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UNSHACKLING THE SILVER CHAINS: HONG KONG'S ROAD TO THE ABANDONMENT OF THE SILVER STANDARD 1929 TO 1935

Hong Kong has been a small open economy ever since it was ceded to Britain in 1842 where the political and economic currents of China and the West strongly influence its policy and well-being. This is evidenced in its choice of currency system throughout its history. This paper explores the interplay between external factors and the process of Hong Kong's abandonment of the silver standard from 1929 to 1935.

The paper is structured as follows: the first part will describe the events from 1929 to 1931 where the intention to change the silver currency system was first discussed. The second part will elucidate the events from 1931 to 1934 and how the rise of silver delayed the eventual currency reform. The third part will touch upon the year 1935 when China abandoned the silver standard and how that led to Hong Kong's following its action as well. The fourth part will analyze the factors behind Hong Kong's action and a general conclusion.

THE 1929-1931 PERIOD

The great depression began in 1929 and most commodities including silver fell precipitously against gold and the major currencies which were on the gold standard. The

Chinese currency was based on the silver system and as such a fall in their exchange rates created an influx of liquidity and "the Shanghai financial market enjoyed an unusual boom."[1] Hong Kong was also based on the silver system as the major banks issued notes against silver coins. "As at July 1929, the Hong Kong Bank had issued $47.2m, the Chartered Bank $15.2m and the Mercantile Bank $1.7m."[2] The major issuer, Hong Kong Bank would print note issues which were "covered 80-90% by silver coin or bullion and the remainder by interest-bearing securities."[3]

There has always been a premium in pricing for the bank notes versus silver coins as it represented the cost of laying down silver dollars. Usually the premium was at "about 4%" but "by July 1929…the premium had risen to 14%."[4] With the international price of silver falling, "remittances home from the many Chinese working overseas had increased."[5] "On 4 October 1929 the note premium had reached 20%."[6]

The reason for the premium to rise was because the major banks, chiefly Hong Kong bank, were not willing to import silver physically to issue additional notes. As liquidity flew into Hong Kong, in a classic silver standard, the note issuers should import silver and create additional notes to maintain the silver to Hong Kong dollar parity. However, it was Vandeleur Grayburn, the chief manager of Hong Kong Bank, who determined the amount of note issuance rather than any member in the government. The bank feared that when liquidity reverses, it would have to sell down the silver and withdraw the notes, thus incurring a cost. The Hong Kong dollar premium against silver caused a panic amongst the business

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[1] Tomoko Shiroyama, *China during the Great Depression: Market, State, and the World Economy, 1929-1937* (Cambridge, MA: Harvard University Asia Center, 2008), 140.
[2] Steve Tsang, *A Documentary History of Hong Kong: Government and Politics* (Hong Kong: Hong Kong University Press, 1995), 19-30, quoted in Gavin Ure, *Governors, Politics and the Colonial Office: Public Policy in Hong Kong, 1918-58* (Hong Kong: Hong Kong University Press, 2012), 46, http://www.jstor.org/stable/j.ctt1xw9j1.
[3] Gavin Ure, *Governors, Politics and the Colonial Office: Public Policy in Hong Kong, 1918-58* (Hong Kong: Hong Kong University Press, 2012), 46, http://www.jstor.org/stable/j.ctt1xw9j1.
[4] Ibid.
[5] Ibid., 47.
[6] Ibid., 48.

community as this meant a loss of competitiveness against Shanghai. Such was a classic example of how a major Hong Kong corporation's acting on its self-interest would harm the well-being of the public.

Due to external pressure, "Hong Kong bank increased its "note issue from HK$46m to HK$71M between 30 November 1929 and 28 February 1930."[7] And in light of the instability of the Hong Kong dollar versus the silver price, the government created that Hong Kong Currency Commission[8] to explore the possibility of currency reform. One of the issues that came about was the delinking of the Hong Kong's system from that of China's. One of the commission's members R H Kotewall "asked for the option to be explored of moving to gold even if China did not."[9] Moreover, Kotewall and others "thought that control of the currency was too much in the power of the Chief Manager of the Hong Kong Bank."[10] However, after much deliberation, no concrete action was taken as the commission published a report on 14 July 1930 that "Hong Kong's currency should remain on silver as long as China's did."[11] The economic ties with China ran so deep that a different currency system could create uncertainties and economic stability.

Turning to economic data in *Table 1*, one could observe that the sharp fall in silver from 1929 to 1931 had a substantial effect on the economy that was not nullified by the large premium of the Hong Kong Dollar against silver. During this period, as the silver dollar rate fell by 45.4%, the amount of currency circulated grew by 78.5%. Driving by the rise in liquidity, government revenue rose by 40.7% as expenditures increased by 41.7%. The general rise in money supply caused total land revenue to increase by 37.5%. Such rosy

[7] Ibid.
[8] Ibid.
[9] Tony Latter, *Hong Kong's Exchange Rate Regimes in the Twentieth Century: The Story of Three Regime Changes* (Hong Kong: Hong Kong Institute for Monetary Research, 2004), 9.
[10] Ure, 49.
[11] Ibid.

economic performance could also partially explain why the government was reluctant to push for any currency reform.

Table 1 – Hong Kong government finance and silver dollar rate (1926-1939)

	CURRENCY (HK$M)	REVENUE (HK$)	EXPENDITURES (HK$)	TOTAL LAND REV (HK$)	SILVER DOLLAR RATE (GBP / 1 OZ. SILVER)
1926	86.1	21,131,589.0	23,524,716.0	1,540,289.09	0.11
1927	82.7	21,344,543.0	20,845,065.0	1,432,390.02	0.10
1928	79.9	24,968,399.0	21,230,242.0	2,973,034.63	0.10
1929	96.6	23,554,475.0	21,983,257.0	3,354,833.98	0.10
1930	145.4	27,818,474.0	28,119,646.0	4,432,354.55	0.07
1931	172.6	33,146,724.0	31,160,774.0	4,614,372.67	0.05
1932	171.7	33,549,716.3	32,050,283.5	2,931,060.40	0.07
1933	175.8	32,099,278.0	31,122,714.8	2,510,370.45	0.07
1934	172.0	29,574,286.0	31,149,155.7	2,231,759.18	0.08
1935	151.1	28,430,550.0	28,291,636.3	1,511,978.12	0.10
1936	162.9	30,042,984.0	29,513,520.1	1,590,704.89	0.06
1937	232.2	33,196,367.0	32,111,222.3	2,281,478.06	0.06
1938	242.3	36,735,855.0	37,175,897.8	3,113,266.57	0.06
1939	228.9	41,478,052.0	37,949,116.5	4,197,105.02	0.06

Source: C.F. Joseph Tom (1964), *The Entrepot Trade and the Monetary Standards of Hong Kong, 1842-1941*: Appendices 13-15; *Hong Kong Blue Book* (1844 - 1940).

THE 1931-1934 PERIOD

In September 1931, the UK left the gold standard and "in Shanghai the exchange rate with countries in the sterling bloc rose as the pound sterling depreciated"[12] because silver appreciated against gold and other currencies. The silver dollar rate rose by 43.8% (in *Table 1*) from 1931 to 1934 and this reversed the liquidity flow into the Hong Kong monetary system. As such, there was a "decline in the premium (of the Hong Kong dollar to silver) to a more tolerable level."[13]

Moreover, there was a "hesitation on the part of Hong Kong Bank"[14] for any currency reform especially the establishment of a government body that would store silver and issue notes against reserves. The Hong Kong bank feared that such an action would damage the

[12] Shiroyama, 148.
[13] Latter, 11.
[14] Ibid., 10.

prestige of the bank. This is an example of how the motivations of a large private institution could affect the policy of the city purely based on how it would affect its own reputation and interest. Moreover, the government realized that "nothing could happen until the end of 1935 when the Hong Kong Bank's new storage facilities would be available."[15] It is difficult to people nowadays to imagine that the timing of infrastructure building for reserve storage would affect a city's monetary system. Such was the balance of power between Hong Kong bank and the local government and it was firmly in the financial institution's favor of resisting any currency reform.

Table 2 - Hong Kong Trade Statistics: WPI, Import, Export and External Trade

	WPI	IMPORT	EXPORT	EXTERNAL TRADE
1931	100	738	542	1,280
1932	89.60	624	472	1,096
1933	75.77	501	403	904
1934	66.98	416	325	741
1935	57.03	365	271	636
1936	75.48	452	351	803
1937	95.97	617	467	1,084
1938	95.61	618	512	1,130
1939	93.70	594	533	1,127
1940	126.87	753	622	1,375

Note: Index of wholesale prices, 1931=100.
Sources: *Hong Kong Blue Book* (1931-40); *Hong Kong Statistics* (1947-67).

Turning to economic data during the period, the rise in silver caused a fall in money supply and a moderate readjustment of the boom enjoyed from the 1929 to 1931 period. From 1931 to 1934 (in *Table 1*), the amount of currency circulated fell 0.3% while government revenue fell 10.8% and expenditures stayed the same. Total land revenue was sharply affected and was down 51.6% in the period. The rise in silver and fall in money supply caused general deflation with the wholesale price index down 43.6% over the period (in *Table 2*). The amount of external trade also fell by 42.1%, no doubt caused by the global

[15] T 160/1068/2, despatch from Secretary of State to Governor, Hong Kong, dated 11 February 1934 and the Governor's reply, dated 27 April 1933, quoted in Ure, 50.

depression as well as the general deflation trend in Hong Kong. This period illustrated that in the face of the fear of the destabilizing effect of delinking Hong Kong's currency from China as well as the resistance from the major corporations, the authorities in Hong Kong would choose to delay the issue of currency reform in the face of moderately poor economic performance. The events that were to come in 1935 would demonstrate that the local government would act when there was no alternative available.

THE 1934-1935 PERIOD

In the midst of the depression, the US left the gold standard and contemplated a new currency system that was based on gold and silver. This is partly driven by the 7 states in the US which were silver producers. A rise in silver prices would benefit their economies. There were some misgivings to the plan and "although the administration had opposed the proposal to raise silver prices, Congress still passed the Silver Purchase Act on June 19, 1934.[16] This paved the way to the "establishment of an American monetary reserve that was 75% in gold and 25% in silver."[17]

The rise in silver prices due to US purchases had a huge negative impact on the monetary affairs of China. The country enjoyed positive silver balances in the early 1930s; but, as a result of the US Silver Purchase Act, silver trade reached a huge deficit of 259,941,414 Yuan in 1934."[18] Hong Kong was not immune to the issue and the peculiar system of allowing a privately owned bank to dictate monetary policy further compounded the problem. "In the middle of April 1935, a further increase in the silver price caused the value of the Hong Kong dollar to rise to 40% more than the Shanghai dollar which caused

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[16] Zhaojin Ji, *A History of Modern Shanghai Banking: The Rise and Decline of China's Finance Capitalism* (Armonk, N.Y.:M.E. Sharpe, 2003), 187.
[17] Ibid.
[18] *Jinji Yanjue 1*, no.1 (1939):12 quoted in Ji, 188.

"growing anxiety."[19] As an example of honest reflection, "the Colonial Office admitted it did not know what to do."[20]

Following the policy to having Hong Kong's currency linked closely to China, in May 1935, "the Governor of the Bank of England, Montagu Norman, stated that "it was better to follow China in any changes to the monetary regime than to precede it."[21] The concern could be diplomatic and not merely economic as the Japanese regarded China's abandonment of silver as part of a British design to draw China into the British bloc.[22] If the Hong Kong Dollar would abandon silver, it would "shift immediately to a sterling peg."[23] This would anger the Japanese as they would view it to be Britain's plan to draw China into the sterling bloc using Hong Kong as the trailblazer of the endeavor. This was again an example of how external forces affected the crucial decision for the well-being of Hong Kong.

The effect of such postponement of currency reform was dire as1935 would eventually prove to be a horrendous year economically for Hong Kong. For the year, as the silver dollar rate rose 30.1%, the amount of currency in circulation fell 12.2% (*Table 1*). Government revenue fell 3.9% and expenditures dropped 9.2% (*Table 1*). Land revenue fell by 32.3% (*Table 1*) and the wholesale price index fell 14.9% (*Table 2*). The amount of trade fell 14.2% (*Table 2*) as well.

Mindful that "a weak Chinese economy would have a negative impact on British interest in China,"[24] in September 1935, the British government sent Sir Frederick Leith-Ross to Shanghai to consult on currency reform.[25] "The Leith-Ross mission to China created

[19] CO 323/1312/11, minute from Caine dated 26 April 1935 and telegram from Governor, Hong Kong to Secretary of State, dated 26 April 1935, quoted in Ure, 51.
[20] Ure, 51.
[21] Latter, 12.
[22] Ibid., 13.
[23] Ibid., 12.
[24] Ji, 196.
[25] Ibid.

hostility in Japan"[26] as they saw China as a semi-puppet state to Japan and British involvement was an act of aggression on Japanese interest. The US also did not allow Leith-Ross to make a stop on their soil as they felt that the British were acting unilaterally on this matter. In any event, at the advice of Leith-Ross, on November 4, 1935, China left the silver standard and "the new currency system was based on minimum reserves of 25% in silver and 35% in foreign currency and government bonds."[27] Japanese was suspicious "that China had left silver at Britain's behest and that it would later switch to sterling and join the sterling bloc."[28] Vindicating that sentiment, Hong Kong Bank "cooperated by turning its silver holdings against the Central Bank notes over to the Chinese government banks."[29]

The early days of the Chinese currency reform was highly unstable and especially when the Japanese were against such a move. After the announcement of the reform Japanese banks "purchased the foreign currency of Chinese banks and put pressure on China's new policy of dealing in foreign exchange in unlimited quantities."[30] Sensing that it could use its vast capital to influence the affairs of the vastly populated country of China, the US belatedly agreed to support the new Chinese currency system. On November 13, 1935, at the request from the Chinese side, the US agreed to immediately "purchase 50 million ounces of silver for 32 million US dollars."[31] The US action helped to stabilize the new currency system, albeit temporally.

As a result of China's abandonment of the silver standard, Hong Kong followed suit as well once there was some stabilization in the system. "Hong Kong legislation was enacted,

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[26] Ibid., 200.
[27] Ibid., 194.
[28] Ure, 54.
[29] Ji, 197.
[30] Wang Xi, "A Test of the Open Door Policy: America's Silver Policy and Its Effects on East Asia, 1934-1937," in *American, Chinese and Japanese Perspectives on Wartime Asia, 1931-1949*, ed. Akira Iriye and Warren Cohen (Wilmington: Scholarly Resources, 1990), 53-57, quoted in Ji, 201.
[31] *Foreign Relations of the United States: diplomatic papers, 1935: Vol. 3. The Far East.* (Washington: U.S. Govt. Print. Off., 1935), 641-42, http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS-idx?type=header&id=FRUS.FRUS1935v03.

on December 5 1935, which terminated the silver standard."[32] However, mindful of the suspicions of the Japanese and American powers, the "Chancellor recommended that Hong Kong should not leap to a sterling standard but rather manage its currency to keep approximate parity with the Chinese dollar."[33] In response to the change in currency system, "banks surrendered their silver in return for silver certificates which they could use as backing for the note-issue."[34] "An Exchange Fund was established under the Colonial Treasurer…which had power to sell foreign exchange and silver."[35] The authorities declared that "the Hong Kong dollar was now a managed currency."[36]

When the ordinance was passed, the market rate of Hong Kong dollar against sterling was between 16d (pence) and 18d which was much lower than "its peak of around 30d per Hong Kong dollar in April."[37] As a result of the US ceasing to acquire additional silver, the silver dollar rate fell 35.4% in 1936 (*Table 1*). The abandonment of the silver system led to a lower Hong Kong dollar which fueled an economic boom in the city from 1935 till the outbreak of the Pacific War in 1941. From 1935 to 1940 (in *Table 1*) the amount of currency in circulation rose 55.0%. Total land revenue rose by 123.2% during the period (*Table 1*) while the wholesale price index increased by 122.5% (*Table 2*). The total volume of external trade rose by 116.2% (*Table 2*). For the period from 1935 to 1939, government revenue increased by 45.9% as expenditures went up by 34.1% (*Table 1*).

The British government did not want to stir any hostility from the Japanese and Americans regarding China and Hong Kong's currency reform and to be perceived that it

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[32] Laws of Hong Kong, chapter 66, http://www.legislation.gov.hk/blis_pdf.nsf/CurAllEngDoc/B14512AEA9D0D8E9482575EE0036BEF8/$FILE/CAP_66_e_b5.pdf.
[33] Bank of England, OV44/104/96, quoted in Latter, 13.
[34] Ure, 55.
[35] Ibid.
[36] Hong Kong Hansard, 5 December 1935, p. 249-52, and T160/1069/8 note for Governor Caldecott prepared by Young in December 1935, attached to letter to Leith-Ross from Young dated 17 December 1935, quoted in ibid.
[37] Latter, 16.

tried to draw them into the sterling bloc. However, the Hong Kong dollar was nonetheless "held steady against sterling and the assets of the Exchange Fund were soon to be held almost exclusively in sterling."[38] The world currencies were by and large stable versus each other in the late 1930s and also had limited volatility against silver and gold. The silver dollar rate dropped 2.1% from 1936 to 1940 (*Table 1*) with no major fluctuations.

Hong Kong's new managed currency system had little drama until the Japanese launched a full scale war against China in 1937. As China plunged into turmoil, "there was no longer sense in thinking of keeping the two currencies in close alignment. From then on the Hong Kong dollar assumed unambiguously its sterling link."[39] This was a case of Hong Kong staying economically and monetarily tied to China until there was a turmoil of gigantic proportions in the mainland. Hong Kong would then be in a privileged position to be linked closely with the international system that it could delineate from the rest of China.

CONCLUSION

This paper examined the events that led up to Hong Kong's abandonment of the silver standard in 1935. The intention for currency reform began in the 1929 to 1931 when the great depression caused a sharp drop in commodity prices versus the major gold-linked currencies. Such liquidity flow into China and Hong Kong also caused a steep premium in the Hong Kong dollar versus the Chinese yuan. The instability of the spread was caused by the fact that most of the city's note issuance was done by Hong Kong bank, a private financial institution that correctly put its interest above the general well-being of the city. There were voices that change was necessary but the Hong Kong bank was resistant because it would hurt its prestige. Moreover, there was a general understanding that given the strong economic ties

[38] A Bank of England memo of 17 November 1936 stated that the assets were by then "almost entirely in sterling". OV44/106/57, quoted in ibid., 14.
[39] Ibid., 16.

with China, Hong Kong's monetary system must maintain a level of stability with the Chinese currency. These forces caused the authorities to delay any reform.

The period of 1931 to 1934 saw a moderate rise in the price of silver as the major currencies got off the gold standard. This reversal in liquidity caused the premium of the Hong Kong dollar to come down and thus dampened the urgency of currency reform. The economy during this period was relatively weaker than the previous period but it did not hit crisis level to warrant action. This illustrated that currency reform would be difficult for the city if there was no crisis.

The moment of monetary system change happened in 1935 when the US began purchasing silver in large quantities in 1934 in the anticipation of using the metal as part of the its currency reserves. This created a liquidity crunch for Hong Kong and China and could be demonstrated that the domestic policies of the major powers could seriously affect the affairs at home. The resulting rise in the silver price in effect forced China to abandon its silver standard system. With the help of Britain, it went into a managed currency system and Hong Kong followed suit soon after. The Japanese was displeased with how China became close to Britain and one could even link the outbreak of the Sino-Japanese War to China's currency reform as she did not consider Japan as its leader during the process.

Hong Kong's abandonment of silver was thus a result of the US's purchases that caused a crisis in China which in turn forced both China and Hong Kong into a managed currency system. As seen from this paper, Hong Kong had its own currency but had to consistently dance to the tune of the powers around her. If it was not for a major crisis, the authorities of Hong Kong had neither the will nor the power to reform its currency system. This episode in 1935 could serve as an important lesson for observers of the currency monetary system and form a conclusion that we would continue to be in this current exchange standard until there was a major crisis close to home. One must wonder if Hong Kong could ever develop itself to becoming more proactive with its economic well-being.

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