴

Park's deputy, G.C. Rodda, cabled in late September, informing him that the Reserve Bank bill was being prepared along with a Loans Consolidation bill incorporating section

⁹⁹ Park/Treasury, 19/8/32, T52/717.

¹⁰⁰ Wilford/Stewart, 13/9/32, on T53/2/1.

¹⁰¹ Rodda/Park, 15/9/32, T52/717

¹⁰² Notes of meeting, 15/9/32, B.of E., G1/335.

¹⁰³ Stewart/Prime Minister, 16/9/32, T52/717.

¹⁰⁴ R.N. Kershaw/Governor, 4/10/32, B.of E., OV59/16.

42 of the Public Revenues Act.¹⁰⁵ Section 42 authorised the issue of Treasury bills in London, in anticipation of loans raised under a borrowing authority, to a limit of £1 million. Park had wanted to alter the section to delete the limit entirely, but the move was rejected by the Bank of England.¹⁰⁶ Park then met with Sir Frederick Phillips of the British Treasury to enlist his support for the conversion of the short-dated bonds, despite the Bank of England's embargo on colonial conversion loans. Phillips also informed the Bank that Park had discussed the issue of 'revenue' Treasury bills, which were repaid by the end of the financial year, but were also currently prohibited.¹⁰⁷ Apparently, Park had disclaimed "all intention of raising money by Treasury bills in order to finance capital expenditure or for the purposes of being able to postpone long term borrowing."¹⁰⁸ New Zealand's Treasury was trying to economise on expensive local issues, and Park's plea was for a £4 million issue per year. Norman replied that the New Zealand issues had caused considerable trouble, would now be issued through the Bank, and a remittance programme had to be guaranteed so there was sufficient sterling when bills fell due.¹⁰⁹

Park had been notified that the Chairman of the Associated Banks had approved the Reserve Bank bill, as long as it was identical to Niemeyer's draft. However, Niemeyer's recommendation meant legislating for strict parity with sterling on the gold trading points, which had become impossible while the gold standard was suspended. The legislation would now require that an Order-in-Council be made to link the currencies in the future.¹¹⁰ Park had approached the Bank of England to enquire if that proviso was possible, given the prevailing exchange conditions, so that the gold standard was to remain the fundamental basis of the legislation.¹¹¹ This entailed a legal, or 'de jure stabilisation' of the currency on gold. The Bank was quoted as saying: "the whole idea of stabilisation is meaningless if it is possible to move on and off a standard in response

¹⁰⁵ Rodda/Park, 26/9/32, T52/717.

¹⁰⁶ R.N. Kershaw/Chief Cashier, 4/10/32, B.of E., C40/282.

¹⁰⁷ F. Phillips/Governor, 10/10/32, on B.of E., G1/335.

¹⁰⁸ Ibid. Phillips also reported that a local body, Matakaoa County were about to default on their loan.

¹⁰⁹ Norman/Phillips, 13/10/32, B.of E., G1/335.

¹¹⁰ Rodda/Park, undated, T52/645, "Central Bank discussed with cabinet, Coates valuable assistance.

Prime Minister calling a meeting of Coalition parties to explain. Article 46 links currency to sterling."

¹¹¹ 'New Zealand Reserve Bank', R.N. Kershaw, 3/10/32, B.of E., OV59/16.

to temporary changes in price levels.”¹¹² Park’s cable with this edict for ‘stabilisation’ was forwarded by the Prime Minister to Gordon Coates, who had been lobbying for a devaluation.¹¹³ The legal form of stabilisation and a convertible currency prevented this.

In October, Park cabled Wellington for an Order-in-Council to be provided for in the legislation, with no specific period defined in which the legal stabilisation would occur. The legislation would have no restrictive effect on the Reserve Bank setting the exchange rate, especially as the Bank of England would lend one of its officers to act as the first Governor.¹¹⁴ However, the Associated Banks questioned the Bank of England’s idea of convertibility: how could it ensure the value of notes remained stable, given the obvious evidence of sterling’s floating exchange rate, and the scant prospect of revaluing the £NZ?¹¹⁵ In the Associated Banks’ view, therefore, guaranteeing stability within a narrow range was the essential permanent task of a central bank, but understood as a general principle rather than a legal obligation. It appeared that Coates was not prepared to have convertibility, understood in terms of exchange rate parity, if not ‘de jure’ stabilisation.

As Park and Stewart sailed from England, the banks appeared to be ready to depreciate the currency once again, to prevent a black market ‘bounty’ on informal exchange transactions.¹¹⁶ Park assumed that Treasury had lectured the banks on the exchange instability being contrary to the Ottawa resolutions, especially in view of the effect on the sterling value of external loans.¹¹⁷ Park and Stewart had returned to find the exchange question ‘raging’, but the BNZ Directors had rejected devaluation.¹¹⁸ There had also been vague discussions of a compulsory conversion of the public debt to a lower interest rate, but no decisions made. The Reserve Bank bill had been introduced, but faced obstruction from the BNZ. That Park suddenly became ill had also stalled proceedings. Stewart might have felt that some progress was made, in the consolidation of the NZ Loans Act proceeding through Parliament, along the lines of Niemeyer’s advice in 1930.

¹¹² *Ibid.*, and Park/Treasury, 4/10/32, T52/717.

¹¹³ Forbes/Coates, 5/10/32, is in W.B. Sutch collection, MS-93-244-1, ATL.

¹¹⁴ Park/Rodda, 18/10/32, T52/717.

¹¹⁵ R.N. Kershaw/O.E. Niemeyer, 14/11/32, B.of E., OV59/16.

¹¹⁶ Rodda/Park (Rangitane), 17/11/32, T52/717.

¹¹⁷ Park (Rangitane)/Rodda, 19/11/32, T52/717.

The 1932 Loans Acts enactment had been preceded by a Finance Act, which included an apparently innocuous clause amending the 1926 Public Revenues Act. The new clause dealt with the 'recoupment' of interest from separate accounts to the Consolidated Fund. Under the "new proposal the securities of separate accounts will lose their identity," and while the interest due would be calculated, it would not actually be paid.¹¹⁹ Treasury's clause had been drafted in late November, and provided for the Minister of Finance to fix the interest rates for loan accounts without actually identifying the specific securities.¹²⁰ The Audit Office was made aware of the amendment on the day the Finance Bill was to be introduced, 7th December 1932.¹²¹ The clause was made necessary because the Loans draft legislation, rather than being merely consolidating legislation, did involve new departures from the existing system of separate accounts. In fact, the consolidation bill was "intended to destroy the connection between any particular loan and the account for which the loan was raised."¹²² As the clause had been intended only if the Loans Act consolidation proceeded, and had been scheduled since September, it was also designed to circumvent any legal dispute from the Audit Office. It was obvious that if the securities were not identified with an account, it was pointless to calculate interest due from separate accounts. Stewart claimed that the connection between particular loans and the identifying accounts would be preserved in Treasury records. Apparently, "the procedure proposed for dealing with unpaid interest in respect to loans issued in New Zealand is already in existence for interest accruing due through the Bank of England to London investors."¹²³ But the investor did not need to know which account was linked to his security, or the particular way in which his money was expended. The recoupment of interest within the public accounts, under section 5 of the Finance Act 1932 (#2), was defined so as to apply to any fund or statutory account using loan money.¹²⁴

Treasury subsequently clarified the effect of the 1932 Loans Act. The public debt would now be recorded in capital accounts, but with individual borrowing authorities replaced

¹¹⁸ W.D. Stewart/R.N. Kershaw, 24/12/32, B.of E., 0V59/16.

¹¹⁹ B.C Ashwin/Minister of Finance, 30/11/32, T40/15.

¹²⁰ Ashwin's draft, 30/11/32; D.A. Welsh, 'Legislation 1932', 8/9/32, both on T40/15.

¹²¹ G.C. Rodda/Controller & Auditor-General, 7/12/32, T40/15.

¹²² Controller & Auditor-General/Minister of Finance, 8/12/32, A33/50.

¹²³ Stewart/Controller & Auditor-General, 9/12/32, on A28/48.

by the Loans Act. In the debt records, "it will be possible at any time to say how much of any particular [loan] issue is for the purposes of a particular account."¹²⁵ The idea was to categorise securities, as to price, interest rate, and maturity date. But besides the interest payable, there also needed to be a way of determining the costs of brokerage and other expenses in terms of separate accounts.¹²⁶ Similar difficulties would be found when dealing with the vouchers for redemptions, temporary investments, and exchange costs, but the legislative basis of Audit's position had been undermined. In passing the Debt Conversion Act 1932-33, with operations to convert the internal public debt to a lower interest rate, it became impossible to identify specific securities in separate accounts.¹²⁷

The Audit Office assembled examples of anomalies under the Loans Act to present to Gordon Coates, Stewart's successor, in September 1933. Coates replied that "individual holdings of stock on the London register have not, at any time, been allotted to a particular account, and the Treasury proposals merely involve an extension of this practice to debentures and New Zealand stocks."¹²⁸ The fact that investors were not concerned with the borrowing authorities on their securities did not necessarily mean that the system of separate accounts was redundant. This is what Niemeyer had, in effect, advised in 1930, and Coates was merely facilitating it. It was ironic that Niemeyer's advice had first been pursued in the public debt legislation, not the Reserve Bank Act.

5.4 Devaluation and the Question of the Surplus Sterling Funds

Gordon Coates had written in January 1932, that the "question of fixation of the exchange rate is at the moment of decisive importance."¹²⁹ A year later it was probably of less economic importance, but politically it was time to strike. Coates' understanding in 1932 had been that the Minister of Finance could fix the exchange rate, in consultation with the banks. Later in 1933, Coates realised that concession rather than 'consultation'

¹²⁴ R.M. Sunley/Controller & Auditor-General, 7/2/33, A23/47, copy on A28/30/32(2).

¹²⁵ B.C. Ashwin/Controller & Auditor-General, 13/2/33, T42/62, on A28/48.

¹²⁶ R.M. Sunley/Controller & Auditor-General, 18/2/33, A28/48.

¹²⁷ B.C. Ashwin/Controller & Auditor-General, 19/9/33, T42/62, on A28/48.

¹²⁸ Coates/Controller & Auditor-General, 15/11/33, on A28/48.

¹²⁹ Coates/Prime Minister, 23/1/32, Coates Papers MS-1785-38, ATL.

was the more apt description of negotiating with the banks over the exchange rate. There had already been the experience of the exchange pool, when the banks had claimed that to safeguard London funds it was necessary to effect exchange control, although the banks had also suggested that their balances weren't under pressure at the existing exchange rate.¹³⁰ Coates devalued the exchange rate from a 10, to a 25% discount on sterling, and as the banks were likely to accumulate sterling funds, they sought to indemnify any losses resulting from a return to parity.¹³¹ This situation was complicated by the knowledge that the Bank of England expected central bank legislation to include a legally binding clause for convertibility, for the return to exchange parity with sterling.

As Treasury later admitted, the Associated Banks held a strong tactical position in the negotiations. Under the resulting Bank Indemnity (Exchange) Act 1933, the Government agreed to purchase any surplus sterling reserves from the banks, but the banks could define what was 'surplus' to requirements. Treasury were aware of the "dangers of the arrangement being exploited by the banks and the advantages they would obtain from, in effect, obtaining high rated investments in New Zealand instead of low rated ones in London."¹³² It seemed clear that the form of indemnity was unnecessarily generous.¹³³ There was, in fact, something of a pre-history of the banks putting up proposals that would earn them over 5% on government debt. In 1931 the Banks had proposed a rate of 5% for borrowing by the Government, which was looking to increase deposit rates to prevent the drain on Post Office funds, if the tax on the note issue was held.¹³⁴ The banks were consistent, but Coates realised that paying 5% because of the note tax faced by banks was exorbitant.¹³⁵ But there was no need to convince Treasury of this fact.

Coates had essentially tried to fix an exchange rate controlled by trading banks, without the financial machinery of a central bank. The banks' operations were still based on sterling reserves in London. The Bank of England was aware of the problem with the

¹³⁰ H. Belshaw, 'Crisis and Readjustment in New Zealand', *Journal of Political Economy*, 41(6), 1933.

¹³¹ Bassett, pp.190-1, 195.

¹³² Secretary to the Treasury/Minister of Finance, 28/9/33, in W.B. Sutch collection, MS-92-244-1, ATL.

¹³³ Belshaw, 'Crisis and Readjustment', p.765. Belshaw was, of course, working for Coates at the time.

¹³⁴ Secretary to the Treasury/Minister of Finance, 31/3/31, T52/668.

¹³⁵ Coates/Stewart, 16/5/33, W.D. Stewart Collection, MS-985-1/1/46, Hocken.

Treasury bill rate commanded by the banks. Kershaw was somewhat perplexed by the arrangements made with the banks: it was not clear how the question of indemnity arose unless the currency appreciated; and as the Government was seeking to hold the rate, it was running the exchange risk on the sterling it held.¹³⁶ The National Bank in London suggested refusing to convert the holdings of long-dated stock, a total of £10 million, “if the Government would not play the game in the matter of sterling.”¹³⁷ Coates decided not to tolerate such unreasonable tactics from the banks, as he could recall their notes, or issue Treasury notes against revenue and for every sovereign that the banks held.¹³⁸

In April 1933, Coates cabled the High Commissioner to inform him that the government was transferring £2.25 million of surplus exchange from London to Australia.¹³⁹ In effect, this was a transfer of sterling to the Australian Government, immediately increasing their London balances, while saving New Zealand the interest on Australian domiciled debts. The second leg of the proposal was that, as in the previous year, it was proposed to issue ‘revenue’ Treasury bills in London, if the Bank of England would allow it. The new Finance Officer, A.R.F. MacKay, indicated that the short-dated bonds could then be repaid. Kershaw stated that revenue bills could not be issued to cover for shortages caused by remittances or debt repayment; but the bills could be issued if limited to £3 million, under the Bank’s control, and repaid upon maturity.¹⁴⁰ Coates reaction to this was that surplus exchange was expensive in terms of the Treasury bills held by banks, some benefit was gained in reducing the banks’ holdings, if the revenue bills could be renewed.¹⁴¹ He also stated that export proceeds had been bought as surplus exchange.

The sterling purchased under the indemnity agreement with the banks had been placed in a separate account with the BNZ, and escaped the Audit Office’s scrutiny. The Auditor-General told the Minister of Finance that it was not possible to verify whether the surplus exchange being purchased from the banks was from the normal seasonal rise in export

¹³⁶ Kershaw, ‘New Zealand’, 26/1/33, B.of E., OV59/16.

¹³⁷ ‘Confidential’, 24/2/33, B.of E., OV59/16. Mr Willis was told the alternative government was worse.

¹³⁸ Coates/Stewart, 16/5/33. Coates said that this was necessary to get the Banks to agree to an exit clause.

¹³⁹ Coates/High Commissioner, 3/4/33, copy on B.of E., OV59/1.

¹⁴⁰ ‘New Zealand’, L. Lefeaux, 5/4/33, B.of E., OV59/1.

¹⁴¹ Coates/High Commissioner, 6/4/33, on B.of E., OV59/1.

receipts, or due to the exchange rate change; and only the latter was intended under the Indemnity Act.¹⁴² The only evidence of exchange purchases and sales came from the Chief Auditor of the BNZ, seen by the Audit Office as an insufficient basis to exercise a statutory authority. The BNZ's Chief Auditor subsequently wrote to the Minister, suggesting that the legislation did not limit the sales of sterling, and that 'seasonal fluctuations' were not easily defined.¹⁴³ Coates explained to the Audit Office that a clause in the agreement prevented the banks off-loading the exchange derived from exports, as the government only had to hold £1 million for re-sale to them.¹⁴⁴ The agreement with the banks therefore appeared to mean different things to the parties involved. In fact, the government was carrying a loss in the sense of having taken over the London funds that would in any case have been held by the banks for its London payments.¹⁴⁵ The investment of the surplus exchange in London, in the Australian Government securities, was also questioned. The legislation did not provide for the re-sale of sterling, other than to the trading banks, nor was the investment authorised as part of the public account cash balance under section 39 of the Public Revenues Act.¹⁴⁶

It now became clear that the Government had not actually purchased 'surplus' exchange, in the sense of that being surplus to the ordinary requirements for payments in London, given the devalued exchange rate. The Auditor-General sought an opinion from the Solicitor-General, to ascertain if the surplus exchange could be used for general purposes, such as making interest payments in Australia.¹⁴⁷ As the surplus exchange funds were not in the public accounts, strictly speaking, legislative authority was required to use exchange for another purpose. The Minister admitted a legal technicality had arisen in utilising the 'surplus exchange' for interest payments.¹⁴⁸ In clarifying a point with the Secretary to the Treasury, the Solicitor-General had been informed of a transaction to redeem Treasury bills issued under the Indemnity Act and replace them with 'revenue'

¹⁴² Controller & Auditor-General/Minister of Finance, 5/5/33, A29/69.

¹⁴³ Chief Auditor, BNZ/Minister of Finance, 17/5/33, copy on A29/69.

¹⁴⁴ Coates/Controller & Auditor-General, 23/5/33, on A29/69.

¹⁴⁵ R.M. Sunley/Controller & Auditor-General, 27/5/33, A29/69.

¹⁴⁶ Controller & Auditor-General/Minister of Finance, 26/5/33, A29/69.

¹⁴⁷ Controller & Auditor-General/Solicitor-General, 16/6/33, A29/69.

¹⁴⁸ Coates/Controller & Auditor-General, 30/6/33, on A29/69.

Treasury bills.¹⁴⁹ This seemed to imply that the statutory limits on the issue of Treasury bills could be exceeded. Then there was the matter of identifying the exchange used for normal requirements. Treasury explained that, in practice, all exchange had been bought through the 'one channel', and that the 'net surplus' was just a residual left after the amounts for normal payments calculated.¹⁵⁰ In other words, all sterling exchange had been bought under the Indemnity Act, rather than just a surplus resulting from changing the exchange rate. The purchase of millions of sterling exchange appeared to be illegal, and any saving on remittance was outweighed by the interest cost on Treasury bills.¹⁵¹

In May 1933, the banks also wanted Treasury to inform them of the amount of exchange utilised for normal requirements in London, on a monthly basis.¹⁵² With £5 520 000 (sterling) purchased from the banks up to May, it was estimated that a further £14.5 million would be sold in the rest of the year. The Minister was also reminded that the £4 million figure for outstanding Treasury bills had been exceeded, that those Treasury bills had been issued for surplus exchange, and would not be reduced even if later used for other purposes. Coates appears to have been rather irritated by this approach from the banks, and at the figures provided by the BNZ.¹⁵³ The Bank of England was made aware of the details from the National Bank, and it appeared that the BNZ were using the short-term funding requirements of the government to ensure that the Reserve Bank began operations in a "state of comparative helplessness."¹⁵⁴ Although the other banks were also concerned with the liquidity of the Treasury bills, they did not want to embarrass the Government, and would continue funding the bill issues. In fact, the banks were buying Treasury bills just to utilise their sterling balances, and were not making new advances.¹⁵⁵

On June 30, Coates cabled to the Prime Minister in London, that the Treasury bill programme of £12.5 million for the financial year was being held up the BNZ.¹⁵⁶ Coates

¹⁴⁹ Solicitor-General/Controller & Auditor-General, 29/6/33, on A29/69.

¹⁵⁰ Secretary to the Treasury/Controller & Auditor-General, 29/7/33, T48/6, on A29/69.

¹⁵¹ Controller & Auditor-General/Secretary to the Treasury, 7/8/33, A29/69.

¹⁵² Chairman of the Banks/Minister of Finance, 4/5/33, Coates Papers, MS-1785-39, ATL.

¹⁵³ See Coates' annotations on Grose/Coates, 15/5/33, Coates Papers, MS 1785-39, ATL.

¹⁵⁴ R.N Kershaw/Governor, 26/5/33, B.of E., G14/282.

¹⁵⁵ Note on cables from NZ government, 26/6/33, B.of E., OV59/17.

¹⁵⁶ Coates/Forbes, 30/6/33, T52/645.

suggested meeting with Bank of England officials concerning the technical details of central banking, to help assuage the BNZ, something the Bank was keen to do. So in early in July, 1933, the Bank of England devised a plan for Forbes:

“2(a) The Government quite obviously cannot promise to redeem their treasury bills in cash on demand.

(b) That instead of using the £6 million sterling, which the Government expects to have surplus as the result of purchasing exchange, to pay off debt in London and Australia the Government might sell it to the Reserve Bank and with the proceeds redeem a large portion of the Treasury Bills now held by the banks who would then get cash balances. In this way Bills could be redeemed in the least objectionable way, the Reserve Bank having 100% sterling cover against the liabilities created.

(c) That the way to deal with the internal Floating Debt must be by a gradual process of funding through the issue of internal loans.”¹⁵⁷

After a conference at the Bank of England in July, Forbes cabled back to Wellington a brief description of the plan. It was also suggested that the banks be assured of a reduction of the Treasury bills to £4 million, if the Reserve Bank were established.¹⁵⁸

The Bank of New Zealand then sought a condition on the issue of Treasury bills: that the Reserve Bank would not begin operations without first arranging with the BNZ to liquidate the Treasury bills it did not want to renew.¹⁵⁹ The new funding programme involved a total requirement of £22 million from the banks: half the Treasury bills were issued under the indemnity arrangements, with £5 million in revenue bills, and the remainder funded public works and the budget; the total would be halved in 1934.¹⁶⁰

Following the meeting at the Bank of England on the Reserve Bank's role, the Prime Minister again met the Governor and Kershaw, concerning on-going debt questions. The High Commissioner had already signalled that the sinking fund payments were still an issue, and later, that surplus sterling could be used to repay short-dated bonds.¹⁶¹ Forbes wanted to reprise the discussion of issuing 'revenue' Treasury bills in London, at a greater level than the £3 million that the Bank had decided the market could bear.¹⁶² The Governor was not willing to concede any ground on Treasury bill issues, or an attempt to

¹⁵⁷ 'New Zealand', 5/7/33, B.of E., OV59/17.

¹⁵⁸ Forbes/Coates, 12/7/33, Coates Papers, MS-1785-41, ATL.

¹⁵⁹ Buckleton/Minister of Finance, 17/7/33, Coates Papers, MS-1785-39, ATL.

¹⁶⁰ Chairman of the Banks/Coates, 19/7/33, Coates Papers, MS-1785-31, ATL.

¹⁶¹ Wilford/E.M. Harvey, 6/6/33, B.of E., G1/335

suspend the sinking fund payments. The Treasury official, G.C. Rodda, had tried to argue that that the Repayment of Public Debt Act had only been mentioned in loan prospectuses since 1925, and did not cover debt created before that; in response the Bank of England said the intention of the 1925 Act was to cover the total public debt.¹⁶³ In regard to the conversion of bonds, New Zealand had faced an embargo, as had all securities in the trustee category, but this had been lifted for Australian conversions.¹⁶⁴ The Governor could keep a place for a New Zealand issue but the remainder of the Australian stock would take precedence.¹⁶⁵ The Australians were aware of the other Dominion debtors seeking to convert, and had threatened to default on loans if they were not first in line.¹⁶⁶

With the Government having to purchase the whole of the net surplus of London exchange for the 1932-33 financial year, including the export receipts, there was then £3.6 million surplus exchange.¹⁶⁷ In 1933, a further £4 million had been purchased, double that required for normal payments. It appeared that some of the banks were accumulating funds in Australia, and not drawing on their London balances. With the net surplus sterling rising to a possible £10 million, the cost of exchange and interest on Treasury bills would add £2.5 million to the budget deficit.¹⁶⁸ Due to the fiscal impact of the banks' agreement and the sales of £12 million, Treasury preferred an exchange rate revaluation. By October 1933, Treasury reported that it was faced with having to acquire £16 million in excess of its own sterling requirements – four times the estimate that had originally been made.¹⁶⁹ Treasury suggested that special legislation would be required for the treatment of surplus exchange if it were not to be imposed as a charge on the Budget; but then stated such a move would be looked upon as expedient, and affect investor confidence. Therefore, rather than have to legislate for a separate account showing the effect of the transactions in exchange, Treasury could separate the cost of

¹⁶² 'New Zealand, notes of discussion', 19/7/33, B.of E., G1/335.

¹⁶³ 'New Zealand, Suspension of Sinking Funds', R.N. Kershaw, 14/7/33, B.of E., G1/335.

¹⁶⁴ 'Provisional programme under "Embargo"', 12/7/33, B.of E., G1/335. South African and Canadian conversions also followed the two Australian loans, totalling £32 million, preceding New Zealand.

¹⁶⁵ 'Notes of discussion' 19/7/33. The main stumbling block was default by NZ local authorities.

¹⁶⁶ Cain, N. & S. Glynn, 'Imperial Relations under strain: The British-Australian debt contretemps of 1933', *Australian Economic History Review*, 25, 1985, pp.39-40, 47.

¹⁶⁷ Secretary to the Treasury/Minister of Finance, 16/8/33, Coates Papers, MS-1785-39, ATL.

¹⁶⁸ *Ibid.* This was based on a purchase of £20 million of exchange, at a total cost of £5 million.

¹⁶⁹ Secretary to the Treasury/Minister of Finance, 10/10/33, Coates Papers, MS-1785-41, ATL.

surplus exchange purchases from the budget statement; then present the exchange costs as a 'suspense item' in the financial statements. Treasury had noted in August that the operations of the Reserve Bank would alter the situation, as sterling funds were taken over and the banks' holdings of Treasury bills cancelled. In October, Treasury stated that this matter was separate from the budgetary one, even though the Indemnity Act would be repealed, and the Reserve Bank could credit any profits from the transactions to the public account. Park quoted Norman's comment, that if the £NZ was still at the devalued level, and sterling assets were taken over at par, the Reserve Bank would 'write up' the assets and pay the difference to the public account. But the Bank of England's Governor had "regarded the present depreciation of New Zealand currency as temporary only."¹⁷⁰

Park had referred to the Minister of Finance's own public statements, that the devaluation (or pegging the exchange rate) was intended for the duration of low export prices. In other words, the exchange rate devaluation was a temporary expedient, and should not be incorporated into the Reserve Bank legislation. Of course, it would be incorporated into the Reserve Bank Act, as Park appeared to realise, because of the situation caused by the arrangement with the banks for purchasing sterling; also for the budgetary relief to be obtained from ending the agreement along the lines indicated by the Bank of England. But the question of the treatment of exchange in the public accounts was still unresolved. In August 1933, Treasury had informed the Audit Office that, "basically our pound is identical with the pound sterling and there is no reason to suppose that we will not return to exchange parity with sterling as soon as the present economic strain is eased."¹⁷¹ Though it provided something of an excuse for the accounting practices, the Treasury obviously desired convertibility, as promised by Park to the Bank of England. There is some indication that legislation being prepared would separate exchange transactions from the public accounts, to have the sterling transferred to Wellington.¹⁷² It seems that secret borrowing in London was once again being mooted, as the fiscal crisis continued.

¹⁷⁰ Ibid. "It is a fixed principle that money policy is entirely a matter for the State which should carry all the costs and receive all the profits arising therefrom."

¹⁷¹ Secretary to the Treasury/Controller & Auditor-General, 21/8/33, T47/290, on A29/14.

¹⁷² Controller & Auditor-General/Secretary to the Treasury (confidential), 17/11/33, A29/69/1.

"You know that we have a loan of £17 millions due 1 Jan. 1940. You know also that we are right down to our statutory minimum Reserve (calculating our gold at face value in our currency). What concerns me most is the feeling of complete assurance in some circles here that we will be able to renew that loan at maturity whatever the state of our London funds and however much we play with our finances here. It will only be a question of what we will have to pay, is the opinion one hears expressed; and the idea of being allowed to default is pooh-poohed.

But is it certain we will be able to renew? Can we safely rely on the Underwriters covering the whole amount in case of need, or the Bank of England (or some other fairy Godmother) coming to our rescue if not?"¹

The Reserve Bank Governor, Leslie Lefeaux, in early 1939, sought from the Bank of England a foundation for his sense of foreboding over possible loan default. A former Deputy Chief Cashier at the Bank of England, Lefeaux was obviously aware of the formal conditions attached to borrowing in London. In 1938 he had reminded the Minister of Finance, Walter Nash, of the effect of the provisions of the Colonial Stock Act. Certain changes in financial policy, including having a guaranteed price and the Dairy Industry marketing account held at the Reserve Bank, meant that dairy export proceeds could be commandeered to ensure bondholders were repaid. Lefeaux referred to what might happen to 'us' in London during loan negotiations, given the reaction of the City to the events in New Zealand.² According to Sinclair, "Lefeaux apparently regarded himself as an agent of the imperial government and the Bank of England."³ Certainly the imperial government's influence on him is unknown, but Lefeaux was steeped in the 'traditions' of the Bank of England. In the personal correspondence that has remained in the Bank of England's files, Lefeaux is portrayed as an exasperated envoy coping with the misguided colonials.

In the January 1939 letter to the Deputy Governor, Lefeaux stated that the Bank must be looking on at events with amazement and alarm, wondering what was going to happen next. But it is somewhat odd that the real foundation for concern was unclear: "I am not

¹ L. Lefeaux/B.G. Catterns, 17/1/39, on B.of E., G1/339.

² Ibid. "I don't want our people to walk into serious trouble with their eyes shut."

³ K. Sinclair, *Walter Nash*, Auckland 1976, p.137.

quite sure as to how far London would be likely to go in giving us a well-deserved lesson.”⁴ But in this case, London had to include the City and Whitehall’s view.

Lefeaux was in the pivotal position concerning London loans, with the Reserve Bank having assumed a role in debt management and control of sterling exchange. But in early 1939, the Bank was obliged to impose exchange control, following a run on sterling reserves in 1938. Lefeaux had become most perturbed by the policies of the first Labour Government, and the implications for his well-defined concepts of debt management. He also maintained that the Minister of Finance had not given the Bank a clear formal statement on monetary policy, as the legislation indicated he would. Actually, Nash’s policy was quite clear, in holding down interest rates on local loans, and have the Reserve Bank take up Treasury bills to fund the State Housing scheme. The question was whether this ‘internal’ financial policy could be conducted without affecting sterling exchange. Lefeaux was sure that it couldn’t, but had taken the orthodox move to combat a loss of reserves in the London context, of raising the discount rate on Treasury bills. This was primarily a symbolic gesture, as there was no local short term money market to react to the higher rate, but it sent a clear signal to the London market, and to the Minister.

Lefeaux had been counselling the Minister, to build up “our balances in London to a more respectable level, as well as behaving in a more seemly way here.”⁵ However, behaving in a ‘more seemly’ way was a matter of perspective, if seen as a reference to the issue of Treasury bills, or ‘Advances to the State’ for new capital expenditure. The immediate question was maintaining the statutory reserve ratio, ie the proportion of gold and sterling assets to demand liabilities, as new money was used on public spending. The ratio was also affected by the loss of sterling funds, while the Reserve Bank was legally obliged to exchange local currency for sterling. But the legal obligation to exchange sterling had been suspended when exchange control was introduced in 1938. The legal obligation to exchange sterling had been defined in the 1934 Finance Act; and the

⁴ Lefeaux/Catterns, 17/1/39, on the other hand, Lefeaux also stated that, “nor do I want us to fail to do the decent thing – especially after a period of exceptional prosperity.”

⁵ Ibid. Lefeaux suggested that since the imposition of exchange control, “it has been rather like trying to keep steady in a boat with a high wind blowing and a strong tide running.”

suspension clause was part of the 1936 Reserve Bank Amendment Act. The legal obligation under a sterling exchange standard was not necessarily the form of statutory stabilisation favoured by the Bank of England, defining convertibility by reference to gold trading points. Certainly the convertibility could not be maintained by the Reserve Bank at the devalued rate of 25%, the 1933 level. Lefeaux did not necessarily share the Bank of England's view on the currency standard. Before identifying the 1938 exchange crisis, and the effect on the 1939 loan conversion, the role of Lefeaux is examined.

6.1 The Sterling Exchange Standard and Debt Redemption 1934-6

The Bank of England had been officially consulted about devaluation in January 1932, and had (successfully) advised against it. But the Bank had not been consulted for the devaluation in January 1933; and in September that year exception had been taken to a statement, which was attributed to the Prime Minister, that there was a consensus of opinion in London favourable to the devaluation.⁶ There was also concern about the repayments of London loans by local authorities, especially the ability to service the loans in sterling after devaluation of the £NZ. The Bank of England and the Imperial Treasury stressed the moral obligation on the New Zealand government to see that local authority repayments were made in sterling. It seems that where certain municipal issues had given bondholders the option of receiving payment in New Zealand or London, payment could have been made at the current rate of exchange of £NZ, rather than in the full nominal value of sterling.⁷ Having decided to devalue, New Zealand would have to take the rough with the smooth: "the Government could not possibly have overlooked the fact that sterling obligations would be rendered more expensive when measured in [the] New Zealand currency."⁸ Treasury was still in a quandary over relative exchange values.

With the Reserve Bank not coming into operation until August 1934, the banks continued to restrict their purchases of sterling to regular trade payments, and refused to permit the remittance of capital. The Bank of England saw this as evidence that the £NZ was under-

⁶ 'New Zealand: Exchange Depreciation', 8/9/33, B.of E., G1/337.

⁷ 'New Zealand Municipal Issues', 29/1/34, B.of E., OV 59/2.

valued, but noted that this was a difficult point with 'many ramifications'.⁹ The question of the exchange rate was tied up with the government holding the sterling funds that had been purchased from the banks, to be then transferred to the Reserve Bank at the devalued rate. The transfer of sterling funds, at £100 for £NZ125, gave the government the opportunity to repay the Treasury bills held by the banks. This factor alone seemed to indicate that an exchange appreciation wasn't very likely, despite the Bank of England's wishes.¹⁰ With over £20 million in sterling in reserve, the Reserve Bank would be starting in a strong position, with more than twice the annual debt-servicing requirement. The way seemed clear to consider an optional redemption of London debt, although a major conversion operation was expected for local loans in 1937. With the Treasury bills held by the banks all repaid, there was still a question of the Reserve Bank's operations in dealing in securities with banks. The banks could always hold their reserves in sterling, rather than in New Zealand government stock or 'liquid' securities. The Banks Indemnity Act was repealed when the Reserve Bank was launched, so the banks no longer expected "the Government was for ever going to maintain them with a nice 5% investment."¹¹

In the lead-up to the Reserve Bank's inauguration, the Associated Banks appear to have maintained their public position on the exchange reserves, at least for politicians.¹² The question remained whether the Associated Banks would disclose the amount of sterling funds kept as reserve on New Zealand business, as the new legislation required. Lefeaux wrote that, "little purpose is served by a bank attempting to show what, if any, portion of its London funds may be regarded as held against New Zealand liabilities, as such funds cannot be earmarked for a specific purpose."¹³ In particular, the exchange rate difference with Australia had created the problem of 'three-cornered' transactions, or opportunities for arbitrage, where money for payments in London could be diverted through Australia to take advantage of the exchange rate. The Bank of England assumed the segregation of London funds had taken place since devaluation, when the banks had agreed to sell their

⁸ Note attached to memo, F. Phillips/E.M. Harvey, 13/9/33, on B.of E., G1/337.

⁹ 'New Zealand Exchange', 23/11/33, B.of E., OV59/2.

¹⁰ 'New Zealand', 23/1/34, B.of E., OV59/9.

¹¹ Niemeyer/Lefeaux, 8/6/34, B.of E., OV59/9. "I should imagine the Banks will be rather lachrymose now about it...a curious result of old Buckleton's frantic desire that Treasury bills be repaid not renewed."

¹² Notes of meeting of NZ Parliamentary Monetary Committee, 13/6/34, B.of E., OV59/2.

'surplus' sterling to the government under the Indemnity Act. Niemeyer insisted that the Reserve Bank needed to know if the banks, especially the Australian-based ones, were keeping external assets in London or not. Indeed, if the Australian banks were not made to do this at the beginning of the Reserve Bank's regime, an undesirable and "much more drastic separation of Australian and New Zealand banking" could occur at a later time.¹⁴ The calculations made for the Minister of Finance indicated that the banks' London assets had increased by £8 million in 1935, almost doubling from the previous year. The banks "apparently prefer to retain their surpluses of sterling in London and invest them at a low rate rather than sell to the Reserve Bank and thereby increase their balances."¹⁵

Treasury had estimated that there had been between £8-10 million 'temporarily sheltering' in New Zealand in speculative flows resulting from devaluation, as well as in the black market on exchange.¹⁶ But the Secretary to the Treasury continued to argue that sterling funds had accumulated at the previous exchange rate, depreciated 10% from par, so the current rate was undervalued. Meanwhile, Lefeaux had been considering the exchange rate with sterling, on the basis of the higher internal price structure in New Zealand compared with Britain. Lefeaux suggested to the former Minister of Finance, W.D. Stewart, that without the constraint of the gold standard the exchange rate could be altered to address the disparity of internal price levels.¹⁷ In his analysis of relative prices, the £NZ was still overvalued, not undervalued. Lefeaux's opinion was that keeping the existing rate of a 25% depreciation on sterling was necessary for certainty in the foreign exchanges, but it could go down further if reserves were not accumulating.¹⁸ Treasury and the Reserve Bank both sought an exchange stabilisation, then, but at different rates.

Treasury's idea of a legal basis, or 'de jure' form, of stabilisation, and therefore a permanent level for the exchange rate, came from the Bank of England. The Bank desired a statutory link with sterling that fixed the rate for exchange in legislation. The

¹³ Lefeaux/Niemeyer, 30/10/34, B.of E., OV59/9.

¹⁴ Niemeyer/Lefeaux, 13/12/34, B.of E., OV59/9.

¹⁵ 'Net increase in Public debt 1931-5', in W.B. Sutch Collection, MS 85-185-15, ATL.

¹⁶ A.D. Park/Lefeaux (confidential), 10/5/34, [ABTW, 7002, #1b].

¹⁷ Lefeaux/Stewart (confidential), 27/4/34, in W.D. Stewart Collection, MS985-10-15, Hocken.

¹⁸ 'Comment on Government Statistician's memo', 27/4/34, [ABTW, 7002, #1b].

Reserve Bank Act had only legally enshrined the exchange of bank notes for sterling, it had not fixed the rate for the sterling exchanged by the Reserve Bank. This meant the connecting link between the currency and sterling had not been formalised, and there was no statutory link. Therefore the government would have to set the exchange rate until stabilisation was achieved.¹⁹ This was to be addressed in the 1934 Finance Act, so the Reserve Bank could commence operations. But the Treasury argument implied that the exchange standard had in fact been suspended, until it could be stabilised at a fixed rate in legislation. The Minister of Finance, Gordon Coates, pointed out that the exchange rate movement was temporary in either direction, it could now be moved up or down; and “what is not yet legally determined is the rate at which New Zealand currency shall exchange for sterling.”²⁰ Despite the apparent confusion, Coates’s understanding was that the legal basis for sterling was clear, and the sterling exchange standard had been defined in the principal statute – in fact a New Zealand currency had emerged.

Lefeaux informed the Bank of England that “the die is cast, and we have decided to aim at giving the present rate of exchange an extended trial,” though this was not to be regarded as an endorsement of the devalued rate.²¹ Lefeaux doubted sterling would accumulate at the present rate, but if it did it could be used for the annual debt servicing of £7 million in sterling, while new borrowing was being avoided. Indeed, given the dependence on the London market, it seemed wise to have this ‘de facto’ stabilisation on sterling, and wait for sterling’s ‘de jure’ stabilisation.²² Lefeaux also thought that the consolidation of the ‘Sterling Bloc’ along these lines was possible, linking sterling and its dependent currencies. The Bank of England entirely agreed with an imperial currency bloc being formed at that time. Thus, a ‘strong’ letter was drafted to Lefeaux, endorsing the de facto stabilisation of the £NZ, even though sterling was off the gold standard.²³ This apparently created an area of stability around sterling, if it meant that the dependent

¹⁹ Secretary to the Treasury/Law Draftsman, 25/6/34, T52/645.

²⁰ Coates/Secretary to the Treasury, 25/7/34, on T52/645.

²¹ Lefeaux/Governor (Personal & confidential), 23/7/34, on B.of E., G1/338; G14/282.

²² Ibid., “there was a feeling that it is essential for Britain to stabilise on gold before the Dominions attempt to stabilise on sterling...I incline to the opposite point of view.”

²³ Norman/Lefeaux, 6/9/34, B.of E., G1/338.

currencies could devalue. The Bank had previously opposed devalued currencies, but it now recognised that de jure stabilisation limited freedom of action for central banks.²⁴

The effect of the exchange rate on public debt still had to be dealt with, and Coates seems to have wanted to avoid a series of payments in and out of the Consolidated Fund, due to any exchange variations. In November 1934, Coates and the exchange policy came under attack in the Legislative Council, by Sir Francis Bell, for the result being that interest payments had increased by 25%.²⁵ Sir Francis also claimed that the public debt had been increased by £25 million in the previous year, although this counted Treasury bills held by banks; and he compared this to the £70 million a former Prime Minister had promised to borrow. Coates replied that up to £5 million had been gained in £NZ, when exchanged for £20 million in sterling, in setting up the Reserve Bank. However, Coates also implied that there would be no early return to the old parity with sterling. The press picked up on this, as Coates had effectively made devaluation a permanent change in the currency law.²⁶ This also meant that accounting practice had become an issue again.

The Audit Office once more queried the Treasury practice of appearing to ignore the difference in exchange rates, or did not discriminate between currencies in charging costs in the public accounts. Treasury had even used 'three-cornered' transactions: by first remitting money to London through the banks, and then using the sterling to invest in Australia, until the Australian currency was needed for debt redemption there.²⁷ The issue remained significant while the exchange rate with Australia was at a premium, and, rather oddly, Treasury were effectively accounting for exchange costs in Australian currency. Treasury seemed to confirm this in reply to the Audit query, by maintaining the view that payments were made from funds held in Australia, and no actual remittance occurred because cash from investments was used.²⁸ The Audit Office was able to make

²⁴ Notes by Overseas & Foreign Department, 28/8/34, B.of E., OV59/9; Norman/F. Phillips (personal), 28/8/34, G14/282; with stabilisation, it was believed sterling was strengthened by dependent currencies.

²⁵ 'High Exchange', *Dominion*, 7/11/34, with numerous annotations on A29/14.

²⁶ 'The Burden of Debt', *Evening Post*, 7/11/34, on A29/14, annotated by Sunley: "Mr Coates stated before the Public Accounts Committee in 1933 that if the exchange depreciation were permanent he thought that Audit would be right in requiring that exchange be properly brought to account."

²⁷ R.M. Sunley/Controller & Auditor-General, 14/12/34, A29/14.

²⁸ B.C. Ashwin/Controller & Auditor-General, 25/3/35, T44/8, on A29/14.

its point more effective, due to the premium on exchange with Australia rather than with the discount seen in the London rate, because the accounts for debt repayment would show a greater cost than was actually paid.²⁹ However, the point seemed to have been covered by section 55 of the 1932 Finance Act, as designed by Sir Francis Bell. Treasury then sought an opinion from the Solicitor-General, merely to confirm the rhetorical question: “as a unit of account is not the New Zealand pound the same as the Australian pound?”³⁰ The opinion given by Crown Solicitor cited an Australian case, as had been suggested by Treasury, to indicate that the difference in value of the respective pounds was recognised as a rate of exchange not a separate currency. The Auditor-General pressed for another legal opinion, but Treasury countered this by indicating the wider implications of the Audit position. If Treasury’s view was not adhered to, “the only alternative is to convert all payments overseas at the current rate of exchange on the assumption that the New Zealand, Australian and British pounds are different units of account.”³¹ The Solicitor-General, H.H. Cornish, accepted the Treasury view, that the accounting system must be uniform, and that the nominal amount in pounds was the same except for the cost of remittances to Australia or London. The Treasury could also “assume a par basis for all overseas transactions and isolate fluctuations in the relative values of the various currencies.”³² Sir Francis Bell had also offered an opinion, based on the pound sterling being the unit of account, and costs of exchange on remittance being incurred on that basis.³³ This resulted in the absurd situation where a pound had the same value, as it had the same name, but different transfer costs between countries.³⁴ If there was a national currency, the accounting treatment of exchange was inappropriate.

However, London debt repayment was now determined by the sterling reserves of the Reserve Bank, and by the Governor. Lefeaux had entered into a ‘forward contract’ to sell the sterling funds to Treasury, for a maximum of £10 million in the financial year.³⁵ In

²⁹ R.M. Sunley/Controller & Auditor-General, 18/4/35, A29/14.

³⁰ Secretary to the Treasury/Solicitor-General, 30/4/35, enclosed with, B.C. Ashwin/Controller & Auditor-General, 2/5/35, T44/8, on A29/14.

³¹ Notes, B.C. Ashwin, 11/5/35, on A29/14.

³² Solicitor-General/Controller & Auditor-General, 21/5/35, on A29/14.

³³ ‘Vouchers and requisitions on payment of Public moneys abroad’, 14/6/35, on A29/14.

³⁴ R.M. Sunley/Controller & Auditor-General, 2/7/35, A29/14.

³⁵ Lefeaux/Controller & Auditor-General, 29/4/35, on A29/14.

February 1935, the High Commissioner had informed the Bank of England that the government were looking to conduct a conversion operation, and had £3 million in sinking funds to repay debt.³⁶ The High Commissioner obviously assumed the Bank of England's endorsement, but Lefeaux was cautious about depleting the London funds. His view was that new London borrowing was unthinkable in the meantime, and existence of idle funds provided for a potential drain of sterling, so it was imperative to maintain the London balances.³⁷ By May 1935, Treasury still intended to use the £3 million for debt repayment, and avoid other exchange costs in the budget.³⁸ Lefeaux had questioned the practice of remitting large sums to London for temporary investment, well ahead of the actual repayments. Indeed, "until required for use, the proper place for such funds is the 'reserves' of the Reserve Bank," and the arrangement for forward exchange cover did not entail early remittance.³⁹ Meanwhile, the Bank of England had selected a week in early June to be made available for the New Zealand loan conversion operation.⁴⁰

Lefeaux had also questioned the decision being made without prior consultation with him. Gordon Coates was in London, in June 1935, and was expected to attend meetings with the Bank of England. Lefeaux had suggested the Bank could inform Coates of the 'normal' functions of a Treasury, given the differences emerging in New Zealand on the 'normal' development of his institution.⁴¹ The Bank of England wasn't quite sure about how to read his request, though it had been intended to stress on Coates the need for exchange stability, and promote Lefeaux's ability as a policy advisor. It then emerged that Lefeaux resented the Secretary to the Treasury having a place on the Reserve Bank Board.⁴² He also had practical concerns about the banking arrangements in London, with payments still being made through the Bank of New Zealand, representing a notional loss in interest for the Reserve Bank balances. The Public Revenues Act required funds to be passed through the Public Account in London, at the BNZ, and the High Commissioner

³⁶ 'New Zealand', 15/2/35, B.of E., C40/282.

³⁷ Lefeaux's cable, 18/2/35, B.of E., G1/338.

³⁸ Secretary to the Treasury/Lefeaux, 22/5/35, T52/645/21.

³⁹ Lefeaux/Park, 23/5/35, RB17.01/7.

⁴⁰ 'New Zealand', 12/6/35, B.of E., C40/282.

⁴¹ Lefeaux/Norman (Personal & confidential), 2/5/35, B.of E., G1/338.

⁴² 'Points to be discussed with Mr Coates', 26/6/35, B.of E., G1/338. "#4 sale of govt interest in BNZ".

favoured the practice.⁴³ Coates was informed of the proper procedures during his interview with the Bank of England, but he also took the opportunity to raise the question of the Bank's management charges. The difficulties with Treasury were put down to its reluctance to surrender the management of loan operations. Treasury had also found the attitude of Lefeaux 'conservative' in the final allocation of Reserve Bank profit, as this had meant a substantial deficiency in revenue that Treasury had expected in estimates.⁴⁴ Coates had conceded the need for establishing the Reserve Bank on a sound basis while the circumstances made this possible. In other words, there was an awareness that other parties intended to take political control of the Reserve Bank. If Lefeaux had problems with Treasury, then the Labour Party was a greater threat to the Bank's independence.

6.2 Nationalisation, Internal Credit Inflation, and Capital Flight, 1936-38

The election of the first Labour Government in 1935 signalled legislative change for the Reserve Bank, and the removal of private shareholding. The Bank of England had consulted with J.B. Condliffe, and on the basis of his knowledge of Labour MPs, it was believed that the functions of the Bank would not be changed.⁴⁵ Lefeaux decided that the election result signalled a crisis for the Bank. With the safeguards for its independence now to be removed, the possibility of "unlimited inflation" was opening up, as the control of credit was lost.⁴⁶ It was likely that the prices of government inscribed stock in London would fall, making conversions more difficult; trade would also be affected, and therefore exchange control would be needed. If his position was undermined, Lefeaux suggested that he would have to resign. The Deputy Governor of the Bank of England attempted a soothing reply, emphasising the consequences of less capable hands in control of the Reserve Bank, and the "vital imperial interest" at stake.⁴⁷ Lefeaux took the point that stability was at stake, and that Nash was likely to proceed cautiously. However, he was aware of the views of Labour's 'inflationist' faction, that wanted to expand credit without statutory restraint, and which "looks upon the Bank of England and all it stands for as

⁴³ Rodda/Lefeaux, 1/8/35, T40/162/1.

⁴⁴ Norman/Lefeaux (Personal & confidential), 18/7/35, B.of E., G1/338.

⁴⁵ 'Note', 3/12/35, B.of E., OV59/2. Nash had said they would not tinker with the monetary system.

⁴⁶ Lefeaux's cable, 10/1/36, on B.of E., G14/282.

being obsolete and mainly responsible for present economic ills.”⁴⁸ The economic situation was actually improving, with buoyant export earnings and healthy sterling balances. Lefeaux wrote to the Bank of England that he wished to avoid the Reserve Bank being a ‘currency-issuing’ department of State, or the ‘play-thing’ of political parties; but realised the Reserve Bank was a “useful link in the chain” of the Empire.⁴⁹ The Bank of England observed that the Labour Party, in its own zeal for financial autonomy, might heed advice to avoid policies resulting in depleted sterling balances.⁵⁰

The major question for the Labour Government was the extent to which it was going to control exchange transactions, given the role of the trading banks, especially with the plans for dairy industry export receipts. Nash was aware that the banks had not adjusted their internal operations to centre on the Reserve Bank, and continued an accumulation of sterling reserves.⁵¹ It became clear that if the Reserve Bank was to control overseas funds, having the monopoly of sterling required more than just the control of export receipts. W.B. Sutch advised Nash that imports would have to be licensed, and other transfers to London controlled, otherwise the sterling funds of the banks could still be engineered in a flight of capital.⁵² Treasury was asked to submit its views on the control of sterling funds, and two points were emphasised.⁵³ Firstly, mobilising the sterling funds from exports and other receipts could be covered by regulation: the banks would have to comply this, or with any policy variation on the ratio of balances kept with the Reserve Bank. If that drastic action were taken, the exercise of control over the sales of sterling funds would also be necessary. This meant the legal obligation to exchange local bank notes for sterling would have to be suspended, without then abolishing the legal foundation for the currency. B.C. Ashwin advised that this form of legislative clause would be similar to that in section 18 of the existing Reserve Bank Act, which allowed the minimum reserve ratio of the Bank to be suspended. But overall, “the point to be stressed is that the measures taken to safeguard the London funds should not be such as to

⁴⁷ Harvey’s cable, 10/1/36, on B.of E., G14/282.

⁴⁸ Lefeaux’s cable, 13/1/36, on B.of E., G14/282.

⁴⁹ Lefeaux/Norman (Personal and secret), 13/1/36, on B.of E., G1/339.

⁵⁰ Harvey’s cable, 13/1/36, on B.of E., G14/282.

⁵¹ W.B. Sutch/Nash, ‘Control of Overseas and Internal Credit’, 18/3/36, N348, 0272.

⁵² *Ibid.* Dr Sutch’s paper ‘Exchange Control’ is on N348, 0102.

precipitate the very thing it is desired to avoid, ie a run on such funds.”⁵⁴ The amended Reserve Bank legislation included the proposed suspension, so Lefeaux realised that a form of control would later supersede the obligation to exchange notes for sterling.⁵⁵

The Bank of England observed that the changes to the Reserve Bank Act occurred while the balance of payments was in a healthy condition, due to export prices. With sterling funds of £20 million, the Reserve Bank’s reserve ratio was at 98%, largely because the trading banks had sold sterling to the Bank since the election.⁵⁶ Government’s spending programme was examined, including the Napier-Gisborne railway line, and considered to be reckless and inflationary. The Bank of England assumed that internal loans would be raised, and those government securities would be substituted for sterling assets, to repay London debt. With the existence of such large sterling reserves: “we should no doubt always be willing to have our debts repaid, particularly when a new Government is likely to weaken the security, unless it is very fortunate in the future course of export prices.”⁵⁷ Montagu Norman had private cajoled Lefeaux into staying put, and encouraged into a process of ‘willing collaboration’ with the Government to prevent sweeping changes.⁵⁸

By September 1936, the outline of Nash’s financial policy was becoming clear, just as he was about to embark to London for trade negotiations. Lefeaux sent a letter to Montagu Norman explaining the domestic policy before the Governor met with the Minister of Finance. Nash had tried to fix low interest rates on all financial operations, apart from local conversion offers. The Reserve Bank had agreed to a limited issue of Treasury bills to fund the Housing scheme, for £5 million at 1.25%; Lefeaux maintained that certain conditions applied to this, and it wouldn’t be repeated. But the main point was that Nash had, for the moment, withheld issuing the regulations to impose exchange control.⁵⁹ Exchange control had been seen as necessary to maintain low interest rates, though capital within New Zealand would have to be constrained first, but the funds held in

⁵³ B.C. Ashwin/Minister of Finance, 20/3/36, on N2305, 0642.

⁵⁴ *Ibid.*, “all that should be aimed at is reserve powers to take vigorous action should such be necessary.”

⁵⁵ Lefeaux/Norman, (Personal & confidential) 6/4/36, on B.of E., G1/339.

⁵⁶ ‘New Zealand’, 14/4/36, B.of E., OV59/2.

⁵⁷ *Ibid.*, repaying was “a good political move in view of the record of left wing Governments generally.”

⁵⁸ Norman/Lefeaux (Personal & confidential), 30/4/36, B.of E., G1/339.

London could still be drained. It was apparent that there would be imposition of exchange control when it became necessary. Meanwhile, the Bank of England reflected on the effect on the export surplus, when domestic inflation was stimulating more imports, and thus exchange instability.⁶⁰ The exchange regulations were discussed in London with Lefeaux, when he arrived; but the 'flight of capital' was by that time the real issue.⁶¹

In late December 1936, there was already evidence of a small flight of capital from New Zealand, as well as rising imports putting strain on London funds. The trading banks in London sought a meeting with Nash, under the auspices of the Bank of England, to discuss some banking issues in New Zealand. Nash seemed more concerned with establishing whether he could get an agreement with bondholders to lower the interest payments on London debt, without suggesting repudiation.⁶² But in London the banks had become 'oversold' on sterling: as well as the capital flight, the Reserve Bank's ability to gather up export receipts from dairy products was deemed too slow for the banks. The banks were looking to ration sterling in New Zealand, especially if any more export earnings were taken over by the Government, without being outright exchange control.⁶³

The specific problem seemed to be that the selling rate for sterling exchange offered by the banks was different from the Reserve Bank's selling rate, and despite a black market forming, the banks were not buying exchange from the Reserve Bank. The banks could have moved their rates: "this they profess to be unwilling to do, because of a promise to Lefeaux; but also, it is probable, from fear of the Government."⁶⁴ There seemed to be no fear when the bank representatives met Nash at the Bank of England in 1936. Rather than have to ration exchange, the representatives appeared to have preferred a system of import licenses.⁶⁵ Nash's interest was with concentrating the sterling funds of banks, through control by the Reserve Bank, but this would obviously provide an excuse for

⁵⁹ Lefeaux/Norman, 16/10/36, on B.of E., G1/335.

⁶⁰ 'Some comments on New Zealand Government Policy', R.N. Kershaw, 4/11/36, B.of E., G1/335.

⁶¹ W.B. Sutch/Nash, 14/5/37, on Nash/Rodda, 14/5/37, N2305, 0643.

⁶² Lefeaux/Norman, 21/12/36, on B.of E., G1/335; and see Secretary to the Treasury/Minister of Finance, 6/10/36, 'Overseas Debt Charges' (re-titled 'London Interest' by Nash), N2305, 0491.

⁶³ 'Points about Sterling funds', R.N. Kershaw, 14/12/36, on B.of E., OV59/2.

⁶⁴ *Ibid.*, "they know in the last resort they can buy from him at £125 [per £100] but this means a loss."

⁶⁵ Notes of meeting with Mr Nash, 17/12/36, on B.of E., G1/335.

them to restrict lending in New Zealand. It also assumed that the legal obligation to exchange sterling had been suspended.⁶⁶ The banks were still hoping to have taxation reduced on their New Zealand operations. But their main objective was to have the Reserve Bank change its sell rate for sterling exchange, to bring it into line with the banks' rate, with a concession of .125% on the banks' transactions.⁶⁷ Lefeaux was perturbed at this matter being discussed in London, as he felt it seriously undermined his authority in New Zealand.⁶⁸ The banks had really been looking to cover for their oversold sterling position. Lefeaux made the point that it was not a policy issue at stake, but the Reserve Bank's role in existing conditions that was actually being questioned.⁶⁹

The banks appear to have tried to minimise the transfer of capital items. But the flight of capital was created by the exchange rate between Australia and New Zealand, as it facilitated 'three-cornered' transactions by traders. Analysis prepared for Nash in May 1937, indicated that the exchange rate with Australia was not blocking the sterling transactions, where an Australian could make payments in London via New Zealand, and make a profit from the remittances.⁷⁰ The premium on the exchange rate with Australia was now unrealistic, and needed to be reversed if capital flight were to be halted. But this would also mean devaluing by the same proportion against sterling, which could embarrass the Government. Interest rates were also higher in Australia, attracting the transfer of funds, but matching the interest rate level was ruled out by policy despite the Reserve Bank obviously favouring an interest rate rise. The only solution seemed to be to acquiesce to the trading banks, and allow the .125% concession on sterling sales, as the Commonwealth Bank of Australia had permitted.⁷¹ This would have meant lowering the Reserve Bank's selling rate by .5%, to that offered by the banks. The exchange rates had been examined by B.C. Ashwin of Treasury, but he found no 'large leakage' of funds.⁷²

⁶⁶ Analysis by B.C. Ashwin, 3/9/37, N348, 0228.

⁶⁷ D.F. Reid, BNZ/Norman, 21/12/36, on B.of E., G1/335.

⁶⁸ Lefeaux cable, 16/1/37, on B.of E., G1/335.

⁶⁹ Lefeaux/Norman, 21/1/37, on B.of E., G1/335.

⁷⁰ 'Exchange rates and flow of funds to Australia', D.O. Williams, May 1937, N348, 0279.

⁷¹ *Ibid.* Williams stated that the Reserve Bank had arranged with the banks to sell them London funds at a concession rate, after government requirements were met. But at the time no funds had been offered.

⁷² 'Fears allayed, no large leakage', *Auckland Star*, 21/9/37, on Nash 2305, 0583. Nash has annotated the clipping at the point which suggested, erroneously, that he had asked 'banking officials' to examine rates.

In July 1938, the (alleged) flight of capital to Australia was again being investigated by Treasury. It reported to the Minister that the banks were discouraging the transfer of funds, as it used up their sterling balances; but also that three banks had notified Treasury that their sterling funds had been depleted down to nil.⁷³ The Reserve Bank had stated that the net overseas assets of the banking system had been reduced by £15 million since 1936. Lefeaux also noted that the price of New Zealand government stocks in London were now lower than that of comparable Dominions, and the yields relatively higher, “instead of maintaining the pre-eminence which for many years they enjoyed.”⁷⁴ The point about the yields was that this had occurred when Nash had tried to maintain low interest rates on government stock, therefore the rise appeared to be due to the form of control. Rather than exchange difficulties requiring a further devaluation, Lefeaux saw the fixing of interest rates as the crux of the whole position, especially for the discount rate on Treasury bills. These ‘Advances to the State’ lowered the reserve ratio, as the Reserve Bank’s liabilities were simultaneously increased. Evidence of this affected the overseas position, and the only way out was to ‘meet the market’ with a local loan, before the general election. The logic of debt management practice was to stimulate the price of existing securities, and this ensured that favourable loan terms were gained in the future.

Selling Treasury bills to the banks would have also prevented their local balances being converted into sterling, and London funds being lost.⁷⁵ Lefeaux was concerned with the coming loan maturity in London, and the need to have sterling balances to possibly repay. In fact, as government loans “were raised under the Colonial Stock Act, it is practically impossible to plead inability to pay at maturity, as holders could obtain a judgement in the British courts.”⁷⁶ Nash indicated a local loan issue to be made after the election, and Treasury bills to be issued to the Reserve Bank until then. But in placing this before the Bank’s Board, Lefeaux had also suggested the need to raise the discount rate.⁷⁷

⁷³ Secretary to the Treasury/Minister of Finance, 15/7/38, on N2305, 0676.

⁷⁴ Lefeaux/Nash, 12/7/38, RB17.01/3.

⁷⁵ Treasury bills for financing the Housing scheme were not to be on-sold to banks, on the instructions of the Minister, in September. Secretary to the Treasury/Governor, Reserve Bank, 5/9/38, T44/187.

⁷⁶ Lefeaux/Nash, 12/7/38. Lefeaux added, “and presumably all the dairy produce shipped to the United Kingdom could be attached if matters came to extremes.”

⁷⁷ Lefeaux/Nash, 1/8/38, RB17.01/9.

In October 1938, Nash had specifically asked Lefeaux what needed to be done to deal with the London loan maturities, along with the loss of sterling funds. Lefeaux was instinctively opposed to exchange control, but it would have enabled repayment to be made in the short term. But as New Zealand would be unable to repay in full, confidence must be created in the minds of British investors, and he noted investors in trustee stock usually preferred to renew.⁷⁸ The Government's financial programme for the year had already received a set-back, as a drain on the Post Office Savings Bank had developed, with £1.2 million in cash being needed in just two weeks. Due to the drain on cash, and the commitments to spending programmes, the only alternative was more Treasury bills being discounted by the Reserve Bank. As it was already holding £8 million in bills, the Bank could have been required to take up £20 million by the end of the financial year.⁷⁹ With this and the continued loss of sterling funds, the Reserve Bank indicated that it would raise the discount rate on new bills.⁸⁰ The flight of capital continued during October, with discrimination by the banks in selling sterling, but no change in the selling rate to bring it into line with that of the Reserve Bank. The Bank of England noted that the Reserve Bank was being forced to service some of the requests for small transfers due to the banks' restrictions, an indication that formal control of exchange was imminent.⁸¹

The Labour Government had been returned to power in the 1938 election with a renewed mandate for their policies, but with a serious financial situation. Lefeaux had attempted to persuade the Prime Minister that the Reserve Bank could not carry any more Treasury bills, unless there was the prospect of on-selling them. This meant that the Board would have to consider raising the discount rate.⁸² The Reserve Bank subsequently provided an analysis in a series of points, first by suggesting "the financial foundations are showing very definite signs of cracking."⁸³ The emphasis was on the loss of sterling funds, and the internal measures needed to build confidence with British investors. Officials agreed

⁷⁸ Lefeaux/Nash, 19/10/38, RB17.01/3. The Bondholder's "well-known inertia operates to the advantage of the borrower; and, unless he is badly frightened, he can be relied upon to accept reasonable terms of renewal to a considerable extent. Repayment of a small amount he likes..."

⁷⁹ Secretary to the Treasury/Minister of Finance, 25/10/38, T52/77.

⁸⁰ Lefeaux/Nash, 26/10/38, RB17.01/9. The increase to 2% on new bills excluded 'Housing' bills.

⁸¹ 'New Zealand', 19/10/38, B.of E., OV59/2.

⁸² Lefeaux/Nash, 3/11/38, RB17.01/9.

⁸³ Confidential memo, 8/11/38, on N1590, 0062.

that an internal loan at the market rate was essential to restore economic equilibrium. Treasury also sought an end to the use of Reserve Bank credit and a short term London loan at a high rate, which would not then affect domestic rates.⁸⁴ The most pressing problem was the drain on sterling funds, but Lefeaux remained implacably against exchange control, and claimed it would affect future London borrowing. On 18th November 1938, Lefeaux informed the Minister of Finance that the discount rate on Treasury bills would be raised to 4%, to apply to all bills being renewed including those for Housing. Nash claimed that the announcement of this rate would affect the internal loan being issued, but Lefeaux suggested that the price of such stocks had risen in any case, and the imperative was to prevent the 'depreciation of the currency' by inflation.⁸⁵ It later emerged that Lefeaux had also asked the trading banks to also raise their lending rates by 2%, but the banks declined, having feared government recrimination.⁸⁶

The Bank of England noted the change from the Labour Government's first term, when it had taken 'extensive powers', but did not directly affect the position of the Reserve Bank.⁸⁷ In the Bank of England's analysis, exchange control seemed inevitable to re-establish the sterling funds, given the capital flight. The Imperial Treasury was informed of the position, and the likelihood of the suspension of the exchange of notes for sterling. This was at least preferable to a devaluation that might influence other sterling-based countries.⁸⁸ It was also thought that devaluation would accelerate the capital flight. In fact: "Lefeaux's horror of exchange control would be justified, if it were a case of bolstering up an over-valued currency, but it is not."⁸⁹ Lefeaux himself seemed to believe that the position could be held, but the Bank of England weren't advising any particular policy, just that exchange control would be the least disruptive course.

On 25 November 1938, an inter-departmental meeting took place at the Board of Trade, to discuss a telegram to be sent to the New Zealand Government concerning the use of

⁸⁴ 'Restoring Economic Equilibrium', undated, on N348, 0239.

⁸⁵ Lefeaux/Nash, 19/11/38, RB17.01/3.

⁸⁶ 'New Zealand', R.N. Kershaw, 11/1/39, B.of E., OV59/3.

⁸⁷ 'New Zealand', R.N. Kershaw, 14/11/38, G1/339.

⁸⁸ Norman/S.D. Waley, 16/11/38, B.of E., G1/339.

⁸⁹ Folio 148, 21/11/38, B.of E., G1/338.

import controls. R.N. Kershaw of the Bank of England, stated that the United Kingdom should not let the exchange situation deteriorate if it could be saved; and it was decided to acquiesce in exchange control, despite officials having opposed Nash's views on control since 1937.⁹⁰ In early December exchange control was introduced, and the obligation of the Reserve Bank to exchange its notes for sterling was suspended. Although an apparent crisis measure, the Bank of England certainly saw it as a policy to 'insulate' the internal economy, at least from the effects of the Government's own imprudence.⁹¹ The use of 'public credit' for spending, with its inflationary effects, meant exchange control was really the denial of an effective 'depreciation of the currency'. Kershaw expected "an increasing degree of public complaint, which might ultimately lead to a change of Government."⁹² Lefeaux was by now struggling to keep the legal reserve ratio at 25%.

6.3 The 1939 Financial and Political Climacteric: or Insulating Internal Credit Creation?

The 1939 visit of Nash to London to negotiate a conversion loan of £17 million, has been interpreted by Sinclair and G.R. Hawke in the terms of the inadequacies of the Labour Government's financial policy. However, the real context was New Zealand financial policy of London borrowing since the 1880s, and the maturing loans had been actually arranged by the Agent-General in London. Nash's policy was to repay external loans, and to pursue a national development policy through internal credit creation, using the Reserve Bank's accommodation of Treasury bills. The Governor, Lefeaux, had tried to frustrate this by raising the discount rate. At some point Nash would have to have control of the interest rate on Treasury bills to continue the Housing scheme, and use was made of the 'war emergency' for this, and the 1939 Reserve Bank Amendment Act passed.⁹³ Though it had been recognised that Nash had passed this legislation to control the interest rate on Treasury bills for Housing in his history of the Reserve Bank, Hawke has subsequently decided that the Housing scheme was not funded by Treasury bills after 1939. Apparently the "Bank warned against, but accepted, the Labour government's

⁹⁰ Notes of meeting, 25/11/38, on B.of E., OV59/2. The Bank ensured the telegram did not make threats.

⁹¹ Norman/Lefeaux, 8/12/38, B.of E., G1/339.

⁹² 'New Zealand' draft, R.N. Kershaw, 9/12/38, B.of E., OV59/3. Kershaw later altered the sentence.

⁹³ U.K. High Commissioner to New Zealand, secret cable, 4/10/39, on B.of E., G1/339.

timid experiments with credit creation.”⁹⁴ Treasury bills continued to be issued in the 1940s, but Hawke believes that the London authorities had forced Nash into the change.

What was really at stake was whether the Labour Government had insulated its internal policies from external conditions, and could also retain the control of sterling funds for debt repayment. Treasury had reported in November 1938, that with the continued drain on the Post Office deposits, the whole of the works programme was being funded by the Reserve Bank. In January, it noted that the statutory reserve ratio was down to 26%, and “if disaster is to be avoided it is evident that loan requirements must be obtained from the public and not the Reserve Bank.”⁹⁵ The Bank chimed in, stressing the need to create the most favourable atmosphere possible for a loan conversion. Lefeaux also pointed out the paradox, or the perversity, of investors: the less healthy the sterling position of a debtor government, the greater the chance of repayment, and the less likely was loan renewal.⁹⁶ Lefeaux mentioned possible default, and bondholders invoking the Colonial Stock Act.

The more informative analysis of the financial situation in London, made available to Nash, had been written by the Finance Officer in the High Commission, R.M. Sunley.⁹⁷ Sunley noted the general factors that were depressing all gilt-edged stocks, especially the continued flight from sterling in London. Certainly the news from New Zealand, and particularly the suspension of the obligation to exchange sterling and the formal exchange control, had affected stock prices. But the “raising of the re-discount rate of the Reserve Bank caused further selling of New Zealand stocks”; and this had been accentuated by the underwriting arrangements for fresh Australian issues on the market.⁹⁸ Sunley reported that the brokers, J. & A. Scrimgeours, had approved of the exchange control measures, as likely to improve the possibility of a conversion loan. If this was timed to coincide with the export season in May, sterling funds would be higher, and small

⁹⁴ Hawke, *The Making of New Zealand*, Cambridge 1985, p.310.

⁹⁵ B.C. Ashwin/Nash, 11/1/39, N2305, 0509, £15 million had already been borrowed from the Bank.

⁹⁶ Lefeaux/Nash, 11/1/39, RB17.01/3.

⁹⁷ Finance Officer/Secretary to the Treasury, 15/1/39, T44/82, on N348, 0447.

⁹⁸ *Ibid.* News from New Zealand had an immediate effect on the market: “the Reserve Bank figures, which appear in *The Times* each Friday, much in advance of information received through other channels, are frequently quoted as a reason for movements in the prices of our stocks.”

investors would be considered more secure. Sunley also expressed doubt as to whether large repayments were desirable, as this would require further restrictions on imports.

Sunley sought a 'private talk' with the Bank of England in March, having been prompted by Treasury to get a lead, or 'start the ball rolling' on the conversion.⁹⁹ The Labour Government had not sought direction from Treasury yet, and were expecting most of the maturing loan to be converted. The lead was certainly coming from Lefeaux, who again wrote to the Deputy Governor, in early April, about the effect of the Colonial Stock Act. Clarifying his letter from January, Lefeaux asked if individual bondholders could follow an actual default with a court order on the assets of a Dominion government in London. If not, "it would appear that N.Z. sterling securities are not as well secured as [was] thought," at least by the bondholders.¹⁰⁰ This seemed to clarify the point that had perplexed the Deputy Governor, on the question of New Zealand 'not being allowed to default' by His Majesty's Government. B.G. Catterns had always taken the power of disallowance "to be a safeguard against new measures that might be objectionable."¹⁰¹ But this would have to be exercised before a default whereas, in practice, the sanctions could only be invoked after default. Lefeaux obviously saw the ability to suspend the reserve ratio of 25% as objectionable; but there was now the matter of the control of the discount rate.¹⁰² The Bank of England had checked with the Imperial Treasury about the conditions of the Colonial Stock Act, and the ability to seek disallowance before default. The reply to Lefeaux was debated within the Bank, and it was decided to agree with the technical point, but the possibility of default still seemed remote, even far-fetched.¹⁰³

On 12th April 1939, Nash received from Treasury extracts from Sunley's private letter, and notes of his meeting with the Governor of the Bank of England.¹⁰⁴ Norman had been completely non-committal on the subject of the conversion loan, other than inferring that £10 million would have to be repaid, and by disagreeing with the terms suggested by the

⁹⁹ 'New Zealand', 10/3/39, B.of E., G1/339.

¹⁰⁰ Lefeaux/B.G. Catterns, 3/4/39, B.of E., G1/339.

¹⁰¹ B.G. Catterns/Lefeaux, 20/2/39, B.of E., G1/339.

¹⁰² 'New Zealand', R.N. Kershaw, 28/4/39, B.of E., G1/336. Lefeaux would resign if Nash suspended.

¹⁰³ B.G. Catterns/Lefeaux, 25/4/39, B.of E., G1/339. Kershaw's note used the term 'far-fetched'.

¹⁰⁴ 'Extract from private letter dated 23/3/39', in Ashwin/Nash, 12/4/39, on N2305, 0396.

brokers. In any case, the Government had already sent a cable to the High Commissioner seeking to raise £10 million for public works, as well as converting the £17 million loan maturity.¹⁰⁵ The rationale for this was that New Zealand had not borrowed fresh money in London since 1932, and it was because of the reliance on local borrowing and some debt repayment that sterling balances had been depleted. With the addition of a £5 million loan for defence purposes, it all appeared hopelessly unrealistic to the Bank of England, in view of general market conditions. There were also the 'special difficulties', it being "useless to deny that New Zealand's somewhat ambitious domestic programme had affected the attitude of investors here."¹⁰⁶ The Bank of England assumed that the High Commissioner would not even bother approaching the brokers, but he immediately met with H.C. Scrimgeour. This confirmed that the market would not lend new money, even if market conditions improved, and that this was affected by the loan maturity.¹⁰⁷ Treasury reviewed the public works programme: no excess Post Office deposits were available, and by utilising debt repayment money, £22 million still had to be borrowed.¹⁰⁸

Treasury had excluded housing expenditure, and made the now familiar point about the use of Reserve Bank credit 'depreciating the value of the currency'. In May, work was begun on the budget, while Nash was on the boat heading for London. The local loan had been arranged as a 'short sharp' issue, and Treasury hoped it would give a fillip to market prices, having intended since November to try to boost confidence in the market.¹⁰⁹ The outlook for sterling funds was not improving, the Reserve Bank was still struggling to maintain the reserve ratio, but the only issue of Treasury bills to the Bank was for Housing (£600 000). According to R.N. Kershaw, Nash's immediate problems included providing cash in Wellington and London for new expenditure, and reconciling the loan failure with his past promises. It was thought that Nash might talk of possible default on the loan maturity; but any threat could be discounted, as New Zealand would probably be shut out of the market for a decade.¹¹⁰ Kershaw now endorsed Lefeaux's view, that a

¹⁰⁵ Savage's cable, 11/4/39, on N2305, 0393.

¹⁰⁶ Folio 213, R.N. Kershaw, 12/4/39, B.of E., G1/339.

¹⁰⁷ High Commissioner's cable, 14/4/39, N2305, 0392.

¹⁰⁸ Secretary to the Treasury/Minister of Finance, 28/4/39, T52/77.

¹⁰⁹ B.C. Ashwin/Nash, 26/5/39, on N2305, 0458.

¹¹⁰ 'New Zealand' (secret), R.N. Kershaw, 16/5/39, B.of E., G1/336.

petition of right exercised by bondholders under the Colonial Stock Act could seek to commandeer export receipts. This position was adopted in an Imperial Treasury paper.¹¹¹

The Bank of England would therefore make Nash realise that, to repay a substantial amount of the loan maturity, he would have to restrict imports and revalue the Reserve Bank's gold holding. New Zealand was engaged in 'half-fledged' totalitarianism, based on wasteful public works financed from Reserve Bank credit, but this surely could not be endured by the public of New Zealand.¹¹² Kershaw also predicted that the left wing of the Labour party would not accept a retreat from their position, so there would be a split within twelve months. He also had received from the Reserve Bank an analysis of the Government's 'left wing', and a copy of the 'Lee Letter', which had been debated at the 1939 Labour Party conference.¹¹³ John A. Lee had been censured for issuing the letter. Lee would later claim that only a minority of the Labour Party Executive had passed the motion, and it had been reported in a way so as to help Nash with the London bankers.¹¹⁴

Meanwhile, the Reserve Bank had rejected the revaluation of its gold assets as being only temporary relief, when it could no longer provide cover in sterling for the banks. The National Bank in London, had informed the Bank of England of this, before Lefeaux's cable, and that it was also being asked to raise £2 million in sterling.¹¹⁵ The Reserve Bank would arrange for the banks to receive 'revenue' Treasury bills to cover the London borrowing, as long as the bills were not marketed and could still be used as collateral for borrowing. Kershaw saw in this an attempt to avoid any public attention on sterling shortages: "this operation shows the straits to which the N.Z. Government is being driven and their great anxiety to hold up the position and make it appear better than it is during Mr Nash's visit."¹¹⁶ The Governor of the Bank of England reminded Lefeaux of the

¹¹¹ 'Financial Situation in New Zealand', Waley, Treasury/Dominions Office, 25/5/39, B.of E., OV59/3.

¹¹² Kershaw memo, 16/5/39. Apparently, Nash and his more moderate colleagues did not desire it.

¹¹³ E.C. Fussell/R.N. Kershaw, 5/5/39, on B.of E., OV59/3.

¹¹⁴ J.A. Lee/W.B. Sutch, 14/11/??, in W.B. Sutch Collection, MS-7170-021, ATL.

¹¹⁵ 'New Zealand', R.N. Kershaw (secret), 26/5/39, B.of E., OV59/3.

¹¹⁶ R.N. Kershaw/Governor, 'New Zealand' (confidential), 25/5/39, B.of E., G1/336.

conditions that were imposed on New Zealand issuing Treasury bills in London in 1933, and that the collateral position was impossible if Treasury bills were not marketable.¹¹⁷

By the end of May 1939, the Bank of England had defined their negotiation position for Nash's visit, based on the possibility of default on the maturing loan principal. As this would be the first occasion of such a default by a Dominion, help was both necessary and advantageous, and arrangements would be made to carry the balance of the £17 million maturity.¹¹⁸ Nash need only show some signs of goodwill, and attempt to accumulate a modest amount of sterling funds. The British Government's view, as represented by its Treasury, was that repeated friendly warnings about the effects of the internal policy had fallen on deaf ears.¹¹⁹ Although countries like Turkey had recently borrowed in London, these loans had been arranged before rearmament commitments were made. New Zealand had a stronger claim politically, but the market conditions now prevented borrowing.

Kershaw's initial meeting with Nash, in early June 1939, rather established the tone of the proceedings. In Kershaw's version, Nash seemed quite 'impenitent' about his Government's policies.¹²⁰ The purpose of the new borrowing was also made clear: although public works funding was required, this was an internal expenditure question; the London loan would be required for exchange purposes, to meet 'invisibles' (debt commitments), and 'visible' payments (imports). Kershaw was particularly unimpressed with the argument that lasting injury might be done to imperial relations if help wasn't provided, and New Zealand was 'left in the lurch by London'.¹²¹ Apparently, Nash also hinted that he would be prepared to accept special terms, if this made it easier to raise money. This would be put to lenders as a programme of transfers, Kershaw using the phrase, a 'prior lien on exchange'.¹²² Kershaw informed the Governor that Nash was still unrealistic about the situation, though less so than in 1937. Norman had already

¹¹⁷ Norman's cable, 26/5/39, B.of E., G1/336.

¹¹⁸ 'Default by New Zealand' (secret), R.N. Kershaw, 26/5/39, B.of E., OV59/3.

¹¹⁹ 'Notes by the treasury', Discussions with Mr Nash, Board of Trade, 30/5/39, on B.of E., G1/336.

¹²⁰ 'New Zealand' (secret), R.N. Kershaw, 7/6/39, B.of E., G1/336.

¹²¹ Ibid. Kershaw stated that Australia had been in a worse position in 1930-1, and had pulled itself out.

¹²² Ibid. Nash's versions of the meeting don't include this aspect, N347, 0207, 0208-9.

determined the financial solution: as in 1932, a short-dated sterling bond issue, with a condition that New Zealand export proceeds be used for monthly repayments.

When Lefeaux received this advice, he was unable to see how it relieved the sterling situation, if the loan proceeds were to be earmarked for the loan maturity.¹²³ There were also technical problems with a bond issue, in regard to existing stock being issued under the system of borrowing involving authorising Acts in New Zealand. This was because the priority granted to the sterling payments on the later bond issue could affect the security of the earlier loans. Therefore, "the rights of the existing bondholders would be infringed by the grant to holders of a new loan of a prior allocation of exchange."¹²⁴ The Finance Officer, Sunley, suggested that section 14 of the 1932 N.Z. Loans Act gave authority to issue additional securities to cover the exchange premium on conversion.¹²⁵ But the British authorities expected an Order-in-Council to be issued, and Treasury was prepared to do this under section 15 of the Loans Act. A more obvious point was that the form of bonds discussed did not have trustee status, and could not be issued under the Colonial Stock Act. A declaration under the Act was expected, as the operation's success made it vital that trustees were encouraged to take up the conversion offer.¹²⁶

Though the technical points could be resolved, the whole negotiations were based on the Bank of England's view that the market conditions made an ordinary long-term loan conversion issue impracticable, as it could not be underwritten by the brokers. The Bank would have to underwrite the conversion offer itself. The lengthy political negotiations that Nash and his officials endured all came down to that point, in deference to the Bank of England's representation of the market's view. Kershaw had indicated, in early July, that the specific charge on export proceeds might be negotiable, and it would be possible to pursue long term loans in the future.¹²⁷ The Bank of England sent Nash the conditions for insertion into the prospectus for the Bond issue, on 5th July 1939. The monthly payments of interest would come from a special account of the Reserve Bank at the Bank

¹²³ Lefeaux's cable, 12/6/39, on B.of E., G1/336.

¹²⁴ Freshfields, Leese & Munns/B.G. Catterns, 14/6/39, B.of E., G1/336.

¹²⁵ 'Proposed Conversion 1st January, 1940, Maturity', R.M. Sunley, 20/7/39, N2310, 0124.

¹²⁶ *Ibid.* Sunley noted that the Bank of England wanted to issue 'deed' stock, rather than inscribed stock.

of England, and the Bank would publicly announce the receipt of the payments.¹²⁸ The Bank of England also wanted the right to extract interest and six-monthly capital repayments from the Reserve Bank's account, if there was a failure to pay. The Prime Minister did not object to those conditions, but agreed with Nash that the announcement of interest repayments was unnecessary and humiliating.¹²⁹ When Nash met the Deputy Governor on 7th July, he made a telling remark: "You are our agent; it seems a funny position – I am fighting our agents all the time."¹³⁰ In the Bank's view the public announcement: "creates a positive opportunity as time went on to improve New Zealand's credit by making public her due observance of the terms of the new loan;" in the same letter to the Governor, the Deputy Governor, B.G. Catterns had described the New Zealand objection as evidence of 'amour propre'.¹³¹

Nash had been expecting to leave London in early July, but with no agreement on the loan conversion the Bank was concerned about keeping all the British authorities 'within the ring'.¹³² As it was impossible to withhold British Government assistance for export credits and rearmament expenditure, the Bank felt obliged to make some concession. If Nash left without an agreement, the stock prices would fall, and there would be a 'first-class political hullabaloo'. Nash finally approved the required Order-in-Council, and got Lefeaux's agreement for the Reserve Bank account at the Bank of England.¹³³ The Bank's proposals were determined after the Governor 'talked to the market', to confirm that the usual underwriting options were still closed, partly due to mistrust of the Labour Government's intentions. The Bank of England would have to be the underwriter: "unless the operation was done now it would not be done at all, as it was more likely that the financial position in New Zealand would deteriorate still further before the end of this year, and [the Governor] was afraid that if the matter were left over it might be extremely difficult to avoid an open default, which would place His Majesty's Government in a very delicate position."¹³⁴

¹²⁷ 'Note of telephone conversation with Mr Kershaw', 3/7/39, N347, 0003.

¹²⁸ '£16 Million 5-year Sterling Bonds' (secret), N347, 0001. Nash put a 'N' in the margin.

¹²⁹ Savage's cable, 7/7/39, T44/196.

¹³⁰ Notes of meeting with Catterns and Kershaw (secret), N347, 0007.

¹³¹ 'New Zealand', R.N. Kershaw, 10/7/39; Catterns/Norman (in Basle), 11/7/39, B.of E., G1/336.

¹³² Ibid. "Nash will, of course, go on with his little game of poker right up to the last moment."

¹³³ 'New Zealand' (secret), 24/7/39, B.of E., G1/336.

¹³⁴ 'New Zealand', B.G. Catterns, 14/7/39, B.of E., G1/336.

In practice, this meant that the Bank of England arranged with trading banks and the Crown Agents to subscribe to the conversion loan when it failed, and Nash finally left.

In the immediate aftermath of Nash's negotiations, the fall-out was already becoming clear, especially given Nash's apparent lack of gratitude to the imperial authorities. Montagu Norman was less than impressed upon hearing from the Imperial Treasury that Nash had tried to negotiate a loan with a co-operative society in Britain, and failing that was now heading for New York. Norman seems to have been more than bemused by his encounter with New Zealand's Minister of Finance: "Mr Nash interests me by his devout wrongheadedness, by his friendly attitude towards his enemies and his determination on the economic slaughter of his Dominion."¹³⁵ Despite Nash's best, or perhaps worst, efforts the prices of New Zealand government stocks had started rising, from August 1939. The brokers certainly appreciated the efforts of the Bank of England Governor, and hoped that the New Zealand Government realized the "immense debt" of gratitude it owed to Norman.¹³⁶ In reply, the Deputy Governor's remark encapsulated the difference in point of view between the imperial authorities and the wayward colonial cousins.

"From the indications that we had from Mr Nash before he left, it seems more than doubtful whether the New Zealand Government will be at all appreciative of what has been done for them. Indeed, it seems likely they will regard the special arrangements which have been made in their favour more as a matter of right than anything else!"¹³⁷

The New Zealand government had not been allowed to default on its loan, and the bondholders would not have to invoke the conditions of the Colonial Stock Act. New Zealand had always converted loans in the past so, apart from the situation specific to 1939, there was no reason to expect that imperial relations had changed in the financial area. But the Bank of England had a particular interest in New Zealand's domestic policy, so the question remains if the British were attempting to influence or change the policies of the Labour Government, and if the Reserve Bank was affected as a result of Nash's visit.

¹³⁵ Norman/Inskip, 2/8/39, B.of E., G1/336.

¹³⁶ H.C. Scrimgeour/Norman (personal), 9/8/39, B.of E., G1/336.

¹³⁷ B.G. Catterns/H.C. Scrimgeour, 9/8/39, B.of E., G1/336.

7 IMPERIAL POLITICAL BONDS And NATIONAL SOVEREIGNTY

“Norman thought that the policy of the bankers might push New Zealand to default on payment, though Nash said this was the last thing they would do. There were really no advantages in pressing a Dominion government to this extreme... and the harsh treatment explains the economic and emotional reasons why the Labour Party were to be in future reluctant to borrow long-term abroad, or to borrow from any international organization which, as a condition of its lending, would prevent the carrying out of the economic and social policy of an elected government.”¹

W.B. Sutch has stated that what was at stake in 1939 was New Zealand's status as a colony, and the British objection to the Labour Government's attempts to establish a measure of economic sovereignty. But if the British authorities were not going to allow there to be a default, for political reasons, the formal constitutional sanctions in the Colonial Stock Act would not be invoked, and legislation could not be disallowed. Later writers have been assiduous in providing a different interpretation from Sutch, but local historians have also assumed that the 1939 negotiations had a major impact on domestic policy. Though there did not seem to be a question of default, there has also recently been a suggestion that this could have been a useful threat to make as a tactical ploy. The Canadian economic historian, Drummond, has observed how the version penned by Nash's adviser (ie Sutch) meant that the episode had acquired a place in Labour myth or political demonology.² Drummond's point was that the British authorities could not have been expected to act any differently. But to assess the 1939 exchange crisis as a question of default, or economic sovereignty, it has to be compared to the 1932-3 fiscal crisis.

Keith Sinclair has provided a lot of detail about Nash's London negotiations, against the background of the exchange crisis. But his verdict on Nash had been pre-determined: “he was saved, not by the whistle, but the war.”³ In other words, Nash's financial policy was unsustainable, his election promises could not be kept, but the war mitigated what would have otherwise been policies of retrenchment. Nash's version of events stressed the unfortunate circumstances of the time, implying that because of rearmament a relatively

¹ W.B. Sutch, *The Quest for Security*, Wellington 1966, pp.233-4.

² I.M. Drummond, *The Floating Pound and the Sterling Area, 1931-39*, Cambridge 1981, p.115.

³ Sinclair, *Walter Nash*, Auckland 1976, p.172.

normal loan conversion operation was made difficult.⁴ Though Sinclair went all the way to London to research his version, he didn't consider what effect rearmament had on the British debt market operations, and American pressure to defend the value of sterling.⁵

But Sinclair's view of imperial relations has become the standard account. It has been recently recycled by one of his successors, James Belich, under the theme: 'Better Britain at Bay'. This repeated the observation that Nash was treated like an 'errant schoolboy' by the British, and that New Zealand was threatened with receivership, if not bankruptcy. Belich's up-dated version refers to the loan default by New South Wales, to infer that Nash had not played his cards very vigorously and, like the Australians, voiced the heresy of debt repudiation.⁶ The New South Wales default had been in 1931, but the Australians had also threatened repudiation in 1933 if loans weren't converted to a lower interest rate. Cain and Glynn have exposed how the Australian High Commissioner had admitted this in 1939, suggesting it was a bluff, and the London reaction to this admission.⁷ The more significant aspect of the article was in emphasising how the story of the debt conversions had not been revealed, because economic historians assumed they were straightforward operations taking advantage of lower British interest rates in the normal way. The role of imperial relations has also been examined in Australia's loan negotiations in 1940, when there was no threat of default, although the same High Commissioner had to overcome the effect on Australasian stocks of the strained New Zealand negotiations from 1939.⁸

Nash, and especially the London brokers, had actually denied any intention of default and also portrayed the imposition of exchange control as the means to ensure sterling debt obligations were met.⁹ Drummond has stated that New Zealand was no more likely to default in 1939, than in 1933, at least they would not be allowed to default in 1939,

⁴ W. Nash, *New Zealand: A Working Democracy*, London 1945, p.49.

⁵ R.A.C. Parker, 'The Pound Sterling, the American Treasury and British Preparations for War, 1938-9', *English Historical Review*, 48, 1983.

⁶ J. Belich, *Paradise Reforged*, Auckland 2001, pp.264-5.

⁷ Cain, N. & S. Glynn, 'Imperial Relations under strain: the British-Australian debt contretemps of 1933', *Australian Economic History Review*, 25, 1985, pp.39-40.

⁸ K. Tsokhas, 'S.M. Bruce, Imperial Relations, and War Finance, 1939-45', *Australian Journal of Public Administration*, 49, 1990, p.445.

⁹ 'Weekly Report, New Zealand', J. & A. Scrimgeour, 9/12/38, on N2305, 0635.

because the United Kingdom was obliged to preserve the general credit of the Empire.¹⁰ Although Drummond mentioned the possibility of invoking the conditions under the Colonial Stock Act, he seems to have been more interested in why devaluation was not the solution to the exchange crisis. After providing an account of the development of exchange control in New Zealand, including the regulations being drafted in 1937, Drummond asks why the British Treasury and Bank of England officials did not allow devaluation, but had acquiesced to a 'temporary' exchange control regime that remained in place.¹¹ The first answer was that the New Zealand government had stated that it didn't want to devalue. The second explanation was in the position of the Reserve Bank, and its objection to internal credit creation. The devaluation would have meant that the effect on the balance of payments of the policy of 'unsound finance' was evaded.

But by November 1939, the Reserve Bank 'Advances to the State' had increased to £17 million.¹² Lefeaux had been forced to accept a low discount rate on the Treasury bills, after the 1939 Reserve Bank Amendment Act had been passed. Nash had won some kind of victory over Lefeaux, but history seems to have denied him this. Economic historians, such as Hawke, have simply asserted that the Treasury bill programme ceased at the £5 million mark. But securing the Advances to State policy was more of a test of patience, given the interventions from Wellington during the London negotiations. In June 1939, when Nash thought that the trading banks were raising £2 million in sterling to ease the exchange situation, a report from Reuters had hampered discussions, when it had been announced that the banks were refusing to make sterling available for imports until Nash provided adequate sterling in London.¹³ When the loan negotiations were being finalised, London newspapers reported the views in the Reserve Bank annual report published in Wellington, linking the loss of sterling funds to the continued issue of Treasury bills to the Bank. Apparently, Nash had even changed his policy to suit London: "assurances given by Mr Nash have largely invalidated the insulation policy to which he was never

¹⁰ Drummond, pp.105, 113.

¹¹ *Ibid.*, p.110, Drummond asked why they didn't see the New Zealand situation like the British position. The problem with his explanation is that the Bank of England did approve of exchange control in 1939, and formalised the Sterling Area at that point, as part of the preparations for war. See B.of E., EC4/15.

¹² 'New Zealand', R.N. Kershaw, 14/11/39, B.of E., OV59/3.

¹³ Reuters message, 8/6/39, N2305, 0641. An *Evening Star* reporter was seeking Nash's comment.

wholly committed.”¹⁴ Nash was actually committed to the Treasury bill funding of the State Housing scheme, and because of a Solicitor-General opinion favouring Lefeaux’s 4% discount rate, he knew that new Reserve Bank legislation was necessary in late 1938. Labour’s appointee to the Reserve Bank Board, Mark Silverstone, had been monitoring discussions about the discount rate being raised higher, moves made with the banks to fund imports, and the buying support provided for the maturing loan stock.¹⁵ Silverstone had been unable to see Lefeaux’s communications with the Bank of England, which had aroused his suspicions. Lefeaux had already sought the Bank of England’s advice on what parts of the legislation should be altered in the event of a change of government.¹⁶

Lefeaux had been in the Bank of England in 1932, when default by New Zealand seemed inevitable. New Zealand had actually been bankrupt in that situation, with a balance of payments problem in terms of export prices, and the inability to raise new loans to pay the interest on existing debt. There was also a budgetary crisis, with Treasury unable to find the funds to buy exchange from the banks for transfers to London. The Bank of England had insisted that sinking fund payments could not be suspended because of the Colonial Stock Act conditions of the loan prospectuses. The appearances were kept up and default avoided, but the Bank of England had provided sterling funds, and paved the way for the trading banks to dictate funding for public programmes for two years, while extracting 5% interest for holding Treasury bills. Historians appear to have failed to see a default situation, which differed from the ‘exchange’ crisis of 1938-9. Hawke has even asserted that the balance of payments was not the cause, but only echoed Niemeyer and T.E Gregory.¹⁷ As the Bank of England had come to the rescue, and London borrowing rates were reduced, it became business as normal. Hawke claims there was a conversion loan in 1932; but the Bank of England had an embargo on conversion loans at the time.

The 1932-3 financial situation suggests that not only was default imminent, but that in not recognising the way in which the Bank of England would not allow this to occur, the

¹⁴ ‘British Aid for New Zealand’, *The Times*, 22/7/39, on N2310, 0049.

¹⁵ Silverstone/Nash, 25/3/39, N348, 0002-0011; Silverstone/Nash, 24/4/39, N348, 0032-0039.

¹⁶ B.G. Catterns/Lefeaux, 26/9/38, B.of E., G1/339.

question of sovereignty has not even been recognised. This is also evident in discussion of the control of the exchange rate, and the creation of the Reserve Bank. Hawke believes that the Treasury official, B.C. Ashwin, analysed the sterling exchange standard, and this was instrumental in shaping the Reserve Bank legislation. The Bank of England is seen as a benign influence, although it aimed at enshrining convertibility and thus the gold standard in the Reserve Bank Act. Treasury did in fact pursue this objective, and with convertibility being distinct from the legal obligation to exchange bank notes for sterling. Treasury would still prepare public accounts on the basis of convertibility into sterling, even after the 25% 'political' devaluation. Despite New Zealand not having been on the gold standard, Treasury had determined that the currency was based on gold sovereigns, and a pound was a pound whether in London or New Zealand. It was rather unusual, if not anachronistic thinking, to assume convertibility for exchange costs irrespective of whether Britain was on the gold standard or not. The suspension of the obligation to exchange sterling and the imposition of exchange control was obviously planned by the first Labour Government: Hawke has asserted there was no carefully designed strategy.¹⁸

If the economic history is inaccurate in places, the analysis of financial policy is non-existent. As evidenced in previous chapters, New Zealand had an evolved system of accountability for the use of loan money proceeds, in statutory accounts or funds. The prospectus of inscribed stock in London detailed the authorising acts, and loan proceeds were earmarked for particular purposes defined by purpose or statutory account. The system of accountability for the loan accounts involved a pre-audit, or check of spending vouchers, by the Audit Office. Any form of transaction not specifically provided for in public finance legislation required the legislative authority of Parliament, and a clause in the annual Finance Act. The Parliamentary control of loan finance was a defined Audit function, but the strict accountability for borrowed money and public account cash balances was not seen in the wider constitutional context. The 1925 Repayment of Public Debt Act was an attempt to fine-tune debt management; it was to be emphasised in the

¹⁷ T.E Gregory 'New Zealand's economic difficulties and expert opinion: a comment', *Economic Journal*, 42, 1932, pp.649-56.

¹⁸ Hawke, *The Making of New Zealand*, Cambridge 1985, p.164.

government stock prospectuses, issued in London. The system had emerged within an imperial context, although the form of accounting had never been practised in Britain.

British financial imperialism was certainly related to the role of the Colonial Stock Act, and the New Zealand government stock issues in the City of London. The specific identity of New Zealand stocks in the London market was clear, even as the Australian stock prices fell in 1929. But National solvency was under threat in New Zealand and Australia: 'sound' finance could not be adhered to, exchange rates maintained, local loan contracts strictly observed, and Treasury bill funding avoided.¹⁹ Yet the obligations of the Colonial Stock Act were still observed. But a transfer problem remained: to make the interest payments from the supply of sterling funds, even when managed by the Reserve Bank. The transfer problem required that a surplus of exports was available to make interest payments in London, unless annual borrowing was used to pay interest. If there were no export surplus, or new public borrowing, the government would have to remit funds and therefore buy exchange from the banks. As Treasury had discovered in 1925, even with an export surplus and significant public borrowing, it was up to the trading banks whether sterling funds were used in the Dominion. In the situation of Post Office deposits withdrawal or a cash shortage, London loan proceeds could not actually be remitted to fund public works programmes. The habit of initiating these long-term projects on the basis of London loans prompted Treasury into changing the public debt system. Treasury realised that the imperial form of accounting was not being practised.

The economic situation meant that the incompatibility of the banking system with the highly structured accounting practice had now become apparent. Though the banking system was still tied to sterling, the link had changed. As the Bank of England had recognised during New Zealand's exchange crisis, the 'sterling bloc' created on the basis of a 'de facto' stabilisation limited their options. In fact, "if New Zealand were to start another wave of depreciation, we could do nothing in return because we are the one country which cannot depreciate on sterling."²⁰ The Imperial bonds were breaking.

¹⁹ A.G.B. Fisher, 'Crisis and Readjustment in Australia', *Journal of Political Economy*, 42, 1934.

²⁰ Folio 148, 21/11/38, B.of E., G1/339.

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