

## The balance of payments in the inter-war period: further details

*This research paper was prepared in the Bank's Economic Intelligence Department and is largely the work of R. G. Ware*

A previous article on this subject was published in the September 1972 *Bulletin*. [1] It dealt with the balance of payments statistics available during the inter-war years, showing how information on previously unquantified items had slowly emerged over the period, and considering the figures' scope and method of estimation. The article concluded that even those figures which had then been available could hardly be judged accurate, and details of too many items were missing altogether for a satisfactory picture of the period's balance of payments to be drawn at that time.

Shortly before the earlier article went to press, Dr Feinstein's work on the national income between 1855 and 1965 was published, [2] but, in the time remaining, it was not possible to take proper note of his work. It has since been found extremely helpful in compiling 'best estimates' for the balance of payments (especially the current account) in the years under review.

This article is the result of a comprehensive review of the available contemporary and subsequent material relevant to the balance of payments. Although rather more confidence can now be placed in some of the figures given below, they are nevertheless still subject to varying degrees of inaccuracy. However, it was thought useful to put together all the previously extant data and, at the same time, to add several new items. Any adjustments made to contemporary estimates in the light of more recent research have been noted, the coverage of the figures has been described, and, where possible, their accuracy assessed. There is also a brief analysis of trends in the main components of the account. The estimates are presented in Table B.

### Developments in the balance of payments

During the two decades under review, the main components of the balance of payments changed in different ways, as summarised in Table A. First, the current balance moved progressively from surplus to deficit. In 1920 the trade deficit was comfortably covered by a large invisible surplus, ensuring a reasonable surplus on current account. By 1938, however, the position was very like the one today – a larger deficit on visible trade only partially offset by an invisible surplus, leaving the current account as a whole in deficit.

The terms of trade became increasingly favourable throughout the inter-war years; and, although, by the end of the period, the volume of exports was smaller than in 1920 and the volume of imports greater, the result was that the visible balance in cash terms did not worsen by very much. The surplus on invisibles, however, diminished. Receipts in the form of interest, profits and dividends declined in the early twenties because a large amount of British investment overseas had been liquidated to help meet the cost of the First World War. In the thirties, heavily curtailed overseas lending, larger payments for maturities and to sinking funds, and foreign default on British loans, once more reduced these forms of income. The world depression in the thirties also weakened shipping earnings, and cut fees and commissions earned by City institutions. These factors combined to change an annual average surplus on current account of well over £100 million during 1920–29 to a deficit of £40 million on average in the following nine years.

As the current balance worsened, so the capital account moved from an average outflow of over £100 million in the first period to one of under £20 million in the second. At the same time, the balancing item became

[1] 'The balance of payments in the inter-war period' (M.D.K.W. Foot). Off-prints of this article are available on application to the Economic Intelligence Department at the address given on the reverse of the contents page.

[2] C.H. Feinstein, *National Income, Expenditure and Output of the United Kingdom 1855–1965*, Cambridge University Press, 1972.

**Table A**  
**Summary balance of payments**  
£ millions: annual averages

	1920-29	1930-38
Visible balance	-205	-256
Invisible balance	+319	+216
Current balance	+114	-40
Identified capital movements	-115	-15
Balancing item[a]	+9	+87
Currency flow	+8	+32
Visible deficit as a percentage of GNP	4.1	5.2
Current surplus or deficit as a percentage of GNP	2.3	0.8

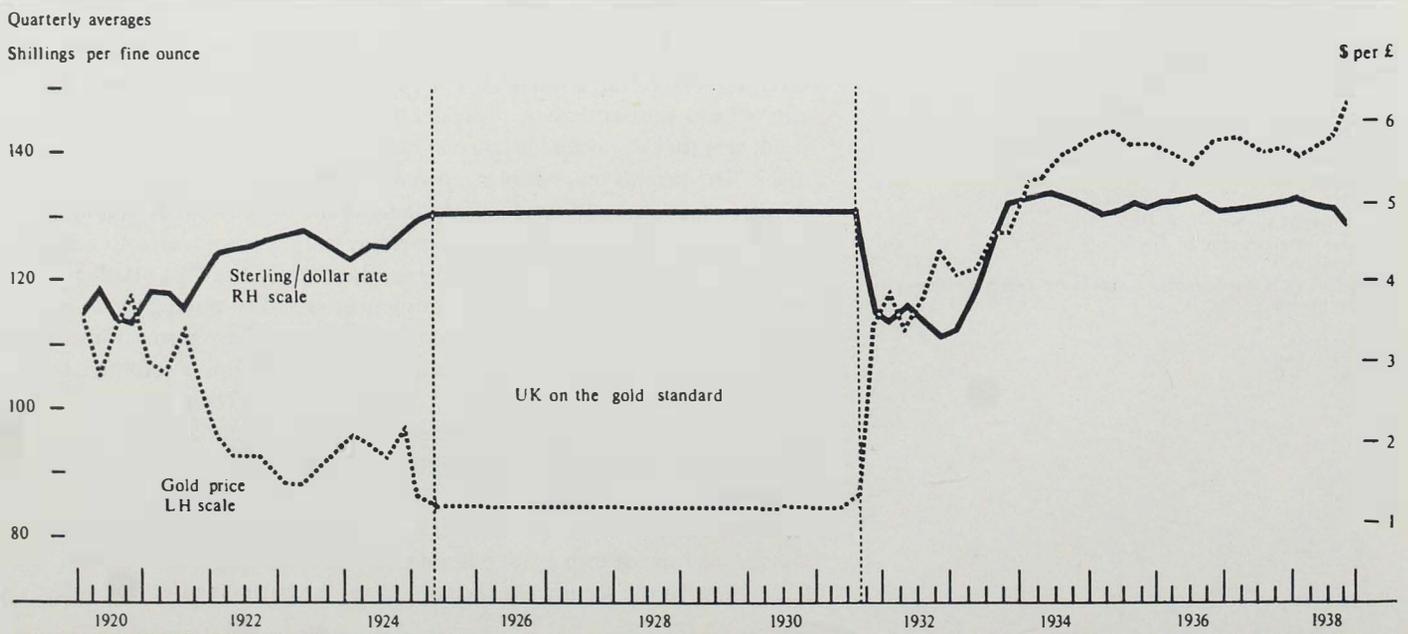
[a] Before 1928 this includes changes in short-term liabilities and acceptances.

much more strongly positive (the average inflow indicated for the period 1930–38 is, however, raised substantially by an exceptionally large figure in 1931). Before the First World War, the surplus on current account had financed large-scale long-term lending: the gradual erosion of this surplus meant that net inflows on capital account became necessary to prevent unacceptable loss of reserves or excessive depreciation of the currency. The reasons for the turn-round on capital account are not hard to find. New overseas issues raised on the London market fell off drastically in the second decade under the influence of various embargoes, while receipts by sinking funds and maturities of existing loans, raised in more favourable times, gathered momentum. In fact, in each year from 1935 to 1938 more money seems to have entered London in connection with foreign loans than left it, a most unusual development.

This reflux of capital was augmented by a large rise between 1932 and 1937 in short-term funds held in London on foreign account – a movement reflecting at various times both the surplus on the Empire's balance of payments and also the favourable covered interest rate differential between London and New York. Such short-term movements confirmed a trend already noted in the 1931 Macmillan Report [1] that 'London is now practising international deposit banking, as distinct from international acceptance business and the deposits associated with this, on a larger scale than before the War'. The attendant dangers continued to be a source of comment throughout the decade. It was perceived that, while a large proportion of UK holdings of foreign assets was illiquid, the increase in foreign deposits held in London – at any rate those of countries not in the Empire – was influenced primarily by short-term considerations and could be rapidly reversed.

Until 1930, the currency flow did not fluctuate by much from year to year. From 1932 onwards, however, fairly large inflows occurred in every year until 1938, enabling the authorities to accumulate gold and foreign exchange reserves. The crisis in 1931 had shown that the existing reserves were inadequate to support the exchange rate in the face of sustained pressure, especially when a proportion of overseas assets could not easily be mobilised. The subsequent acquisition of more reserves was thus a conscious aim, to be justified in 1938 when they were used extensively to ensure that the rate moved only slowly downwards (see the chart), without panic, despite the largest outflow of foreign funds since leaving the gold standard.

### Sterling and the gold price



[1] Macmillan Committee, *Report of the Committee on Finance and Industry*, Cmd 3897, June 1931, para. 349.

**Table B**  
**The balance of payments 1920-38**

£ millions

	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
<b>Visible trade</b>																			
Imports (f.o.b.)	1,812	1,022	951	1,011	1,172	1,208	1,140	1,115	1,095	1,117	953	786	641	619	683	724	786	950	849
Exports (f.o.b.)	1,664	874	888	914	958	943	794	845	858	854	670	464	425	427	463	541	523	614	564
Visible balance	-148	-148	-63	-97	-214	-265	-346	-270	-237	-263	-283	-322	-216	-192	-220	-183	-263	-336	-285
<b>Invisibles</b>																			
Government services and transfers (net)	+1	+25	-11	-4	-7	+8	+10	+15	+15	+14	+19	+10	-8	-9	-9	-12	-12	-12	-19
Other invisibles:																			
Private services and transfers	+214	+117	+76	+85	+81	+53	+57	+91	+82	+78	+60	+31	+30	+24	+25	+22	+34	+80	+40
Interest, profits and dividends:																			
Private sector	+252	+183	+200	+202	+222	+254	+254	+251	+251	+250	+220	+169	+149	+160	+169	+183	+198	+208	+197
Public sector	-4	-3	-21	-24	-24	-19	-14	-9	-7	-3	-1	-2	-17	-1	+3	+3	+3	+3	+2
Invisible balance	+463	+322	+244	+259	+272	+296	+307	+348	+341	+339	+298	+208	+154	+174	+188	+196	+223	+279	+220
<b>Current balance</b>	<b>+315</b>	<b>+174</b>	<b>+181</b>	<b>+162</b>	<b>+58</b>	<b>+31</b>	<b>-39</b>	<b>+78</b>	<b>+104</b>	<b>+76</b>	<b>+15</b>	<b>-114</b>	<b>-62</b>	<b>-18</b>	<b>-32</b>	<b>+13</b>	<b>-40</b>	<b>-57</b>	<b>-65</b>
<b>Capital movements</b>																			
Official long-term capital (net)	-97	-63	-18	-18	-	-5	-4	-6	-3	-5	-2	-1	-7	-1	+5	+2	-	-4	+10
UK new investment overseas	-53	-116	-135	-136	-134	-88	-112	-166	-143	-96	-98	-41	-37	-83	-63	-51	-61	-60	-29
Sinking funds and repayments on existing issues	+15	+15	+15	+15	+15	+15	+27	+34	+35	+49	+39	+27	+48	+67	+42	+81	+107	+61	+39
Other long-term investment abroad												+10	+5	+5	-20	-50	-48	-	-
Net short-term liabilities									+136	-84	-26	-293	+37	+52	+15	+12	+113	+84	-196
British government stocks												+20	+18	+27	+8	+8	+3	-14	
Acceptances[a]									-61	+25	+15	+41	+29	+12	-2	-4	+1	+1	+8
Total identified capital	-135	-164	-138	-139	-119	-78	-89	-138	-36	-111	-72	-257	+95	+70	+4	-2	+120	+85	-182
Balancing item[b]	-132	-10	-46	-11	+67	+45	+151	+78	-86	+27	+64	+337	-4	+70	+38	+68	+131	+101	-21
<b>Currency flow</b>	<b>+48</b>	<b>-</b>	<b>-3</b>	<b>+12</b>	<b>+6</b>	<b>-2</b>	<b>+23</b>	<b>+18</b>	<b>-18</b>	<b>-8</b>	<b>+7</b>	<b>-34</b>	<b>+29</b>	<b>+122</b>	<b>+10</b>	<b>+79</b>	<b>+211</b>	<b>+129</b>	<b>-268</b>
<b>Official financing</b>																			
Reserves (drawings on +/additions to -)	-48	-	+3	-12	-6	+2	-23	-18	+18	+8	-7	-48	+85	-122	-10	-79	-211	-129	+268
Assistance	-	-	-	-	-	-	-	-	-	-	-	+82	-114	-	-	-	-	-	-
<b>Total official financing</b>	<b>-48</b>	<b>-</b>	<b>+3</b>	<b>-12</b>	<b>-6</b>	<b>+2</b>	<b>-23</b>	<b>-18</b>	<b>+18</b>	<b>+8</b>	<b>-7</b>	<b>+34</b>	<b>-29</b>	<b>-122</b>	<b>-10</b>	<b>-79</b>	<b>-211</b>	<b>-129</b>	<b>+268</b>

- nil or less than £½ million.

[a] Between 1928 and 1931 these figures show only changes in acceptances given on foreign account; for subsequent years the figures show the net movements in these acceptances together with those given by foreigners on UK account.

[b] Before 1928 this includes changes in short-term liabilities and acceptances; these are thereafter covered separately.

### Sources of the figures

The figures (see Table B) are broadly similar to those given in the previous article. They have, however, been reviewed in the light of Feinstein's research, and several new items have been incorporated.

### Current account

For items in the current account Feinstein's estimates have been accepted virtually unchanged.[1] Within visible trade, imports are thus shown f.o.b., and other adjustments have been made to allow for the creation of the Irish Free State, for net exports of second-hand ships, and for imports of diamonds.[2] Gold movements have been excluded as properly belonging to the currency flow.

Invisible items have now been grouped in accordance with current practice. All are self-explanatory except for private services and transfers, which include shipping, travel and financial items as well as migrants' transfers. To compensate for their use of c.i.f. import figures, the Board of Trade included a corresponding credit within shipping and insurance earnings. As the lower f.o.b. figures for imports have been used here, appropriate adjustments have been made to the Board of Trade's estimates for earnings from shipping and 'net short interest and commissions'.[3] In the light of opinion within the Bank at the time that the credit for the latter item was overstated, Feinstein's figures for financial and other services have been lowered (somewhat arbitrarily) by £20 million a year between 1920 and 1930 and by £10 million a year thereafter. Estimates for film royalties paid abroad have been included within private services and transfers, and added back to interest, profits and dividends.

Government services and transfers include only current items (military spending, economic grants, etc.), whereas the Board of Trade's estimates treated all government transactions as current.

### Capital account

Official long-term capital here consists of net UK borrowing and lending abroad. Its main constituent is repayment to the United States of loans made during the First World War: such payments terminated in 1932. The special assistance granted in 1931 by the United States and France has been excluded and allocated to a separate category within official financing.

Overseas investment was described fully in the previous article. As was then noted, the Kindersley series (on which the estimates are based) have several drawbacks; in particular, dealing in existing securities is covered only very approximately under changes in other long-term investment abroad. Another important omission is any measure of direct investment inwards or outwards. There are no good estimates of the resources transferred for such investment: all that exist are annual surveys for 1932 to 1938 which show the number of 'factories established by, or with the assistance of, foreign concerns'.[4] These show that 1932 was the peak year for foreign direct investment in this country, over 20% of all new factories being foreign-backed. This proportion fell to under 10% in each succeeding year, but, once established, a good many factories were presumably enlarged, and there are no details on the importance of this. Nor is there any comparable information on the value of UK direct investment abroad.

The first figures for UK short-term assets and liabilities to be anything more than informed guesses were given in 1931 by the Macmillan Report, and covered the period from the end of June 1927 to the end of March 1931. They were, however, incomplete, as they excluded from liabilities the sterling bills held by London-based foreign banks, and from assets UK deposits held abroad. In the light of a recommendation contained in the report, the Bank called for foreign funds returns from over 150 banks

[1] Feinstein, pages 110-27.

[2] A very small change has been made in 1936: £2 million has been added to imports on account of new ships delivered in Germany and bought with money already abroad [*Board of Trade Journal* 25 February 1937, page 260]. A corresponding credit has been added to other long-term investment abroad.

[3] Which included insurance companies' earnings.

[4] Board of Trade, *Surveys of Industrial Development*, 1933-38.

from the end of 1931 onwards. The information so gathered was combined with similar figures from the Crown Agents and overseas currency boards, and published in a White Paper in 1951.[1] The aggregate figures showed net liabilities of £411 million in December 1931, compared with Macmillan's figure for total liabilities of £407 million in March of the same year. As there were large withdrawals of funds from London in the intervening period, the Macmillan figures were certainly too low. Williams, and Moggridge after him,[2] adjusted the figures judgmentally, using £411 million as a bench-mark. Their arguments seem plausible and their figures have been accepted.

The items that were covered by the post-Macmillan returns are given in the accompanying list. The detail thereby available to the Bank enabled a much more comprehensive picture of the short-term position to be drawn, especially as details of currency deposits were now included (Macmillan figures had been purely sterling). A little light had thus been cast on Keynes's 'barbaric darkness',[3] though it remained confined to official quarters and did not extend to the public.

The White Paper omitted acceptances from its figures of net liabilities in order to make the 1931-41 series as compatible as possible with the later series of liabilities. These are now shown separately in Table B.

Changes in holdings of British government stocks are also shown separately, as they are felt to be mostly longer-term liabilities than the remaining items reported by the banks (by definition twelve months or less). These figures for gilt-edged do not, of course, give a true representation of all movements in such securities, as they reflect only changes in holdings of stocks lodged with the banks. Holdings were also reported at nominal, and not market, values: this feature was common to other relevant items in the foreign funds returns.

The estimates for the currency flow represent the actual (as opposed to the nominal) value of changes in the country's gold and foreign exchange reserves. The main constituents of the reserves in the inter-war period were as follows:

- 1 gold held by the Issue Department throughout, and foreign currency (deposits and securities) held by the department between 1928 and 1933;
- 2 foreign currency held by the Banking Department from 1925 onwards (although after 1933 the amount was very small and did not change); a very small gold holding has been ignored;
- 3 gold and foreign exchange held by the Exchange Equalisation Account from its inception in July 1932;
- 4 gold held until 1925 by the Currency Note Redemption Account; and
- 5 gold and foreign exchange held by the Treasury's Exchange Account until its assets were transferred to the EEA in 1932; no details are available of changes in the years 1920-22 (any movements in these years being reflected in the balancing item), while holdings in 1928-31 have been partly estimated.

The figures given in Table B differ from Feinstein's[4] mainly because he did not include the Banking Department's currency holdings. In the present estimates, monthly changes in the constituent parts have been converted at the average monthly gold, US dollar, or French franc rates (where the figures are not already at market rates) to give a broad estimate of the cash flow in each month. Feinstein used the same method, though by quarters, and his approach has been adopted for the few components where monthly information is not available.

The United Kingdom was given special assistance from the United States and France in 1931, a facility nominally equivalent to £130 million. Some

[1] *Reserves and Liabilities 1931 to 1945*, Cmd 8354, September 1951.

[2] David Williams, 'London and the 1931 Financial Crisis', *The Economic History Review*, 2nd Series, April 1963, pages 513-28.  
D.E. Moggridge, *British Monetary Policy 1924-1931*, Cambridge University Press, 1972, pages 118 and 252.

[3] J.M. Keynes, 'The British Balance of Trade, 1925-27', *Economic Journal*, December 1927, page 565.

[4] Feinstein, pages 88 and T79.

#### Items covered in the post-Macmillan returns

Liabilities	Assets
Foreign deposits in the United Kingdom	Deposits abroad
Advances and overdrafts from foreigners	Advances and overdrafts to foreigners
Treasury bills and other bills on UK residents held on foreigners' account	Bills held on foreigners, foreign governments and municipalities
Acceptances given abroad on UK account	Acceptances given on foreign account
British government stocks	Short-term funds employed abroad

of this was repaid in 1931, but most of it in the following year. As the Finance Accounts show, the equivalent of £152 million was in fact received and £184 million repaid – the ‘loss’ of £32 million representing changes in the exchange rate.

The balancing item is merely the amount necessary to make the identified current and capital items sum to the currency flow. It will inevitably reflect different errors and omissions at different periods, but the major omissions from the estimates (dealing in existing securities, and inward and outward direct investment) affect the balancing item throughout.

### Quality of the figures

‘All these heads are of such a nature as to make precise estimates of our receipts extremely difficult, and the amounts paid by us to foreigners for similar services are even more indeterminate.’ Thus the Board of Trade[1] commenting specifically on the invisible item ‘net short interest and commissions’, but the remark could apply equally to many other parts of the complete balance of payments table. Despite the advantage of hindsight, the figures here assembled are really not much better than those available to contemporary observers – although, of course, they were never brought together in one place at the time.

Nevertheless, it is probably reasonable to assume that the trend of year-to-year movements given here is fairly accurate, though the absolute amounts may well be less so. Feinstein has given ‘reliability grades’ for several elements of the current account, some of which vary by up to 25% on either side of his totals.[2] Capital account items are similarly uncertain. As already stated, the figures for long-term investment overseas and for short-term flows are imperfect in several ways. It is unfortunate that one of the Macmillan Report’s main statistical recommendations – that brokers and banks should submit figures for deals done on behalf of UK residents on foreign stock exchanges and for foreign residents on UK exchanges[3] – was never taken any further, as it covered one of the largest omissions in the figures. Other omissions (perhaps larger than portfolio investment) are inward and outward direct investment and trade credit.

The balancing item is large in several years in relation to the net total of known capital flows. It partly reflects omissions and partly errors in the estimates, particularly in the invisible account; and, as today, a share also arises from leads and lags when making payments for goods.

Figures for the currency flow can be considered good estimates despite the missing details of the Treasury’s Exchange Account for certain years: the resources of this account were small, and movements in it would probably not have affected the totals significantly.

### Conclusion

The aim of the article has simply been to assemble all the available figures in a convenient format. Had this ever been done during the period itself, it is possible that the balance of payments might have had more influence on official policy. Some parts of the balance of payments were, of course, recognised as important at the time and were therefore examined fairly regularly. The effect which such scrutiny had on official policy has, however, deliberately not been covered in these articles. The subject will be considered by Professor Sayers in his forthcoming work on the Bank.

[1] *Board of Trade Journal*, 27 January 1927, page 93.

[2] Feinstein, page 115.

[3] Macmillan Committee, para. 417.