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K.N. SAIKIA

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By

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Preface

It is generally agreed that "when a writer offers a book to the public upon a subject on which the public are already in possession of many others, he is bound by a kind of literary justice to inform his readers, distinctly and specifically, what it is he professes to supply and what he expects to improve." Obeying the above principle, the purpose of writing this little book can be said to be, to provide the student of international banking with a concise and handy taxtbook which will enable him to be acquainted with the important foreign banking systems and make a comparative study of them. Books and materials on foreign banking systems are extremely scarce at Gauhati. It is therefore hoped that this book will supply an important need.

The book is not the result of any plan to write one, but was rather hurriedly prepared out of my lecture-notes at the request of my students. However, it contains a precise and up to date treatment of the systems; and I have deliberately incorporated longish extracts from more learned authors for benefit of the students. Knowledge of banking theory is presumed on the part of the stndents; and the emphasis here is on the side of furnishing information rather than explanation.

If any expert has time to glance throug this book, I hope he will very kindly point ou the mistakes, if any, and tell me how this fir publication of mine can be improved.

As the printing of the book had to be com pleted within a short time, a number of prin ting mistakes remained, for which a corrigendum has been suffixed.

I would like to express my gratitud to Shri Bijoy Krishna Sinha, proprietor, Ba printing wo.:ks, Gauhati, for his earnestly seein the book through the press.

Gauhati.
November, 1961.

K. N. S.

B. u. Ahmed.
6 th yr. Eco. 1965.

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PART I

Contents of Part I

THE BANKING SYSTEM OF AUSTRALIA.

The banking system of Australia has some interesting features. The absence of unit banks, large number of branches opened by each commercial bank, the overdraft system of granting even long term credit, the State Rural banks, and the Commonwealth group of banks, are some of the peculiarities in the system. On the central banking side, though until recently the Australian Special Account system was of interest to the outside world, it has now been substituted by the Statutory Reserve Deposit system which again has certain interesting features. The Commonwealth Bank, now the Reserve Bank of Australia, has been trying to organise a short term money market in the country. The **'modus operandi'** of the scheme is rather interesting. The conversion of the Industrial Finance Department of the former Commonwealth Bank into a full-fledged Development Bank is of no less interest, The success of the Australian monetary policy, partly for the different techniques

of credit control developed from time to time, a
partly for the much needed co-operation extend
by the commercial banks, has certain lessons for t
banking systems of underdeveloped countri
Lastly, it is interesting to observe how the Aust
lian system has been trying to achieve the sa
objectives, for which commercial banks are bei
nationalised elsewhere, without nationalisation
commercial banks. It seems there is an attempt
build up a government sector in banking indust
competing with the private sector, and thus forci
the latter to conform to the correct banking pr
ciples and practices as formulated and guided
the Reserve Bank.

The pastoral industry is the oldest a
most important industry in the country ; and t
prosperity in the industry is the prosperity of t
nation. As such, the banking system has be
profoundly influenced by the needs of pastoral a
associated industries. During the post-war peri
however, Australia has been trying to build
manufacturing industries and accordingly, t
banking system is being adjusted to suit the nee
of developing manufacturing industries.

The process of amalgamation carried out
Australia deserves emulation by other countri
It seems to be one of the alternative means
preventing bank failures.

Development of the System :—The first
ading bank of Australia, the Bank of New South
Vales was established in 1817, on the English
nodel. A few local banks were established during
he eighteen thirties, but they failed to compete
vith the larger 'metropolitan banks' which have
pened their branches in Australia. The number
f banks considerably increased by 1841 when
he depression came and many of the local banks
ailed. After 1841 considerable number of banks
vere established, and they opened branches. The
number of banks reached its peak in 1893 when
he great banking debacle came, in which many
of the weaker banks closed their doors. The two
waves of bank failures made the banks realise their
weaknesses ; and they tried to strengthen themselves by amalgamation. By 1914, there were 20
banks. The number was reduced to 15 by 1925.
In 1951 two English banks merged into one.

Some of the earlier banks were organised in the form of partnerships but this proved to be disadvantageous, and incorporation as joint stock companies followed in due course.

All the banks adopted the system of branch banking, and there was no restriction in opening branches throughout a state or the country. Some of the banks, however, confined their branches to single states as a matter of business policy.

Most of the banks issued notes until 1910, wh restrictions were imposed on note issue by t banks.

The private banks were established either Royal Charter, or by special Acts of Parliame or under the Company Laws of the differe States. The Commonwealth government had central legislation regulating the activities of t banks until 1945 when the Commonwealth Ba Act was passed. The Banking Act was also pas in the same year, subjecting the banks to Commo wealth law, which superseded the laws of the stat The two Acts were the results primarily of t recommendations of the Royal Commissio appointed in 1936 to investigate the monetary a banking system of Australia and suggest remedi The main recommendations of the commissi were, greater control over the banking system the Commonwealth Bank, licensing of commerc banks, centralised regulation and control etc. also favoured the system of private banks und the control of the Commonwealth Bank. T recommendations could be given effect to only aft the war.

The purpose of the two Acts was to modi considerably the structure of the banking syste by putting into operation the Royal Commissio recommendations.

The Banking Act, 1945 :—This Act was assed with the declared objective of regulation of anking and making provision for the protection f currency and public credit of the commonwealth. t vested wide powers in the Commonwealth Bank f Australia, mainly on the basis of the war-time ontrols over the banking system. It devised the Special Accounts" system through which the central bank controls could be made effective. Banking in the country could be carried on only by uthorised corporations. For protecting the lepositors, it authorised the Commonwealth Bank o obtain information from the commercial banks rom time to time, and in case of failure to furnish information by any bank, to appoint one of its officers to investigate the affairs of the bank concerned. If any commercial bank is about to suspend payment, it can inform the Commonwealth bank which might then investigate its affairs, and, if necessary, assume control of the bank and even carry on its business. Once control is assumed by the Commonwealth Bank, it has to continue in control till the depositors are paid or suitable provision for payment is made.

The Act also empowered the Commonwealth Bank to make regulations, with the approval of the treasurer, fixing the rates of interest payable to or by banks and also the rates of

discount to be charged by them. The Bank co
also make regulations to the effect that inte
shall not be payable in respect of (1) any dep
repayable on demand or after the expiration o
period specified in the regulations, or (2) t
portion of a savings bank deposit account wh
exceeds a stated amount.

The Act also provided for licensing of ban
which had to be corporate bodies, and grant
licences to all existing banks.

The Banking Act of 1957 :—The A
was passed to nationalise the banks. The declar
objects of the Act were :

(a) the expansion of the banking busin
of the Commonwealth Bank as a publicly own
bank conducted in the interests of the people
Australia and not for private profit.

(b) the taking over by the Commonweal
Bank of the banking business in Australia
private banks and the acquisition on just terms
property used in that business.

(c) the prohibition of the carrying on of th
banking business in Australia by private bank

This Act was later repealed by the govern
ment, which also amended certain provisions o
the Commonwealth Bank Act.

Nature of the Money Market :—*M
Hytten writes : "There is no open money market i

* Backhart—Banking System, P. 41

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ustralia. What little exists is very elementary in
rganisation. There is no commercial bill market,
or the simple reason that commercial bills are
cant in volume and appear to be gradually vani-
hing. Nor has there been any great demand
or short-term investment at low rates of interest,
r the emergence of the very necessary middlemen.
he discounting of treasury bills is confined enti-
ely to the commercial banks and the central bank.
he bills are taken up by the commonwealth Bank
nd sold to the commercial banks."

The largest suppliers of long-term capital
re the insurance and the trustee companies. The
argest borrowers are the Commonwealth and the
State governments. The Wool is the most impor-
ant product of Australia and the profits and
osses of the banking system vary with that of
vool trade. The stock exchanges that have been
established in large cities help in raising private
capital through shares and bonds. There are a
number of issue houses as well.

The capital market is now completely con-
trolled. Bank lending is strictly for working
capital purposes. A board has been set up for
controlling capital issues. Bank lending is con-
trolled by the central bank.

In 1959, the Commonwealth Banks Act
was passed separating the central bank, now called

the Reserve Bank of Australia, and constitu the Commonwealth Banking Corporation und separate Board and with a separate staff with ponsibilities for the Commonwealth Trading B the Commonwealth Savings Bank and the Comm wealth Development Bank. These government titutions working in full swing are likely to in ence the conditions of the money market to so extent.

Of late, the commonwealth Bank, now Reserve Bank of Australia, has been successfu trying hard to develop the short-term mo market. In 1959, the Commonwealth Bank Australia announced that it would be willing to as lender of last resort for dealers in appro securities operating in the short term money m ket, subject to cerntain conditions and requ ments. These terms and conditions were : T minimum paid up capital of a stock broking fi for recognition as an approved dealer must be 1,00,000. Each approved dealer is required lodge with the central bank specified amou in the form of cash or "money market securiti defined as Commonwealth Government securit with currencies not exceeding three years, and confine its operations for the time being to su securities. The lodgments are required to be eq valent in market value to at least 1 per cent

eir holdings of securities maturing within one ear, 2 per cent of one-to-two-year securities, and per cent for two-to-three-year securities. The eserve Bank now approves of a maximum ortfolio of approved securities for each dealer ccording to the amount of the dealer's capital and stablishes a line of credit in his favour to the full xtent of the portfolio. The Reserve Bank is lso willing to deal directly with the approved ealers in money market securities. All approved lealers will be regarded as customers of the central bank.

The Bank also offers safe custody facilities for the dealers' security holdings. It will call for confidential returns from the dealers as it requires. Against this guarantee of liquidity the dealers agreed to consult the fund and to be guided by the Bank's advices on matters of importance relating to the market.

Several firms have already been accordingly recognised and more are expected to be recognised in course of time. As the Journal of the Indian Institute of Bankers (Vol. XXXI, No. 4 P 299) observes, "Meanwhile, the money market has been making steady progress and its holding of short term government securities, which aggregated over A£ 75 million in mid-1960, has resulted in some broadening of the gilt-edged market. As the market's operations grow in size and variety, monetary authorities should be able to weild g ter influence on monetary policy through o market operations. It should, however, be poi out that the restricted supply of short term gov ment securities with evenly spaced maturities the absence of a system of public tender for T sury bills seriously limit the scale of the mark operations. The introduction in November 1 of seasonal Treasury notes has made a desir change in the situation."

The growth of the money market is sur help the commercial banks in maintaining th liquidity. It will also help the central bank following a successful monetary policy and carry on an effective control over the banking syst The 1959-60 Annual Report of the Reserve B observes that the short-term money market is fir established in Australia.

Constituents of the system .-Followi are the constituents of the Australian banki system :

1. The Reserve Bank of Australia. 2. T Commonwealth Banks, namely, (i) The Comm wealth Trading Bank, (ii) The Commonwea Development Bank and (iii) The Commonwea Savings Bank. 3. Commercial or Trading Ban 4. State Rural Banks. 5. Pastoral and La

inance Companies. 6. Savings Banks.

Besides these, the Commonwealth Govern- ent Treasury issues loans on its own behalf, and n behalf of the state governments. There are ther types of credit institutions as well, such as, uilding and investment societies, co-operative redit associations, trustee and agency companies, nsurance companies, friendly societies and hire urchase companies.

Commercial Banks :— * Prof. J. S. G. Vilson mentions two main features of the Austra- ian Trading banks, namely, first, the country has come to be served by a wide network of bank branches ; and, second, banking business has been concentrated in the hands of a relatively small number of institutions. Unit banks are almost non-existent in Australia. As Butlin observes, "the emergence of a unit bank system has never been a real possibility in Australia." Commercial banks have large numbers of branches.

The following are the seven commercial banks of Australia with their respective numbers of branches :

a) Bank of New South Wales 655. b) Commercial Banking Co. of Sydney Ltd. 326. c) National Bank of Australia Ltd. 436. d) Commercial Bank of Australia Ltd. 390. e) Bank of Adelaide 64. f) English Scottish and Australian

* Sayers—Banking in the British Commonwealth. P. 1.

Bank Ltd. 257. g) Australia and New Zea
Bank Ltd. 553.

In addition to the above, there are ab
440 branches of the Commonwealth Trading B
of Australia. Thus, these eight institutions
ssess about 3,121 branches throughout the co
try. Of the seven banks, the first five have t
head offices in Australia, and the last two h
their head offices in London. As has already b
noticed, the reduction in the number of banks
been effected by successive waves of amalga
tions.

Business of Banking :—The business
a commercial bank is mainly to accept deposits
to make advances. Deposits are accepted on curr
account payable on demand, generally bear
no interest, though interest is often paid
current accounts of charitable institutions. Fix
deposits for periods of 3, 6, 12 and 24 months
accepted at interest of $\frac{1}{2}$, $\frac{3}{4}$, 1 and $1\frac{1}{2}$ per cent r
pectively. The rates are varied from time to ti
to comply with the directives of the central ba
but the interests on existing deposits at the ti
of variation are not affected. Though fixed dep
sits are not legally withdrawable except on exp
of the term, most banks exercise the discretion a
llow immature withdrawals and reduce the i
erest. One peculiar feature observed in case

fixed deposits in Australia is that its volume
ctuates inversely with the fluctuation in trade.
rises when the trade is bad, and falls when the
de is good.

The banks make a fixed charge for maintai-
ng current accounts, and make a charge for
gotiating cheques and inland bills, the rate vary-
g according to the time and difficulty of collec-
on.

As regards the ratio between the current
d fixed deposits, during the thirties, fixed de-
sits formed as high as 70 per cent of the total
posits, but the figure has fallen to as low as 24
r cent after the war. This is because of the
se in liquidity preference on the one hand and
e successive lowering of the interest rates by
e banks, on the other.

The cheque habit is well developed in the
untry. Cheques, bills of exchange, promissory
otes, travellers' cheques etc., are the different
redit instruments used in the system.

Advances are made in the form of over-
rafts strictly repayable on demand, generally
gainst securities, though unsecured overdrafts are
ot uncommon. A ceiling for every customer is
rranged; and interest is charged on the daily
ebit balance. There is practically no fixed
ommercial loans for definite periods in Australia.

All loans are on overdrafts, which are
allowed to continue for long periods. This fle
system appears to suit the needs of the cou
The overdraft system is used even to provid
fixed capital requirements of the Industrialists
agriculturists. It is because of this reason
overdraft rates are now controlled by the Com
wealth Bank of Australia, which varies it
time to time. The rates on fixed deposits are
similarly controlled and varied.

Besides advances, the main investmen
the banks are in government and local bodies'
rities, including Treasury bills. Company se
ties are rarely held. Security holdings of the b
are gradually rising in recent years.

The commercial banks have also assiste
financing overseas trade in several ways. Som
them act as agents of the Commonwealth
(Now Reserve Bank) in the exchange control
tem and are allowed to hold working balanc
overseas funds. They also issue letters of c
and arrange for presentation and issue of d
relating to foreign trade.

Inter-bank clearing of cheques is
through the clearing houses by means of che
drawn on the Reserve Bank. In every capital
and in some of the larger towns there is a
ring house.

The Bank of New South Wales is the largest
the commercial banks. Next comes the New
istralia and New Zealand Bank Ltd. followed by
National Bank of Australia Ltd.. After
em may be mentioned the Commercial Banking
mpany of Sydney, the Commercial Bank of
ustralia Ltd., the English Scottish and Austra-
Bank Ltd., and the Bank of Adelaide, in order
size.

The lending policy of the banks is directed
the central bank from time to time by issue of
neral directives. Often the directives are fairly
haustive, setting out the types of transactions,
rposes and proportion of loans to be granted.

The commercial banks also carry on sub-
diary services such as, keeping papers and
luables in safe custody, collecting and paying
terests and dividends, looking after the banking
d non-banking needs of the travellers, payment
insurance premiums etc.. Some of the banks
ave opened departments for economic intelligence
d research.

Structure of Assets and Liabilities :—
n the liability side of the balance sheet of a
ommercial bank, besides capital and reserves, there
the liability to the public consisting of notes, bills
ayable, other liabilities and deposits. As has al-
eady been mentioned, banks are not allowed to

issue notes at present, and therefore, their lities in notes are nominal. Other liabilitie clude contingencies and provisions for bad doubtful debts. The greater part of liabilities sist of deposits, of which nearly 80 per cent demand and the rest time liabilities.

On the assets side, coin, bullion, bal with the Reserve Bank, Balance on Statulory posit Account, advances and discounts, investm and land and buildings.

Commercial banks are now required to considerable sums in Statulory Deposit Acc with the Reserve Bank. Money at call and notice is very little in comparision with assets. Investments and securities include sury bills and government and municipal se ties. Advances are mostly in the form of drafts. Bills discounted forms only about cent of the assets. Permanent assets like land buildings are quite negligible. It is particu so mainly because of the banks' maintaining reserves by showing these assets far below actual values.

Cash and Liquidity Ratios :— So fa the liquidity rules are concerned, the Austr banks follow the English banking practices. B maintain three ratios, namely, the ratio of ad ces to deposits, the ratio of liquid assets to

otal liabilities to public, and the ratio of cash o deposits. Before the war there were differen- es as to what was to be regarded as cash. Besides, here were no fixed rules as to the ratios, different anks maintaining different ratios. Even in the same bank the ratios varied from time to time. Further, cash was interpreted in different ways y the different banks. The point has been settled by the Royal Commission on Monetary and Banking System in 1936, whose report was published in 1937. It described cash as :—"Those tems which are cash in themselves (coin, bullion, and notes) and those which will be urned readily into cash by the Commonwealth Bank (deposits with the Commonwealth Bank, reasury bills, and London funds)". The commission urther observed : "We have not regarded as London unds Australian Government securities held in Lon- lon. The London funds included as cash are taken t their value in Australian currency at the time o which they relate. It is true that no one ank uses precisely these items in calculating its ash ratio but in our view the ratio which we ave adopted is the most important indication of he liquidity of the system as a whole. It might e confusing to call the ratio either 'cash ratio' or iquid ratio'. The items include more than cash the strict sense of the word, and less than

the total liquid assets taken into account b
banks for purposes of their liquid assets r
For convenience we shall refer to it as
"cash reserve ratio", and to the aggregate
treasury bills, and London funds as "cash rese
(para 170. p. 75,)

The Australian Trading banks hold c
derable balances in London which they con
liquid. Speaking on the role of London f
in the liquidity of the Australian banks, P
Wilson writes : "First, because of the season
of their business, it was the practice of
banks to accumulate large sums in London
ing the export season and to allow them
gradually run down during the remainder of
year. Second, and from the point of view
a single bank any increase in its London fu
over and above its normal holdings, witho
corresponding decrease in Australian funds,
ded to improve its liquid ratio and, then
its power to lend. Conversely, any decreas
its London funds, without a corresponding
crease in Australian funds, tended to reduce
power to lend. If one bank found that
holding of London funds were too large, or
small, it adjusted its position by selling to
buying from the other Australian banks.
either case its liquid resources would rem

changed in amount. But, of course, for the
nks as a whole it was not possible to meet
position in this way. A general increase in
London funds, without a corresponding de-
ease in Australian assets, meant a general in-
ease in the liquid resources of the system........
nversely, when London funds decreased with-
t a corresponding increase in Australian assets,
ey were inclined to lend less. Whenever recei-
s from exports were high, or government
erseas borrowing increased, or imports fell off,
e liquid resources of the system tended to rise
d an expansion of credit could be expected.
Whenever receipts from exports were reduced or
overnment overseas borrowing slackened, or im-
orts rose, the liquid resources of the system
ended to fall, and a contraction of credit could
e expecetd.

If the banks were in a position such
hat their cash ratios, liquid ratios, and ratios of
dvances to deposits were satisfactory, and a net
ncrease or decrease in the London funds altered
hem, the steps taken by the banks would tend
o restore the ratios and lead to the necessary
djustments in the London funds. When, for
xample, a rise in export values increased the banks'
oldings of London funds, it simultaneously increas-
d the Australian deposits, or reduced the level of

advances, of those customers from whom t
banks have bought export bills. The first eff
of this was that the ratio of advances to depos
would fall, and the ratios of cash to depos
and liquid assets to liabilities would rise.
this change in the ratios was large enough, th
banks would be prepared to increase their advance
thus raising the advance-deposit ratios. An
increase in advances would tend to increas
deposits. Cash ratios and liquid ratios woul
then fall. In addition, this expansion
of credit would tend to increase the aggre
gate money income of the country and so sti
mulate imports which would in due course reduce
London funds. Conversely, a net increarse in
London funds, leading to a change in ratios
would tend to result in a restriction of advances
and to restore London funds through a decline
in imports." Thus, the liquidity of the system
varied with the volume of London funds.

There has been some change in the lend-
ing policy of the banks since the first world
war. Until 1930, the ratio of cash and balances
with the central bank was usually round about
20 per cent. But the introduction of the Treasury
ills made large cash holdings unnecessary for
he banks as these bills could be discounted
ery quickly with the central bank. Consequently

ratio dropped to 11 per cent. in 1939. The
duction of the special account system in 1941
ted in reduction of advances by the banks.
he other hand inflation after the war had
ted in growth of deposits in the banks.
result, the ratio of advances to deposits
stood at 90 to 100 per cent dropped to
40 per cent. The blocking of funds in
l account had to be compensated by lower-
he cash reserves. As a result the cash ratio fell
per cent during the post-war period.

Post-war Banking Changes :—During
var and post-war years number of banking
ges have taken place. The assumptting of
and more power and control by the Com-
vealth Bank, as it then was, curtailed the
endence of the commercial banks in the
r of banking and credit policy. Increase
oney supply leading to growth of deposits
vated the surplus liquidity problem.
Banking Act of 1945 increased the powers
e central bank and curtailed the freedom
mmercial banks in several respects. The
t of the Treasury bills, however, has enab-
ne banks to lower their cash ratios. The
nment directed the rationalisation of branches,
some of the branches had to be closed. The
tory Deposit Accounts system has now

replaced the Special account system.

The Banking Act of 1947 attempte nationalise the private banks, but the was repealed.

Foreign Banks :–The Foreign banks on banking business only on a lin scale. The Ballarat Banking Co. Ltd., the of New Zealand, the Comptoir National d' mpte de Paris, the Brisbane Permanent Buil and Banking Co. Ltd., the Bank of china important among them.

State Rural Banks :—The Commonw Bank of Australia had two departments providing rural credit. One was the Mort Bank Department, which made long-term up to £5,000, against mortgages of agricul or pastoral land. The other was the Rural Cr Department which could grant loans to prod upon the security of primary produce hyp cated to the Bank. Co-operative associations marketing boards could also borrow against rity connected with the production and mark of primary products. In 1959 the Com wealth Bank was re-organised and re-named. W the Rural credit Department is now a part the Reserve Bank, the Mortgage Bank Departm a part of the Development Bank.

Besides the above two departments, sp

pes of organisations have been established by e different State Governments, in the form of ral agricultural banks. In some cases, how-er, these so called banks are nothing more an State government departments. They derive sources from advances made by the State govern-ents, issue of State-guaranteed debentures, and a small extent, from deposits by the public. hey are generally managed by Commissioners ppointed by the State governments. They do not me under Banking law.

Though they primarily provide long-term ans to primary producers and home-builders, of te, they have extended their business to the mmercial and industrial fields. The Rural Bank f New South Wales, the State Bank of South ustralia are some of the important rural banks.

Pastoral and Land Finance Compa-ies :—Pastoral finance companies grant both hort-term and long-term loans mainly to wool-rowers. These are generally private joint stock mpanies with their own capital funds. They lso raise funds by issuing debentures. Pastoral nance companies also accept deposits from their wn customers, but not from the general public. hey also act as agents of their clients for buying nd selling wool, livestock etc. There are about wenty such companies. In their peak periods, they

often borrow from the banks. They cha
terest generally on the daily balances.

Trust Companies :—There are
number of trust companies which invest trus
either in government securities or on mor
Some of them act as investment trusts.

Savings Banks :—Savings banks
savings deposits and pay interest at v
rates. The state savings banks also lend
on mortgage. All of them invest fun
government securities. The State Savings
of New Souh Wales, the Commonwealth S
Bank, the state Savings Bank of Victoria are
of the important savings banks of the co

Central Banking and its Developm

The Commonwealth Bank of A
ralia :—Established in 1912 by an act pas
the previous year, as a government ban
was not intended by its founders to be a ce
bank but a commercial bank competing
the existing banks. As observed by Prof. Wi
"the ultimate evolution of the Commonw
bank as a central bank, was as it happ
more a matter of accident than of design."
was established with two departments, a gen

king department and a savings bank
artment.

The Bank was established without any
ital. Of course, it was given power to raise
1 million as its capital but the power was never
l. The Commonwealth Treasury advanced
10,000 with which the Bank started and quickly
id the amount. The power to issue notes
not in the first instance vested in the Bank,
being retained by the Federal Treasury. It
no shareholders or board of directors, it
g managed by a Governor appointed by the
ernment, who was vested with wide powers
uding the power to decide the broad lines
Bank's policy. The first Governor to be appointed
Mr. Denison Miller, "a man of considerable
e and strength of character". It is said that
Miller had the idea of central banking in
mind and that is why the Bank never
red into aggressive competition with the
mercial banks. But there was no open and
wed policy to make the Bank a central Bank.
dually, however, it emerged as a fully equi-
d central bank of the country.

The Bank started functioning in 1912 in its
ngs bank department and in 1913 it opend its
eral banking department. It opened account
the government deposit of A£2.3 million.

Soon the Bank got itself involved in the go- ment financial problems of the first world The first step towards making it a central was taken when "it took steps to safeguar trading banks' cash position from the effe the transfer of loan funds to government acco During the war years it supervised the float of all war loans issued in Australia and Lo acted as government agent in effecting ship of gold abroad, and also provided funds various marketing pools. It began taking in all matters concerning the banks as a a leadership which helped it in being the ce bank.

In 1920, a note issue department established when the power to issue notes transferred to it from the Federal Trea A cover of 25 per cent in gold was made pulsory. The Commonwealth Bank Act amended in 1924. It created a Board of Dire comprising the Governor, the Secretary commonwealth treasury, and six other pe actively engaged in agriculture, commerce, fi and industry. The management of the issue department was entrusted to the B The Act also gave the Bank authority to and publish discount and rediscount rates made the settlement of clearing balances

er banks through it compulsory. It is, how- er, interesting to note that due to the absence a bill market, the need for publishing a rate rediscount never arose, and the section was erefore inoperative. Lastly, all banks were uired to furnish to the Treasurer statistics quarterly averages of their assets and liabili- s in Australia.

In 1925, the Rural Credits Department s established within the Bank with the de- ired objective of financing the co-operative rketing of primary products. Fund for the partment was to be received from Treasury ans or from the Bank itself. Further, 25 per nt of the profits of the note issue department s to be made available to this department. dvances were not to be made to individuals, d were not to be for more than 12 months. e Commonwealth Savings Bank was estab- hed in 1928.

From 1925 to 1929 the Commonwealth Bank s functioning successfully in all its departments. rly in 1929 the depression began and strained e entire financial structure of the country. Two ts of factors operated against Australia. First, ecline in the values of Australian exports, and cond, the unwillingness of London to continue nding to the Australian Government. The Austra-

lian exchange rate came down sharply and ex
reserves dwindled. As a remedial measur
Commonwealth Bank was empowered to
over the gold reserves of the commercial ban
others available in Australia, the former
considerably large in those days. Export of
by private individuals was licensed and pr
ted. Despite all these steps, it was found
cult even to provide foreign exchange for me
the interest liabilities on public debt held ove
"In an attempt to meet this situation the Com
wealth Bank with the co-operation of the tr
banks took steps to form an exchange poo
the purpose of providing as a first charge o
country's exchange resources the overseas in
due by the Australian governments." This
known as the Mobilisation Agreement and
entered into in 1930, and it continued
1939. In an effort to provide more exch
reserves, the statutory limit of gold reserve ag
note issue was reduced from 25 to 15 per c
Until then the Australian pound was equal to
English pound. But depreciation of the Au
lian pound brought the rate to £115A equa
£100E. The rate further declined to £12
£130 for one £E. The Commonwealth Bank
fused requests for increased loan funds made
the governments which then began issu

reasury Bills on a large scale. The Bank followed
nsistently a deflationary policy during the period.

The issue of treasury bills had important
fects on the banking system and the central bank
ntrol. In 1931 the Commonwealth Bank under-
ok to meet the bills at maturity and to re-discount
em at a rate differing from the rate at which
ey were issued by not more than ¼ per cent.
r annum. The commercial banks found in the
easury bills a new type of attractive, liquid and
ofitable asset.

The position of the Commonwealth Bank
the central bank is yet to be established. Before
e Royal Commission on Monetary and Banking
stem of Australia in 1936, the Bank pleaded for
hancing its powers, (a) to "give it the right
call upon the overseas funds of the Australian
nking system" and (b) "to require the trading
nks to maintain with the central bank not less
an a fixed percentage of their liabilities to the
blic.

In 1941 the commercial banks voluntarily
terd into an agreement to deposit in Special
counts, bearing a low rate of interest, with the
mmonwealth Bank the deposits held above the
e-war levels. The agreement was made statu-
ry in the form of a National Security Regula-
n which gave the Bank further powers to control

interest rates, control bank advances, and to rate the system of exchange control. By therefore the Bank's position as a central was fully established. During the second wa Bank tried to finance the war efforts and for purpose reduced the different rates of int Foreign exchange was rationed and confine goods necessary for the war, and Australia an export surplus during the period. Its ste reserves rose from £44 million sterling in 19 £167 million sterling in 1945.

In 1945 the Commonwealth Bank Ac passed with three main objects, as stated by Treasurer. They were : (1) to strengthen the ce banking functions of the Bank ; (2) ensure expansion of its general banking business active competition with the commercial ba and (3) to return control of the Bank to Governor, who would be responsible to the surer, in order that the finacial policy of Bank would be in harmony with the gov ment policy.

The Act set out the functions of Bank in the following terms :
Section 8. It shall be the duty of the com wealth Bank within the limits of its powers pursue a monetary and banking policy dire to the greater advantage of the peopl

istralia, and to exercise its powers under this t and the Banking Act, 1945 in such a manner , in the opinion of the Bank, will best contri- te to : (a) the stability of the currency of istralia ; (b) the maintenance of full employ- ent in Australia ; and (c) the economic osperity and welfare of the people of Australia.

The Act made the Central Banking epartment of the Bank statutory, with a capital A£4 million. It also set up a General Banking vision for carrying on the commercial banking isiness, with a capital of £4 million. The neral banking business as directed to be ex- nded by section 18 of the Act which read as llows .

ction 18 (1) It shall be the duty of the Bank, rough the General Banking Division, to deve- p and expand its general banking business.) The Bank shall not refuse to conduct banking isiness for any person by reason only of the ct that to conduct that business would have the ffect of taking away business from another bank.

This section envisaged the Bank in active mpetition with other commercial banks, and that extent it was a departure from its old licy.

The Act also set up an Industrial Finance epartment with a similar capital of A£ 4 Million.

The functions of the department would
(a) to provide finance for the establishment
development of industrial undertakings, and
give advice on the operations of indus
enterprises; (b) to purchase and sell sh
or securities of industrial undertakings,
lend money to them for the above purp
The profits of the Department were to be pl
to the credit of a reserve fund within
department. The Department began its opera
in January 1946.

The Rural Credits Department and
Mortgage Bank Department had been allo
to continue in their old form.

The commonwealth Bank Act prescri
the forms of the balance sheets of the differ
departments of the Bank and also prescribed
nature and limits of some assets and liabili
It prescribed the assets that must be held
the issue department against the notes iss
as follows: gold, deposit with any ba
securities of the United Kingdom governm
or of the Commonwealth or State governme

The figures in the following Balance Sh
give us an idea of relative importance of the di
rent departments of the then Commonwealth Ba
Under the new arrangement, they show the re
tive importance of the Commonwealth Tradi

ank and the Commonwealth Development Bank.

Aggregate Balance Sheet of the Commonwealth Bank, including Central and Commercial anking Activities but excluding Savings Bank, as June 30 1951.*

(Amounts in millions of Australian Pounds.)

Liabilities.	Amount.
Capital	18.
Reserve funds	4.
Special Reserve :	
Premium on gold sold	5.
Notes on issue	275.
Deposits, Bills payable, and other liabilities (including provision for contingencies.)	1,035.
Total—	1,337.

Assets.	Amount.
Gold and balance held abroad (including money at short call)	717.
Australian notes and coins	8.
Cheques and bills of other banks	7.
Commonwealth Govt. securities (including Treasury bills)	308.
Securities of other governments and of local and semi-govt. authorities	94.

* See Beckhart—P. 38.

Bills Receivable and remittances in transit	24.
Bank premises, at cost less amounts written off	2.
Loans, advances, bills discounted, and other assets (after deducting provisions for debts considered bad or doubtful)	177.
Total—	1,337.

On June 30, 1950, the totals of the bal sheets of the other departments were : (in milli of Australian pounds)

Department.	Balance.
General Banking Division	157.
Rural Credits Department	13.
Mortgage Bank Department	5.
Industrial Finance Department	24.

Working of the system since the A of 1945 : The Monetary and Banking Polic

It has already been observed that the main de for control of credit on the part of the Comm wealth Bank had been the Special Account Syst Soon after the war it was realised that for de lopment of the industries, the commercial ba had to make sufficient advances to industries,

›r the purpose they needed sufficient liquid funds. herefore up to 1948 only about 48 per cent of the xcess assets over the pre-war levels were called › be deposited in special accounts. Besides, the mks held large amounts of government securities hich could be realised for making advances and ong with the increase in advances the security ›ldings of the banks declined. The Common- ealth Bank was requested by the commercial mks to allow further withdrawals from their ›ecial accounts. It was, however, realised by the ntral bank that further withdrawals from special counts might lead to inflationary expansion. n the other hand, it was also appreciated that re- sal might hamper the development plans unduly. ccordingly a flexible policy was decided upon, and stead of allowing withdrawals from special counts short period loans were granted at the te of $3\frac{1}{2}$ per cent with the understanding that it ›uld not be a permanent source to the banks but ıs given only to provide some flexibility to the stem.

Prof. Wilson also observes : "Lately, the mmonwealth Bank appears to have adopted the called S. A. C. T. ratio (i. e. the combined total Special Accounts, Cash, and Treasury Bills as atio to deposits) as a rough working rule in ermining what proportion of the increase in deposits should be called to special accounts." ratio has been allowed to hover round 50 per

The Bank has issued from time to time cy directives about advances and purposes of advances. These directives were designed to sure that bank finance available was used for most impotant purposes and that advance p did not add unnecessarily to the existing inf nary pressure on resources." It was empha "that long term capital for development and enterprises should be obtained as far as practi from outside the banking system, that the infl of capital values should not be encouraged by ding on optimistic valuations, that current ex diture beyond current income should no facilitated, and that primary producers shoul encouraged to take advantage of their curr high incomes......" Thus the flexible credit p was applied for curbing the inflationary tend on the one hand, and supporting industrial ex sion on the other.

As regards interest rates, it was rea both by the government and the Bank that low terest rates would support economic expansion employment. It would also lower the burde public debt expenses. The Bank accordingly gulated the rates of interest paid and received not only the banks but also onther finan

tutions. The idea was to bring under control to incorporate in a self-consistent interest rate ture the lending and borrowing rates of tra- banks, savings banks, building and co-opera- societies, and life insurance companies.

The powers given to the Commonwealth k by the Act of 1945 were very wide and some e commercial banks were of the same view. ever, it is being gradually realised not only ustralia but in other countries as well that out wide powers it is not possible to control commercial banks to the desired degree. The ision for active competition with the commer- banks has also been similarly criticised. This ct of competition has advantages as well as dvantages. As an alternative to nationalisa- of the commercial banks, the central bank's ing them to follow the right banking policy ntering into competition is a novel idea and h has been expected of it. Meanwhile, it t be admitted that the Commonwealth Bank built up a very friendly and co-operative rela- ship with the commercial banks, and though it policy is its sole reponsibility, it has very n consulted with them for bringing about nges.

In 1953, by an amending Act, a new system special accounts was introduced. It defined

the maximum amount a bank may be requ
hold in special account, and authorised the
bank to vary that amount from month to

By another amending Act of 195
General Banking Division of the Bank was
rated and converted into a corporate body
the name of the Commonwealth Trading B
Australia, and put under the control
central bank like all other commercial ban
was to be managed by a General Manager
ted by the government on the recommendat
the Commonwealth Bank Board. But lik
Commonwealth Savings Bank, the Common
Trading Bank was still regarded as a part
Bank.

Recent Central banking change **Australia :**—In 1959, Australia's central
the Commonwealth Bank of Australia, was
nised and renamed. Four enactments were p
during the year. They were : the Reserve
Act 1959, The Commonwealth Banks Act
the Banking Act 1959 and the Banking (T
sitional Provisions) Act 1959.

The Reserve Bank of Australia :—
Reserve Bank Act 1959 separated the Com
wealth group of banking institutions from
central bank and formed the Reserve Bank
Australia comprising the central bank and

l credit Department of the Commonwealth
k. The Reserve Bank will function henceforth
as a central bank and will not be responsible
the administration of the retail banking busi-
carried on by the Commonwealth Trading
k of Australia, the Mortgage Bank and the In-
rial Finance Department of the Commonwealth
k.

It also provided that the 'special account
m' be replaced by a system of Statutory Re-
e Deposits. Except for this change, however,
powers of the Reserve Bank in relation to the
king system under the Act are essentially the
e as those exercised by the Commonwealth
k.

The Act contains the following provisions
Statutory Reserve Deposits :

1 Each trading bank is required to maintain a
Statutory Reserve Deposit Account with the
Reserve Bank and to have on deposit in that
Account such percentage of its "current" level
of Australian deposits as is determined from
time to time by the Reserve Bank.

The Reserve Bank may vary the Statutory
Reserve Deposit ratio, on giving at least one
day's notice, provided the ratio is not thereby
increased above 25 per cent.

The Reserve Bank may determine a ratio above

25 per cent, but must give at least
notice where any increase to a ratio in
of 25 per cent is involved.

(d) A ratio remains in force until it is repl
another ratio but any ratio above 25
cannot remain in force for longer
initial period of six months, unless the
Bank gives notice of an extention at
days before the end of each period.

(c) Interest is to be paid on Statutory
Deposit Accounts at a rate determin
time to time by the Reserve Bank w
Approval of the Treasurer.

The central bank is required under t
legislation to ensure that, at any time, the
reserve ratio is in force for all major trading
This is in accordance with the recent pra
the Commonwealth Bank in keeping the r
Special Accounts to deposits uniform for all
trading banks. The cautious provisions reg
changing of the Statutory Reserve are desig
avoid the defects of the variable reserve
system.

A recent writer observes on the i
vements effected by the change over fro
former Special Account system to the Sta
Reserve Deposit system as follows : "Und
Special Account System, the Commonwealth

wers to require balance to be held in Special
ccounts were related to movements in deposits
om a prescribed base date. The position was,
oadly, that the maximum amount callable to the
pecial Account of any bank was increased by 75
r cent of any increase in its deposits and decrea-
d by 75 per cent of any decrease in its deposits.
owever, a limitation was placed on the accumu-
tion of unexercised power to call to Special
ccounts ; the amount of such unexercised power
call carried forward from year to year was not
exceed 10 per cent of a bank's deposits. Under
e new Statutory Deposit provisions, there is no
gal limitations on the proportion of trading
anks' deposits which can be required to be lodged
n their Reserve Deposit Accounts." This will
trengthen the hands of the central bank.

"Previously, there was no legal requirement
or the central bank to give a minimum notice
f changes in the Special Account balances and
here was no statutory provision for periodic review
f Special Account requirements. Under the new
egislation Statutory Reserve Deposit ratios in
excess of 25 per cent must be regularly reviewed
and certain notice provisions in relation to changes
n ratios have been introduced." This safeguards
the interests of the Commonwealth Banks.

"Under the old system, the balances in

Special Accounts of banks remained unc
unless the central bank varied them and the
these balances bore to banks' deposits fluc
with movement in deposits. Under the St
Reserve Deposit System, the ratios are deter
by the Reserve Bank and, unless varied by
amounts lodged in banks' Reserve Deposit
unts will fluctuate from month to month
changes in the current level of their dep
This will keep the central bank alert and
discriminatory effects on commercial banks.
the present system is an improvement.

The Reserve Bank Board has now th
to ensure "that the monetary and banking
of the Bank is directed to the greatest adv
of the people of Australia and that powers
Bank...are exercised in such a manner as, i
opinion of the Board, will best contribute
(a) the stability of the currency in Austral
(b) the maintenance of full employment in
tralia ; and
(c) the economic prosperity and welfare o
people of Australia.

Thus the objects are the same as tho
the Commonwealth Bank.

The Commonwealth Banks Act 1959 e
lished a Commonwealth Banking Corpor
under a new board and with a separate staf
be responsible for the administration of

mmonwealth Trading Bank, the Commonwealth
vings Bank, and a new institution to be called
Commonwealth Development Bank of Austra-
. The Commonwealth Development Bank will
basically an amalgamation of the former Mort-
ge Bank and the Industrial Finance Depart-
nt of the Commonwealth Bank, and it will
cceed to their duties.

The Commonwealth Development Bank
gan its functions from January 14, 1960. Its
in function is to provide finance for primary
oduction and industrial undertakings, particu-
ly smaller business. Its policy will be to pro-
le finance only where it is not otherwise available
suitable and reasonable terms, for development
rposes.

On February 10, 1960 the Reserve Bank
Australia announced an increase of 1 per cent
the statutory reserve deposit ratio. The Gover-
r of the Bank declared that the increase was
cessary for absorbing excess bank liquidity.
rlier in October 1960, the Governor announced
all to the trading banks to pay into special
counts £15 milllon, with the purpose of absor-
ng the excess funds and preventing increase in
nk liquidity. Another call was announced in
cember 1959 for deposit of A£ 16 million for
e same purpose of absorbing excess liquidity.

Bank were directed to follow moderate le
policy. The liquidity increase was indicat
the holdings of liquid assets and governme
curities on the part of major trading banks
35 million in 1959, and A£ 16 million in
As a percentage of deposits the Reserve Ban
tinued the policy of absorbing excess liquidi
March 1960, the statutory reserve deposit ra
17·5 per cent. During the period, high g
ment revenue and rising export receipts cont
to a strong increase in trading bank depos
deposits reached a new hight of A£ 1784 m
In March 1960 the ratio of liquid a asse
government securities to deposits was 2
cent, as against 27·3 per cent in 1959. D
of the public with savings bank rose by 9
cent to a new hight of 1,474 million.
bank advances rose by A£ 34 million to
million. Amounts held in liquid assets a
vernment securities expanded by A£ 923 m
During 1960, the Governor of the Reserve
Dr. H. C. Coombs, asked the trading ba
make immediate and significant cuts in thei
lending and to intensify precautions agains
viding finance for speculative tendencies.
observed that very strong pressure for ban
has produced a sharp extension of bank
and that the request to the banks had been

holding the expansion. Banks were asked to
rain from granting advances for the extension
hire purchase and instalment selling and for
culative activities. The annual report for 1959-
reported that the short-term money market
ablished itself more firmly as an integral part
the Australian financial scene in 1959-60 and
usefulness to lenders was an accepted fact.
also increased the possibility of the central
nk's carrying on of open market operations.
uring the year 1960-61 the expansionist trend
ntinued. The Reserve Bank in an attempt to
ow down the growth of bank advances kept a
ght hand on the liquid reserves of the banks
rough the statutory reserve deposit mechanism.
hese measures, however, failed to bring about
e desired results and the bank advances rose
y 15 per cent to A£ 150 million during the year.
he Reserve Bank listed a number of credits re-
arding which the banks were to be restrictive.
he list included holding of inventories, either
f imported or locally produced goops; consumer
redit by retailers; trade credit; building cons-
ruction where social purposes, such as housing
re not involved; capital projects including un-
derwriting; investment in shares, units and land
trusts and other financial dealings; real estate
ventures and similar credits.

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pa

THE BANKING SYSTEM
OF CANADA.

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mmercial Banking.

Though manufacturing industries have been wing rapidly in Canada, especially during after the second world war, Canadian eco- ny still has an agricultural bias. Canada is an portant producer of food and raw materials uding forest products. Naturally, the banking tem has been designed to suit the needs of producers of these materials. The credit ds of industrial expansion in recent years, vever, has been demanding changes in the king structure and the system has been trying adapt itself to the change.

Prof. G. S. Dorrance* rightly observes that Canadian monetary system has developed along litional lines, and that the Canadian branch king system has been built.

* ayers-Banking in the British Commonwealth p100,103,

up along lines remarkably similar to it
counterpart. Similarly Prof. D.B. March* c
ing the Canadian and the U. S. banking
says: "As a matter of fact, Canada did impo
her banking structure from the United St
over a century ago; but what she impo
no counterpart in the United States toda
da's banking system shows marks of Sco
English origin because Scottish and
precedent and experience influenced A
Hamilton; Hamilton's charter for the
of the United States became the model
earliest charters granted in Lower Cana
these charters in turn have in a continuo
lopment become an integral part of Canad
Act" "The same writer at another place
that there are marks of Scottish and
origin that may be recognised for what t

Prof. Dorrance remarks that the di
in banking practices are few, and that
mainly due to the fact, that there is n
loped money market in Canada, and the f
the Canadian banks generally never gra
draft facilities.

Constituents of the banking system:—

1. The Bank of Canada, the central
the country.

* Beck-hart Banking Systems, pp 1

The chartered banks.
The savings banks.
The Investment Dealers.
Insurance and other loan companies and credit Unions.
The Industrial Development Bank of Canada.

The Bank of Canada is the central bank of the country with the sole note issuing authority, and it carries on the central banking functions. The money supply comprises notes issued by the Bank of Canada and bank deposits. Notes in circulation forms about one-fourth of the money supply and bank deposits form three-fourth.

The commercial banking is carried on by the Chartered banks, numbering eleven in all. They are called chartered banks because they all operate under Dominion goverment charters, as provided in the Bank Act. Practically they alone can use the world bank as part of their names

Main characteristics of the Chartered banks:— As we have already seen, one important characteristic of the chartered banks is that they have large number of branches. The eleven chartered banks have not less than 4038 branches in Canada. This will be clear from the following schedule of bank branches.

Name of the bank	No. of branc
Royal Bank of Canada	793.
Bank of Montreal	603.
Canadian Bank of Commerce	651.
Bank of Nova Scotia	415.
Bank of Toronto	246.
La Banque Provinciale Du Canada ...	349.
The Dominion Bank	183.
Banque Canadienne Nationale ... ,,,	560.
Imperial Bank of Canada	234.
Barclays Bank (Canada)	4.
Total	4038.

(The figures are of 1953)

Thus, four of the eleven banks have than 500 branches each, nine of them have than 200 branches each, only one bank has 4 branches. This has resulted in the concentr of commercial banking in the hands of eleven banks.

The question naturally arises is as to how number of banks could be reduced to 11 and how each bank could develop so many ches ? The answer is simple. It was thro amalgamation and absorption that this state things came to happen. Thus, the Bank Montreal is the result of amalgamation with many as 11 banks, the Royal Bank of Can

10, and the Canadian Bank of Commerce of banks. The process is still continuing. It is imed that this amalgamation has strengthened e banking system enabling it to tide over the pressions without any bank failure. For example, it is claimed that no bank failed in anada during the 1930 s.

The concentration of commercial banking in e hands of only 11 banks has enabled some the banks to open branches not only through t the country, but also in foreign counies. Excepting the Bank of Toronto, La Banque rovinciale du Canada, Barclays Bank (Canada), d the Imperial Bank of Canada, all the other nks have foreign branches in one or more reign countries. The following table shows the stribution of foreign branches countrywise.

nk	Total	U.K.	U. S. A.	France	Cuba	W.Indies	S.Ameria
		Foreign branches in dефferent countries.					
oyal Bank of Canada	69	2	1	1	18	24	23
ank of Nova Scotia	30	1	1	0	7	21	0
anadian Bank of Commerce	9	1	5	0	0	3	0
ank of Montreal	4	2	2	0	0	0	0
ominion Bank	2	1	1	0	0	0	0
anadienne Nationale	1	0	0	1	0	0	0

The existence of foreign branches h
abled these banks to undertake considerable a
of foreign exchange business. In some o
Caribbean islands Canadian banks domina
financial scene. The foreign branches also e
the banks to arrange foreign capital inves
besides the investment of reserves held ov

Though there are a considerable nu
of savings banks in Canada, the Chartered
also have their savings departments. The
tered banks cannot call themselves savings
but can advertise and operate their savin
partments. As a result, the bulk of the s
deposits of the country is in the hands o
chartered banks.

Another important characteristic is
excepting the Barclays Bank, all the Canadian
are "almost entirely owned by residents".
of the banks were initially formed by small g
of local merchants who retained their in
throughout. As a result, it is found that
banks have their head offices within the
nion and are controlled by Canadian nati

True to the English notion of comm
banking, the Canadian chartered banks carr
pure commercial banking, and, as Prof. Do
observes, "Canadian banking has never had
connections with other commercial activities

time have any bank been predominantly
ged in any one field of activity. Healthy
ing tradition and strict banking legislation
two causes leading to this practice.

The Savings Banks :—Savings banks
institutions incorporated under the dominion
Some of them are owned by the provincial
rnments while others are private institutions.
Quebec Savings Banks, Dominion governments
Office Savings Banks, Ontario's Savings
es and the Newfoundland Savings Bank are
ernment institutions and are commonly called
ovincial Government Savings Banks". On
ch 31, 1952, their deposits totalled $340 million.
Montreal city and District Savings Bank not
carries on savings business of individuals
also a limited amount of commercial under-
ngs

Investment Dealers :—There are no
estment bank in Canada in strict sense of the
n. The investment dealers are the nearest
allels of investment banks. Investment dealers
incorporated bodies with limited liability.
ey underwrite and deal in government and
nicipal bonds and debentures either on
ir own behalf or for their clients. They
en grant credits to their clients in the ordinary
urse of business. The Banking Act does not

apply to these dealers and they are under
cial legislation, and conditions, therefore
from province to province.

**Insurance Companies, Loan C
nies, Licensed money lenders etc:-**

The Insurance Companies :—The li
rance companies form the source of mortga
which is scrupulously avoided by the c
banks. Besides the real estate loans, the
loans against policies, invest in debentures an

Loan and Trust Companies:
are incorporated under the Loan Compani
or under provincial legislation. Trust co
are similarly incorporated under the
Companies Act. They are regarded as
banks" because they carry on lending b
on the one hand and, specially some Tru
panies, accept deposits withdrawable by d
They grant real estate loans and invest in
and debentures. Mortgage credit, we have
seen, is not carried on by the chartered
These loan and trust companies accepting d
however, cannot be regarded as banks, f
amounts are supposed to be held in trust
than as deposit, and as such, the banker-cu
relationship is non-existent.

These companies have to invest their
in selected approved securities over which

itors have floating charge,

Credit Unions :—The credit unions are
porated bodies carrying on near-banking
ess. There are 23 central credit unions of
i there are 2,781 member credit unions.
central credit unions carry on some sort of
h banking through their member credit unions.
surplus funds of the member credit unions
eposited with the central credit unions which
credits to other credit unions, co-operative
ties, school boards, municipalities and other
utional borrowers. The credit unions allow
ies to be drawn against credits granted by
and the central unions act as clearing
es for credit unions. They utilise the char-
banks for the purpose.

Licensed Moneylenders :— Licensed
eylenders are individual, partnerships and even
corporations carrying on lending business.
carry on a considerable amount of lending
ness in Canada.

The Industrial Development Bank :—
blished in 1944 by the Industrial Develop-
t Bank Act, 1944, this institution is wholly
ed by the Bank of Canada. Its authorised
tal is $25 million divided into 2,50,000
es of $100 each wholly subscribed by the
k of Canada. The Governor of the Bank of

Canada is also the Governor of the Dev
Bank.

The objects of the Bank, as set forth in the
of the Act was : to promote the econom
of Canada by increasing the effectiveness
tary action through ensuring the availa
credit to the industrial enterprises wh
reasonably be expected to prove success
high level of national income and em
is maintained, by supplimenting the act
other lenders and by providing capital
to industry with particular consideratio
financing problem of small enterprises.

Shortly speaking, the Bank is to
funds for longer terms than those grant
chartered banks to borrowers whose earni
is not so satisfactory as to enable them t
from the insurance companies. To quo
K. Basu* "when an enterprise need ca
not large enough to warrant a public
securities or when an otherwise acceptabl
requires a loan of longer term than a c
bank may be prepared to grant, the
Development Bank will be prepared to
facilities to the enterprise provided it is
trably sound and can be expected to pay ba
wings from earnings over a reasonabl

* Financing of Post-War Industry, pp

purpose is to extend financial assistance to
nd industrial concerns which are unable to
ain their requirements from other sources on
sonable terms and conditions. It is intended
supplement rather than to compete with the
ivities of the chartered banks and other len-
g institutions."

The bank has been granting credits for an
rage term of five years widely distributed among
ious types of industrial enterprises and from
erent provinces. Its activities are increasing
r after year.

Nature of the Money Market :—Prof.
rrance, explaining the cause of differences bet-
en English and Canadian banking practices
s that the differences are due to the fact that
re is no 'money market' in Canada and that
re are practically no commercial bills. The
nadian banks therefore make their liquid invest-
nts in Treasury Bills purchased directly from
e Bank of Canada. The latter deals in such
urities.

The Capital Markets have fairly developed
nce the first world war. By 1935 the Canadian
pital market had become adequate for the coun-
y. In recent years successful efforts have been
de in Canada to develop the money market
ntered round Treasury Bills. The aim is to

transform the narrow artificial Treasury b
ket into a broader short term money marke
first step was taken in 1953 when the fort
tenders for Treasury bills was changed to
tenders and 273-day bills were offered in a
to 91-day bills. Some 182-day bills we
offered. "Later on in the same year, th
of Canada entered into purchase and resal
ments with thirteen securities dealers wh
as jobbers in the short term government
ties market. These agreements assisted
dual dealers in financing portfolios of gov
short term securities and Treasury bills
Bank of Canada agreed to buy from the
limited amounts of such securities on the
standing that it would resell them to dea
a predetermined price and within a specifie
of time. However, neither these agreeme
the introduction of weekly tenders and lon
bills produced by themselves the desired
as no real non-bank interest in Treasur
developed. The allotments of Treasury
parties other than the Bank of Canada a
Chartered banks remained quite small unti
1954 and dealings in bills took place
entirely between the chartered banks a
Bank of Canada. The Bank of Canada
refused to buy Treasury bills and did no

penalty rate and the chartered banks could
ust their reserves more quickly by selling to
bank than to other banks and customers of
er banks" observes Mr. K. N. Ramanathan.*
Ramanathan further says: "It was not till
d-1954, when further steps were taken in this
ection, that the Treasury bills market began to
w signs of developing into a real market. For
ne time past the bank of Canada had encou-
ged the chartered bank to seek non-central
k interest in Treasury bills by widening the
ead at which it would trade in them. In June
54 the Bank of Canada introduced another
ange with a view to discouraging direct Trea-
ry bill transactions with the chartered banks
routing payments for the bills it bought
ough the clearing which entailed a delay of
o days in getting cash. This had the effect
increasing the relative attractiveness of taking
vances from the central bank and of encour-
ng the banks to use the day-to-day loan out-
s. The latter was encouraged by the Bank. The
hartered banks began to extend day-to-day loans
securities dealers in June 1954. Since the rate
these loans was below that of Treasury bills
enabled the dealers to hold a portfolio of such

* Journal of the Indian Institute of Bankers Vol. XXXI, No. 4, pp299 300.

securities ; it also prompted dealers to p all the securities held by the Bank of under repurchase agreements". The T bill market has thus been encouraged to d and it has already considerably devel recent years.

Instruments used in the system: March remarks that the most important instrument used by the Canadian banks promissory note, and that its importance sen both from the active encouragement banks and from the fact that all credit n can be used as promises to pay. The no be accompanied by personal guarantees assignments of negotiable warehouse recei bills of lading or by assignment of the m dise to the bank. The last type of assi has become more popular in Canada as it safest form of security and can be accepte pective of the creditworthiness of the bo

Trade and banker's acceptances a used in Canada, and they can be redisc But their use is limited, and is confi foreign trade. Assignment of accounts rec is accepted by some banks in some cas

Though overdraft is scrupulously a by the Canadian banks, it is used in limited areas.

Loans to governments are made against ernment papers.

Organisation and functions of Char-ed banks :—All banks are required to be in-porated under the provisions of the Bank of 1817 which is renewed every ten s. On incorporation the bank is given a ter. The charter is to be renewed when it ex-s after ten years.

Minimum capital requirement is $500,000 l up, of which $250,000 must be deposited the Minister of Finance "who then allows provisional directors to call a meeting of the afide subscribers to the stock of the bank" erein the directors are elected and bye-laws sed. The Bank has to obtain a certificate for mencement of business from the Treasury rd.

The bank is managed by a Board of Direc-s elected by share holders in general meeting. e directors elect a president and a vice-president m among themselves. While the President is chief executive officer, there is a General Mana- who is the chief administrative officer of the k. In the branches there is a branch manager.

Business of banking :—The Bank Act gulates the activities of the chartered banks, d prescribes what the bank can and cannot do. It also prescribes a supervising ma

Transactions that banks ca into :—A chartered bank "can open b agencies and offices ; deal in gold and silv and bullions ; deal in, discount, and lend bills of exchange, promissory notes an negotiable securities including those of m and other corporations, or against public se issued by domestic and foreign govern lend against lien and other notes and con sales contracts or similar instruments ; a gage in and carry on such business gene appertains to the business of banking.

Transactions prohibited :—They buy and sell or barter goods. They can gage in any trade or business or purcha against, or deal in their own shares or of other banks. They cannot lend agains gage or hypothecation of lands and build other immovable properties, ships, vessels the security of goods wares and merchand cept by assignments under sections 86 of the Act. They cannot lend to their tors except as provided in the Act itself cannot issue bank notes inside Canada.

They are subject to supervision Inspector General of Banks besides supervision by the minister of finance.

The following Consolidated Monthly Return he Chartered Banks will give some idea of the ure of transactions entered into by the Canadian ks.

ONSOLIDATED MONTHLY RETURN OF THE CHARTERED BANKS.

(FOR 31st DECEMBER, 1950)

(in millions of Canadian dollars)

vernment deposits :		500	
y Dominion Government	339		
rovincial Government	161		
blic Deposits Payable in Canada :		7,429	
On demand	2,770		
After notice or on fixed day	4,558		
In foreign currencies	101		
posits payable to banks and Correspondents :		8,866	
In Canada	117		
Elsewhere (Payable) in	187		
Deposits elsewhere than in Canada	633		
ceptances and Letters of Credit :			258
her liabilities to public			10
serves			198
id-up capital and surplus, etc.			164
sh Reserves			810
Deposits with bank of Canada	579		
Notes of Bank of Canada	231		

Other Quick Assets	
Coin	16
Notes of and cheques on other banks	450
Government bank-notes other than Canadian	40
Deposits with other Canadian banks	1
Deposits with non-Canadian banks	259
Securities	
Dominion Government short-term (two months)	823
Other Dominion Government	2,256
Provincial Government short-term (two months)	117
Other Provincial Government	299
Canadian Municipal	194
Public securities, other than Canadian	193
Other securities	405
Loans	
Call and Short loans in Canada (thirty days)	134
Call and Short loans elsewhere (thirty days)	100
Current loans in Canada	2,651
Current loans elsewhere	247
Provincial Governments	41
To Municipalities	84
Non-current	1
Bank Premises, &c.	

ceptances and letters of credit	258
her	11

(Source : The Canada Gezzete, 3, Feb., 51, now taken from Sayers : Banking in the itish Commolwealth, p 104.)

From the above Return the following cts can be inferred : Canadian banks carry a nsiderable amount of what they call "notice posits", about half the deposits being of 'this pe. The absence of a developed money market s, compelled the banks to hold liquid assets alost entirely in the forms of notes of, cheques n, and deposits with other banks. The total these quick assets is less than 10 per cent which level cash reserves are maintained.

The main source of bank investment is goernment securities being larger than loans and dvances. Less than half of the total income of he banks comes from loans and advances, less han a quarter coming from the service charges ; nd the rest come from investments.

It has already been seen that almost all he larger chartered banks carry on a considerable mount of foreign exchange business and derive ncome therefrom as well. On the other hand, hough there is need for mortgage credit, the Canadian banks have never indulged in mortgage

banking, and the field is left for the tr
loan companies.

In Canada, cheques are in practic
drawn against savings deposits and the ba
interest on the minimum quarterly bala
personal savings accounts, i. e., on th
which has been left undisturbed during the q

Legal Reserve Requirements :-
Canadian Chartered banks are required t
in the form of each reserves not less tha
cent of their deposit liabilities payable in
dian dollars, either in the form of Bank of C
notes held by the bank, or in the form of
sits with the Bank of Canada, or partly in
The Chartered banks are also required to
tain similar reserves against the liabilitie
elsewhere and payable in currencies other
Canadian dollars. Periodic Returns are
submitted showing Canadian and outside li
ties separately, to the Bank of Canada.

Cash and Liquidity ratios :—The
dian Chartered banks maintain cash reser
approximately 10 per cent of their Canadian d
sit liabilities ; this 10 per cent is conventional
is rarely deviated from by the banks.

The banks hold liquid assets as secon
reserves in the form of "various obligation
other banks in Canada and abroad", governm

icipal, corporate and miscellaneous foreign
rities besides call and short loans in Canada
abroad.

The banks also maintain secret reserves
rding to their requirements in different ways.

The Clearing System :—Under the Cana-
Bankers' Association Act, the Canadian Ban-
Association provides clearing facilities in
entres throughout Canada. In the clearing
res once a day in the morning, the local
ks clear their cheques through the clearing
se. Ultimate balances are settled daily by" ad-
ment in the accounts of the clearing banks com-
orily maintained with the Bank of Canada.

At non-clearing centres, local cheques are
red by direct presentation. Mofussil cheques
cleared through post or agents. They may
be exchanged with clearing banks at a
mission.

Central Banking.

The Bank of Canada :—The Royal
mission on Banking and currency in Canada,
Lord Macmillan as Chairman, recommended
establishment of a central bank in Canada ; and
rdingly, the bank of Canada was established
1934, under the Bank of Canada Act, as an
pendent bankers' and government bank. It

was to be a privately-owned company [w]
authorised capital of $5 millions, divid[ed]
1,00,000 shares of $50 each. For preser[ving]
independence it was provided that no in[dividual]
could hold more than $2,500 of the Bank['s]
tal: Further, the chartered banks were not [allowed]
to purchase its shares. To prevent its op[erations]
being influenced by profit motive, the di[vidends]
were limited to 4·5 per cent; all profit[s]
dividend requirements were required to be [...]
dered to the dominion Government.

With a view to give the monopoly [of note]
issue to the Bank in course of time, all ch[artered]
banks were required to withdraw their not[es]
by part before 1950 in which year the o[utstan]
ding notes were to be taken over by th[e Bank]
of Canada.

The capital of the Bank was rais[ed to]
$10,100,000, the additional shares being [...]
subscribed to by the Minister of Finance [repre]
senting the Dominion Government. By [a fur]
ther amendment of the Act in 1938, the Ba[nk was]
completely nationalised.

As the banker for the government [and]
banks, the Bank of Canada was given the [power]
to "make loans with a maturity not exc[eeding]
ninety days to and hold deposits for the [Domi]
nion Government, Canadian Provincial and f[...]

[gov]ernments, Canadian chartered banks and foreign [cent]ral and private banks, and official agencies of [Can]adian and foreign governments. In the best [orth]odox traditions it was prohibited from enga[gin]g in similar transactions with private indivi[dua]ls and firms.

It was authorised to buy and sell Domi[nio]n and Provincial securities with a maturity [of] less than two years without restriction, the [hold]ing of securities of longer tenures being limi[ted] to an amount equal to three times that of [the Ban]k's paid-up capital. Securities of less than [six] month's maturity issued by the governments [of] U. K., U. S. A., British Dominions and France [cou]ld also be purchased and held.

The Bank could rediscount bills, with [mat]urity not exceeding ninety days, provided [the]y were endorsed by a chartered bank.

It was also empowered to deal in and hold [fore]ign exchange and bullion.

It was prohibited from purchasing the [sha]res of banks (other than the Bank for Inter[nat]ional Settlements), making unsecured loans, [pay]ing interest on deposits, lending on the secu[rit]ies of real estate, and from doing other busi[ne]ss.

The Bank of Canada was required to hold [a] reserve in gold and foreign exchange equal to

one-quarter of its notes and deposit li
The chartered banks were required to hold
equal to 5 per cent of their deposit li
in the form of either notes of the centr
or else deposits with it or both.

The rediscounting operations of the
of Canada help it in controlling the com
banks ; and the discount rate policy is
effective throgh open-maket operations. Th
can "buy and sell in the open market fr
to any person, either in or outside Cana
curities, cable transfers, bankers' acceptanc
bills of exchange, of limited types and mat
The operations are undertaken, first for re
the market disturbances and smoothing o
seasonal and other temporary changes in
liquidity ; secondly, for keeping bank re
at the desired level for better efficacy of
tary policy ; and thirdly, for improving and b
ning government securities market.

Reserves against notes and deposit liab
formerly 25 per cent in gold coin and bull
no longer required. In May 1, 1949 it was pr
by the Bank of Canada Act : "The Bank sh
have the sole right to issue notes payable to b
on demand and intended for circulation in C
and may, subject to the provisions of
tion twenty-six of this Act (covering re

uirement), issue such notes to any amount."
is gives complete and unfettered discretion
the Bank in matters of note issue and depo-
liabilities

The Bank commenced business on 11th
ch 1935. But prior to 1939 it had only
to establish its position as a central bank,
he central government finacial agency. The
has created the twin tasks of organising war
ce and controlling foreign exchange. A
em of exchange control was introduced and
under the administration of the Foreign
hange Control Board, with the Governor of
Bank as its Chairman. The chartered banks
appointed agents of the Board and allowed
urchase and sell foreign exchange and approve
nents on behalf of the Board. In April,
all residents were ordered to surrender
gold and foreign exchange. The Bank of
da surrendered its gold and foreign ex-
ge, and the chartered banks also surrendered
foreign exchange, thus bringing an end to
da's system of reserves backing the mone-
structure.

In the internal sphere, Bank of Canada
to create employment for the unemployed
rces and decided on a policy of mild inflation
the purpose. Issue of considerable war loans

combined with a budget deficit of a con
dimension brought about the desired eff
once inflation was generated, its trend c
for, the Bank was required to hold m
more government securities to enable the
ment to finance war efforts. The charter
were similarly made to hold more an
government securities leading to increase
sits. These factors provided the basis
increase in the volume of money and
rise in the chartered banks, reserves from
of 313 millions in 1941 to 603 milli
1945. Thus, at the end of the war
economy was in an extremely liquid
The fiscal policy and price control were
in curbing the inflation and prevent
in prices to excessive heights.

Bank of Canada during the P
years:—Even before the end of war, a
ding unemployment after the end of war d
inducements for investment and emp
were sought to be given by lowering th
rediscount rate from $2\frac{1}{2}$ per cent to
cent in 1944. But due to the absen
bill market in Canada, this step had littl
effect. The Farm Improvement Loans A
passed and chartered banks were autho
make loans on the security of mortgage

erty and equipment for the purpose of finan-
development or improvement of farms. Farm
as a result rose from $50 millions at the
nning of 1944 to $256 millions on 30th
ember, 1950.

The Industrial Development Bank was also
lished in 1944, August to fill up the Cana-
version of the "MacMillan Gap". The In-
ial Development Bank was expected to make
uarantee loans in those cases where in its
ion credit or financial resources would not
wise be available on reasonable terms.

During the war Canada earned a large
me of hard currency reserves which excee-
1,500 million U. S. dollars. Inspite of a con-
able amount of capital assistance to Europe,
January, 1950 all import restrictions had been
ved. Earlier Canada had to devalue the Cana-
dollar following the world devaluation of
ember 1949, at which time she was experi-
g a deficit on her current account of balance
payments.

In the internal sphere, the Bank of Canada
to tackle the problem of inflation without
ving the development plans to suffer. The
s were encouraged to increase their loans
non-government investments. These rose by
millions to $2,297 millions. Their holdings

of government securities rose by $61 mi
a result of all these, the total money s
the country increased by $482 millions t
millions. In 1947 the inflation had alrea
ted the foreign exchange situation. Th
bank lowered the cash reserves of charte
by $22 millions, and for further reductio
reserves redeemed the remaining Deposit
tes. During 1948 and 1949 the situation
eased and banks were allowed to increase the
ves slightly. The chartered banks were dir
refrain from purchasing corporate securi
restrict their loans for the financing of fix
tal investment. Thus, by controlling the
of cash reserves the Bank of Canada re
the trend of inflation.

The Bank also tried to curtail e
ture by making credit dearer by raising
terest rates. Consumer expenditure on
goods was curtailed directly:

With a view to harden interest ra
August, 1950 the Bank of Canada raised
on Treasury bills. On October 17, 1950, th
rate was raised from $1\frac{1}{2}$ per cent to
cent. Though there was very little bank
wing or rediscounting with the Bank of C
However, the raising of the short term ra
followed by a rise in the long term rates th

vering of the prices of government securities.
is resulted in raising the loan rates of the char-
ed banks, which had effect on bank liquidity.

The control of consumer credit was effec-
d by defining the consumer goods and regu-
ing instalment payments through fixing the
rcentage of down payments and the period and
mber of instalments. Thus, motor vehicles
quired a minimum down payment of 50 per
nt, with the balance payable in twelve months.

The Bank of Canada also tried to restrict
artered banks' cash reserves. It became reluc-
nt to buy long-term government bonds from
e portfolios of chartered banks. It has been
ghtly observed that this policy was an interesting
d informal application of the 100 per cent
eserve principle, that is, bank assets were frozen
y the sudden transformation of a large part of
heir liquid assets into illiquid, and in effect, non-
egotiable securities.

Qualitative credit controls were also applied
y the Bank of Canada. To restrict chartered
ank loans and holdings of non-government se-
urities to those outstanding on a target date,
et at February 28, 1951, excluding wheat loans
nd loans to purchase Canada Savings bonds, the
Bank of Canada issued a press statement on February
22 mentioning "the specific working rules":

"(1)...except in the case of small cr chartered banks will refrain from mak loans or purchasing corporate securities term of one year or longer.

(2) Margins of at least 50 per cent required to carry corporation stocks, that lateral for such loans must be equal in not less than twice the amount of the lo

(3) Margin requirements will be subs increased in the case of bank loans on rity of instalment finance paper, and th valume of bank credit for such purpos not be increased.

Wheat loans and loans to purchase Saving Bonds were excluded from the abo trictions. For other types of loans, the principle laid down was that "lending pr will be tightened whenever possible...in o achieve the desired objective of avoiding over-all increase in the banks' total loan non-government investments."

To avoid creating further inflation th continued capital inflow due to undervaluat the Canadian dollar as a result of devaluat 1949, the dollar was set free to find its level in the world market and the Canadian rose to premium of as high as 5 per cen

On September, 1953, the Canadian govern-nt circulated a proposal allowing the chartered ks to extend mortgage loans on new housing der a mortgage insurance scheme administered the Central Mortgage and Housing Corpora-n. The effect would be that the banks' liqui-y would be maintained through mortgage urance, the corporation remaining liable to pay insured loan.

The growth in the scope and tempo of ivity in the short-term money market during previous two years or so, necessitated a more ible and closer relationship of the Bank rate other short-term rates. As yields of Treasury s and short-term Government bonds declined terially during this period, the Bank rate was uced from 2 to $1\frac{1}{2}$ per cent in February, 1955. t to curb the inflationary tendency the e was again raised to 2 per cent on August 1955. For the same reason the rate was rai- to 2·25 per cent on October 12 and to 2·75 cent on November 18 of the same year. On ril, 1956 the rate was further raised from 2·75 cent to 3 per cent, to arrest inflationary pre-re. The chartered banks were requested for a itive and significant reduction of credit.

In 1956, the induatrial production in Canada e by 6·5 per cent. As a result of rise in

investment and consumer outlays, bank cr
by 12 per cent ; and wholesale prices
a nett rise of 2 per cent. An important
tion was introduced by the Canadian m
authorities in its operation of the disco
mechanism in 1956. It was announced t
November 1, 1956, the Bank rate would
quarter of 1 per cent above the preceding
average tender rate for 91-day Treasu
This required fixation of the Bank rate eve
Under this formula the discount rate h
as high as 4·06 per cent. The Bank rate
sed from 3 to 3·25 per cent in August
again to 3·50 per cent on October 1
Monetary measures were also suppleme
budgetary policy of increase in taxation
duction in expenditure.

The Annual Report of the Bank of
1956 at pp. 45-46 stated the objectives of
Bank rate technique as follows : "The old
of keeping the Central Bank's lending ra
the treasury bill rate by raising th
rate at intervals of some months, when
treasury bill approached or exceeded th
ous level of the bank rate was abandoned in
of the new method to achieve two main
tives. First, it would ensure that the ba
would always be higher than the treasury bi

secondly, it would prevent the unexpected,
redictable, infrequent and some what large
nges in the Central Bank's lending rate from
lucing a disturbing effect on business in
eral and on all persons who might be contem-
ing to make new investments."

During the years of 1957 and 1958 the
ssionary phase characterised by an abatement
inflationary pressure began. This permitted
xation in monetary and credit restraint, accom-
ied by appropriate changes in fiscal policies.
neral tax concessions were granted in respect
income-tax and profit-tax. During 1959
re was no change in wholesale prices. The
xible discount rate, however, was raised from
5 per cent to an all-time peak of 6·41 per cent
ing mid-August 1959 and it stood at the
r end at 5·37 per cent. This was necessary
hold excessive expansion in check. The bank
dit expanded by 13·5 per cent in 1959, but
e rise was negligible in 1958.

The Canadian chartered banks in response
the wishes of the Bank of Canada made a
mmon move to prevent speculative borrowing
d instructed their branch managers to make every
fort to stop increase in loans, especially to
rporations.

With high interest rates attracting term capital from abroad the exchange r the Canadian dollar rose sharply. The di rate was reduced from 6·41 per cent on 13 to 6·29 per cent on August 20, fol a decline in the yield of treasury bills fro per cent to 6·04 per cent. This was brought by not accepting a number of bids for sury bills since they involved too high i rates, and thus selling less Treasury bills. it appears that by selling less quant Treasury bills, the rate of interest can b low with the Bank rate adjusted accordin 25 per cent higher than the Treasury bi On June 9, 1960 the issue of Treasur was lowered to $95 million, the usual being 115 million, and was sold at an a of 2·65 per cent, the discount rate being c pondingly lowered to 2·90 per cent. Th ward flow of capital followed the lowering o Bank rate. The flexible discount rate sys Canada has been observed with care by the c banks of other countries.

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4. Journal of the Indian Institute of Bankers, Vol. pp 299–300.
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8. Annual Reports of the Bank of Canada,

E CHINESE BANKING SYSTEM

To understand the organisation and func- of the Chinese banking system, a clear ledge of the basic principles underlying the economic system of China is a prerequisite. le 26 of the "Common Programme", adopted he first plenary session of the Chinese People's sultative Conference, in Peking on September 949, says : "The basic principle for economic truction of the People's Republic of China is to lop production and bring about a prosper- economy through the taking into account public and private interests, of benefiting both ur and capital, of mutual aid between city countryside, and circulation of goods between a and abroad. The state shall Co-ordinate and late state-owned economy, co-operative economy, individual economy of peasants and handic- sman, private capitalist economy and state talist economy, in their spheres of operations, ply of raw materials, marketing, labour con- ons, technical equipment, policies of public

and general finance, etc. In this way all
nents of the social economy can, under t
dership of state-owned economy, carry ou
sion and co-operation of labour and play th
pective parts in promoting the developmen
social economy as a whole."

In conformity with these principles,
39 of the 'Common Programme' also lays
the principles of currency and banking,
"Financial enterprises shall be strictly con
by the state. The right of issuing curre
longs to the state. The circulation of f
currency within the country shall be pro
The buying and selling of foreign ex
foreign currency, gold and silver, shall be h
by the state banks. Private financial ente
operating in accordance with the law sh
subjected to supervision and direction by the
All who engage in financial speculation and
dermine the financial enterprises of the
shall be subjected to severe punishment",

The People's government establis
1949 faced a financial choas, a legacy
Kuomintang regime. In 1949, the curren
culation was 176,800 million times of the
in 1937, and the hyper-inflation has caus
currency to depreciate so much that there
absolutely no faith in the currency system.

t task was, therefore, currency reform. The
cific problems were : first, to provide a uniform
dium of exchange until the People's bank notes
uld attain circulation ; secondly, how to replace
existing eight different People's government
rrencies in eight different regions ; and thirdly,
ating the necessity of a change, for establi-
ing the basic rules for the new currency.

There was practically no uniform monetary
stem within the country ; the weight, measure
d fineness of the coins were different in diffe-
nt parts of the country. There was no centra-
ed system of note issue. Even the foreign
nks were issuing notes. All these created pro-
ems of interregional transfer of money. True
at the currency system was reorganised a num-
r of times. In 1935 the silver standard was
andoned and gold-exchange standard adopted,
r avoiding inherent instability of the silver stan-
rd owing to fluctuation of price of silver.
ntralised note issue was effected, but the
panese war prevented its materialisation. Be-
use of all these factors, foreign currencies en-
yed more prestige in China than her own curren-
s. Ideologically also, the reform of the curren-
system became an imperative under the new
gime. Speaking on this point, Dr. Gyanchand,
his New Economy of China, writes : "The

old currency and credit system had to
cally altered not merely because of its
manifestations but mainly because, (a)
instrument of a hybrid economic syst
of a decadent feudalism on which was
an imported aggressive capitalism and
in a large measure, had been used for
economic penetration and domination
self-condemned by the results which it
duced. This system was controlled by
interests and served their ends. It was,
necessary to remove the latter, (foreign
completely from position of authority
currency and credit system ; but it
essential to change its functions and purp
regaining complete autonomy of China
ding up, the new economy of China."

In 1948, a new currency was issu
in a year, the new currency also beca
less, as the currency in circulation increas
295 millions to 82,000,000 millions, that
nearly 291,527 times.

It was, however, realised by the
ties that the existence of a stable curre
important for the working and developm
the new economy.

As the first step in the process of
a new currency, the

the old currency without bringing about
change in the basis of the currency system.
e Yuan depreciated so much that the basic
rency unit was practically 10,000 yuans, and
ctically nothing could be purchased below
t price. Wages and salaries amounted to
0,000 yuans and often 2 to 3 million yuans.
and postage for a letter amounted to 800 yuans.
ssive figures had to be calculated in normal
nsactions of life.

Under these circumstances, on March
955, the People's Bank of China issued new
nk notes to replace the old currency at the
e of 10,000 old yuans for one new yuan.
l the existing liabilities were adjusted at this
e. Only a new unit of reckoning was intro-
uced, without changing the basis of currency,
d as a result, only simplification was effected
calculation, four zeros being removed, the
rrency remaining the same in all other respects.

The new currency has been issued in one,
o, three, five and ten yuans. One yuan is
ual to 10 chiaos, and 10 fens make a chiao.
ne yuan is equal to 100 fens. Currency has
en issued in these small denominations as well.

There is now uniform unified currency for the
hole country. Following the Common Programme,
e circulation of foreign currency has been

prohibited. Circulation of gold currency stopped. The currency is not basad Gold has ceased to be the regulator of currency ; the quantity of currency tion being determined solely by the re of the people and development of economy.

Though gold has been demonetis trade in gold is prohibited. Gold is n dealt in by the state, but only as a co pure and simple ; and it has nothing t the currency system. Its only possible use is that it can, if required, be settling international accounts, as it is still by other countries.

There is no provision, under currency arrangement, for keeping of any reserve in any designated or unde foreign currencies. Neither is there an for foreign securities. The currency is n to any foreign currency and there is no of China belonging to any currency ar

The new currency has been clai be independent and stable with sufficien bility to allow development of the econo

The Chinese Banking system the Revolution— Speaking on the old banking system, Dr. Gyanchand writes :

its own indigenous system of banking which functioned for and grown through the ries, but modern organised banking had n to develop in the middle of the nineteenth ry, and in 1937, there were about 29 foreign 65 modern Chinese banks. Among foreign s the Chartered Bank of India, Australia and a, the Hongkong and Shanghai Banking orations, the Duetsche Asiatische Bank, the ohama Specie Bank, the Bank de'I Indo-China the National City Bank of New York were most powerful and used their power, so far China was concerned, for sinister ends. y financed Trade and industry, were well aged in the ordinary sense of the word, wing sound banking practices, provided security the depositors and maintained good accoun- standards........ The modern Chinese banks small compared to foreign giants, a num- of them attached themselves to the latter, and when they acted of their own, they ope- d within the limits of the economy which in- ted their growth and was in its turn inhi- d by them. There were also public institu- s i. e., the Central Bank of China, the Bank China, the Bank of Communications, the mer's Bank of China each of which had spe- ised functions of its own. The Central Btnk

was, after currency reform of 1935, invest
most of the functions of a national centr
and by 1942 it acquired the sole right
issue. The Bank of China became the
exchange bank of the state. The Commu
Bank was originally intended to act as th
for the collection of government revenue
railways, telegraphs, posts and navigation
1928 its regulations were revised and it
the functions of an industrial bank. The F
Bank was founded in 1933 for assistin
developing agriculture and by 1936 it
branches and sub-branches, mostly in the
provinces. These institutions were charge
important public functions; but there
integrated system of banking in the c
these institutions had very little motive
and hardly produced any results. Ther
existed 15,000 rural credit co-operatives
1,00,000 members but they were of n
consequence in the country's rural econ
Thus, the constituents of the old b
system were (a) One central
(b) three state-sponsored banks, (c) foreign
(d) commercial banks and (e) Indigenous

The Central Bank:— Established in
it was designed to be the central bank

* New Economy of China PP20-21

ntry in the western sense. It was given
right of note issue which was made exclu-
e in 1942. It acted as the custodian of cash
erves of commercial banks, rediscounted bills
exchange, issued short-term loans and advan-
to the government, cotrolled foreign exchange
d acted as a centre for clearing accounts. It
d no direct transaction with industrial and
mmercial firms.

The Bank was managed by its Board of
rectors with a Supervisory Council, there be-
g one Governor and one Deputy Governor.

In 1934, the Bank had 1086 branches and
b-branches throughout the country.

ate-Sponsored Banks :—

The Bank of China :—The Bank of China
ew out of the old Ching Bank. After the
mation of the Central Bank of China in 1935
was given the exclusive right to deal in fo-
ign exchange. In 1944 it had 208 branches
d sub-branches and 10 agents abroad.

The Bank of Communication :—Foun-
d in 1907, it was designed to be an industrial
nk since 1928, and had the right of note
ue until 1942. In 1944 it had 120 branches
d sub-branches.

The Farmer's Bank :—Founded in 1933,
specialised in agricultural leans to farmers,

farmer's co-operatives and for constr
granaries to others. It also had the rig
issue until 1942 when it was taken
the Central Bank of China. In 1944 i
branches and sub-branches.

Foreign Banks :—In 1934 there
foreign banks with 151 branches. The
was reduced to 14 banks with 29 bra
1949 due to war casualties and amalga
The Foreign banks controlled the for
change and foreign trade and negotiated
loans. They also issued currency notes
own and put into circulation foreign cu
in the country for their convenience. Th
otherwise efficient and attracted large

Joint-Stock Commercial Ban
1935 there there were 100 commercial
43 of them being unit banks, and the
having 407 branches mostly in the
towns. They carried on ordinary com
banking in the western sense.

They received deposits, granted lo
advances, discounted bills and other
Most of the commercial banks were small
and as such, their importance in the cre
tem was slight. Their methods and practice
not very sound and, believing in quick r

neglected the healthy canons of commer-
banking.

There were a number of indigenous ban-
and money-lenders ; but they were of little
ficance in the system.

All the banking institutions mentioned
e suffered during the inflationary period.
foreign exchange banks were accused of
tioning with sinister motive to the detriment
hinese interests. Some commercial banks
also accused of working in alliance with
ile foreign powers. The issue of notes by
ign banks and the circulation of foreign
ency by them wounded the national prestige
he people. They earned huge profits and
sferred to their own countries every year.
y were also accused of trying to interfere
political issues beyond their legitimate duties.
rst of all was the financial chaos ushered into
land to the utter disappointment and misery
he people. As a result of all these, the re-
n of the banking system was an imperative
essity for the new regime. Pursuance to the
nciples adopted in the Common Programme
arding banking and currency, the system was
ically reformed after the collapse.

Principles and objectives of reform :-
. Solomon Adler in his Chinese Economy,

summarises the objectives of reform in th wing words: "First, it is designed to inco the banking system into the State sector. S it aims at greater diffusion of banking fac such diffusion is essential for a high l economic unification. Third, the banking must adequately function as the govern fiscal and foreign exchange agent. Fourt banking system must help to centralise and bilise the social surplus so that finance a should not obstract the growth of invest banks should facilitate both the inflow of the and its outflow into particular spheres mark expansion. The real and monetary gears cumulation must mesh without serious fri and the banks contribute to this end th their control over currency and credit. Fi by providing the means for independent ting of the plans and budgets of particula terprises and so continuing the core of th counting system, the banks are becomin integral part of the mechanism for carryin economic planning." The establishment of nomic sovereignty of the State has been rem bered all throughout the change.

THE CHINESE BANKING SYSTEM AFTER THE REVOLUTIONARY REFORM:

Constituents of the System:—After the rm, the following are the constituents of the nese banking system: (a) The People's Bank hina which is the central bank of the coun- (b) The Agricultural Bank. (c) Rural Cre- Co-Operatives. (d) The Communication Bank. The Jointly Operated Commercial Bank. (f) Bank of China.

Organisation and Functions of the Pe- s Bank of China:— The People's Bank of na was founded on December 1, 1949 in ct succession not to the Central Bank of na, but to the People's Bank in 'Liberated' as. It became the sole note-issuing bank and entrusted with the task of controlling the ency. In June 1949 the use of foreign cur- y was banned in Shanghai, and by the of 1949 the provisions of Article 39 of the mon Programme were fully implemented.

To introduce stability of the currency, troduced a 'commodity unit system' "which ranteed the stability of purchasing power of k deposits and other contractual obligations rms of specified quantities of four or five modities, usually consisting of wheat or rice

or millet, cotton cloth, peanut oil and co
varying from urban centre to urban ce
accordance with the local economic backg
This simple device succeeded brilliantly."*

The Bank is the central bank of the
try. But its functions are very different from
of our central bank. Its prototype is th
bank of Soviet Russia rather than the
of England. It is not the bankers' bank
does not keep the cash reserves of the co
cial banks as our central bank does. It
on some commercial banking functions as
It accepts deposits from administrative
state-owned industrial and commercial enter
co-operative societies, and other firms and i
duals. It also acts as the banker to the g
ment, and all public payments and receip
made through it. Through it the debts b
different enterprises are settled by ch
It provides clearing and remittance facili
co-operatives and individuals.

The Bank also grants loans to the
sants either directly or through the cre
operatives. It also grants loans to the pro
and traders. It issues state bonds and pr
small savings campaigns.

*Solomon Alder : The Chinese Economy, 1

With a view to stabilise and lower the
ices, it tries to balance the currency with the
lume of production of the country. An estimate
the currency requirement for the year is
epared in advance and adhered to during the
riod. For the same purpose, it centralises
cash balances of the nation, emphasises the
ed for settlement of debts through accounting
d minimises the use of cash. It directs all
blic undertakings to surrender the cash received
them in course of business to it. Inter-
erprise indebtedness are to be settled through
counting and not in cash. These measures
p the bank in keeping the prices low. The
sh plan' is prepared with due consideration
these factors.

The people's Bank is not required to keep
reserve against its note issue, and as such,
has unlimited power of issuing notes. The
y criterion followed in determining the change
the quantity of currency is the needs of
ustry and trade ; the only safegaurd against
essive issue is its own judgment. It is claimed
t these rules keep the currency elastic and
can be adjusted according to the needs of
country for her development and expan-
n.

The Bank prepares the 'credit plan' in

consultation with the Administrative B
advance. When credits are granted, t
granted not according to the assets
enterprises and institutions, but acc
the planned allotments. Credits are
granted for working capital purposes,
for three to six months and not exce
year. The purposes of the loans are pre
and the Bank has to see that the l
properly utilised.

Interest is charged against the
is paid on the deposits. The interest
is, however, not the cost of the loan
industrial and trading co-operatives are
lower rates than the public undertakings. I
enterprises have to pay less than the co
enterprises. Independent peasants
handicraftsmen have to pay higher r
co-operative industrial and agricultural en
Highest rates are charged for private
Thus, the interest rate structure in
entirely different from that of ours. In
being a cost of credit ragulating investm
production, it itself puts into effect th
policy of encouraging the development
economy on desired lines.

The Bank is responsible for dete
the official exchange rates it also

ign exchange, which it does directly and not
ugh any exchange control administration.
about four-fifths of the country's
ign trade the international accounts are settled
ugh the agency of the Bank, while one-fifth
he trade is done through the Bank of China
king under the supervision of the People's
k of China.

In 1949 the Bank had 900 branches
sub-branches. In 1954 the number rose to
)00, the number of employees being 30,000.
h this size it has been acting as the director
financier of the new economy of China.

The Agricultural Bank :— Prior to 1955
was one of the functions of the People's Bank
grant loans to agriculturists. During 1949-54
e than 40,000 million yuans were granted to
iculturists for minor irrigation projects,
chase of equipments for farming and irrigation,
ilisers, sprayers etc. Co-operative societies are
ferred to individual farmers for granting loans.
ns are generally without securities and at very
rates of interest, repayable in instalments
ich are often remitted.

In March 1955 the Agricultural Bank took
r the above function from the People's Bank,
e Agricultural Bank provides funds for the
icultural co-operatives for (a) local irrigation

and drainage work (b) buildings, farm im and purchase of draught animals and (c) of seeds fertilisers, etc." Individuals granted loans, generally for one year, for purposes such as, consumption expenses, of implements for cottage industries etc. are also granted to the State farms fo periods for working capital purposes.

Rural Credit Co-operatives :– credit co-operatives have been formed for pr usury and mobilising rural savings by small deposits from the rural people. Th under the guidance and assistance Agricultural Bank. They grant small agriculturists and rural and cottage indus

In 1955 there were 1,60,000 rur co-operatives. Some of them worked as of the Agricultural Bank.

The Communication Bank:– Th munication Bank has been functioning pre-revolutionary period. Established later on it was required to function as ustrial bank until 1954. Its present is to finance and supervise jointly enterprises, receive profits from them their reserves and deposits. Loans are both long and short term at the same interest as is charged by the People's

The Bank has 17 offices with the head office Peking. Its capital was raised by issuing 6,00,000 res, of which 5,20,000 were subscribed by state and 80,000 by private owners. It is naged by its Board of Directors consisting of members and a Board of Supervisors consis- g of 9 members. The state nominates 13 mem- s to the Board of Directors and 5 members the Board of Supervisors. The rest are elec- by the shareholders.

The Manager and the Deputy managers appointed by the state and all major deci- ns require approval of the People's Bank of ina and the State Council.

The People's Construction Bank :-

ablished in 1954, its function is to grant long- m finance only to the state-owned commercial l industrial enterprises. It is required to super- e the utilisation of the loans and bring the notice of the People's Bank and the te Council any irregularity or default in imple- nting the planned schemes.

The People's Bank, the Communications nk, and the Construction Bank are all respon- le for financing the state-owend, jointly erated and co-operative industrial and Commer- l enterprises. They all have to work according state policy and charge interest at rates determined by the State.

The Jointly Operated Com **Bank** :— The pre-revolutionary commer could not continue as such under the up. So they had either to close down a new institution recognised by the st such recogn sed institution was the Joint ted Commercial Bank. Sixty old commer and indigenous banking houses got t merged in it.

The State ownes 30 per cent of it the rest are owned by the institutio merged in it. It has 15 offices and is by a Board of Directors of 103 member them being nominees of the State, the re elected by shareholders.

It receives deposits, and grants jointly operated firms so far as it can to charge standard rates of interest under the direction of the People's Ba

The Bank of China :— The China has survived the revolutionary ch is a jointly-owned enterprise, 4,00,000 shares being owned by the state and owned by private individuals.

The Bank has been assigned the exchange business in non-socialist coun be carried on in conformity with the

the State Council, and under the direction the People's Bank. The proportion of State-ninated and elected directors is the same here in the case of the Communications Bank.

From the above facts about the Chinese nking system, it is clear that there are fund-ental differences between our banking system d the Chinese Banking system. The Chinese stem can very well be said to be a financial chanism, subservient to the supreme planning dy, designed to finance the plan for economic velopment and expansion of the country.

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THE SOVIET BANKING SYS

A nation's banking system is desi
serve its economic system. Accordin
Soviet banking system is designed to se
Soviet collectivistic system of economy.
structure of the Soviet economic sys
peculiarities, so has the Soviet banking
The purpose of Soviet banking
maintain a satisfactory balance between
kinds of productive and distributive
The banking system is entirely subordin
the general plan of the national econo
aim being to promote the development
dustry, transportation, commerce, agricult
other branches of the economy. As
observes, "to the Marxists in Moscow,
of banking must be ancillary to the
plan handed down from headquarters. B
such circumstances become nothing mor
instruments of State policy, with logi
empiric, and their original for dissol

it can be reshaped into a fresh series of ks representing, not the result of capitalist petition in a socialist country, but apparently ing more than book-keeping offices for the erent branches of a controlled production hine." We find a completely socialised variety banking in the U. S. S. R. under which the blems concerning money, credit and banking controlled and managed by the Soviet Government. Condoide rightly says that "all the banks the Soviet Union, Gosbank and the special banks charged with the financing of large scale public rks and investments and are under the control the government, being under the jurisdiction the Ministry of Finance. The President of State National Bank, i. e., Gosbank is at the e time the Assistant Secretary of the Finance nistry of the Soviet Union."*

When the Bolshevic Party came to power Nov. 1917, it closed down and then nationalised the financial and banking institutions. The mer State Bank was re-named People's Bank, l in 1919 its credit functions discontinued and ken over by the People's Commissariat of nances. During the period of War Communism nks practically disappeared. When the New onomic Policy was adopted and private enterprise

*(M.V. Condoide: Soviet Financial System, 1951, pp 26-27)

allowed, the necessity of a bank was fe
Gosbank, as the State National bank was e
in 1921 "for stabilisation of Soviet cur
providing credit to industries." The B
to function in Moscow in Nov. 1922. O
11, 1922 it was aurthorised to issue n
actual issue began in Nov 1922. Number
ches were established in other cities, a
has about 5,500 branches all over the U.

The Gosbank is the central insti
the Soviet banking system. It promotes t
tion of the economic plans through i
policies, and currency issue. In additio
Gosbank, the Soviet banking system comp
other specialised banks providing mostly l
credit. They are the Prombank (Industri
the Selkhozbank (Agricultural Bank), the
bank (Trade Bank) and the Tsekombank
pal Bank). Besides these, there is a net
savings banks and the Venestorgbank (
Trade Bank).

The Soviet Credit System:— "T
of the Soviet credit system is to red
temporarily free funds of the economy
control their employment according to
and it is based on a planned foundation
maximum effectiveness of credit grant
liquid resources of the

bank and the budgetary funds raised by taxes
n the main sources of credit. The liquid
urces of the Gosbank form the source of
t-term credit, while the long-term credit is
ated by the special banks from budgetary
nts. Not being dependant on private deposits,
Soviet credit and banking system provide
ctically unlimited funds to promote develop-
t of the country. All national projects are
nced by special banks which derive funds
n: (1) the national budget, allocated from
receipts, (2) capital funds of enterprises and
r amortisation funds deposited with the special
ks, (3) miscellaneous resources consisting of
e savings deposits etc. As the Gosbank,
special banks also operate under the Ministry
finance. The following are the functions of
Gosbank and the other banks in the U. S. S. R.

The Gosbank

The Gosbank (Gosudarstvennyi Bank SSSR),
e State Bank of the USSR, stands at the head
the Soviet Banking system. This bank was
ablished in 1921 with the objectives of develo-
g a stable new currency, regulating the
netary system, and centralising control of the
tire financial system under its control. It

is the central institution of the system
The nominal capital of the Bank
million Rubles and it has more than 55
all over the USSR, with millions of
over the Soviet Union. It is under the
of Finance and is managed by a B
which the Chairman is ex-officio Deputy
of Finance. Regional Boards have been
to manage branches in their respective
as instructed by Moscow Central Boar
head office (pravlenie) is in Moscow a
were in 1948, 107 regional offices (
and 67 subregional offices (subkontory)

The following are the functions
Gosbank *

(1) It is the sole note issuing a
and it regulates the volume of m
circulation.

(2) It accepts deposits of all stat
prises, organisations and agencies.

(3) It is the central clearing age
all accounts.

(4) It is the sole agency emp
to grant short-term credits for producti
trade pupposes.

(5) It acts as the fiscal agent
Soviet Government.

*(Condoide, p. 28)

(6) It is in charge of all accounts with
eign currencies, and foreign exchange
rations.

Capital and Resources : Over and above
nominal capital of 600 million rubles, it has the
owing resources : "All state, co-operative and
er enterprises are by law, compelled to main-
n deposits at the Gosbank and to settle
ounts among themselves through the Bank.
e Gosbank pays 1·5% interest on deposits
economic enterprises and social agencies, and
% on deposits of savings banks and of collec-
e farms. Thus, the Bank has a huge sum
its disposal. The Soviet treasury also maintains
balances with the Gosbank. All tax revenue
d free resources are handled by the Bank,
e resources of the State insurance agencies,
the special and long-term credit banks, the
vings of the population and the receipts from
vt. borrowing are all concentrated in the Bank.
terest is also collected from loans. Besides,
me income results from note issue.

Modes of Operation :– The Soviet curren-
comprises bank notes issued by the Gosbank,
easury notes and subsidiary coins issued by it
n behalf of the Ministry of Finance. By law
e notes issued by the Bank are required to be

backed by a proportionate reserve of
precious metals and stable foreign cu
The Treasury notes are not backed by
reserve, but its volume is not allowed t
that of bank notes. "All soviet Curren
fact inconvertible."*

THE CASH PLAN :— The Gosb
Note Issue Department which issues not
Cash Plan regulatas the volume of curr
the Gosbank is authorised to issue. Th
bank itself is in charge of drawing
Cash plan which is drawn up quarterly and
ly. The Cash Plan is an estimate of th
inflow and outflow of the currency in
from the Gosbank system, and it is dr
in accordance with the over-all credit pl

The following factors determine th
of currency in the Soviet Union. State
operative enterprises are permitted to
their tills no more than the minimum
prescribed; the excess must be deposite
the Gosbank. All buisiness transactions
the productive enterprises are to be carri
by means of cheques cleared through th
bank. Payments in retail trade and for
and salaries are made in cash. Thus th
need for currency depends on the gross

*(Beckhart. P. 748.)

transactions between the population on the
hand, and the state and co-operative enti-
s on the other. The major part of the
nsactions being already settled through book
ries at the Gosbank for the organisations, cash
uirment depends chiefly upon the incomes and
penditures of individuals, or, what comes to
same thing, the total wages and salaries and
al payments made to collective farmers for
ps purchased from them by the government.
e volume of employment and the volume of
sumer goods are also to be taken into considera-
n.

If as a result of the economic plan there
overemployment, or lowering of wage rates, or
preciation of the currency, the Gosbank does
ue additional currency to correct the trends, or
thdraw currency from circulation, though there is
record of any deflationary step being ever
ken to lower prices. But it cannot independently
ate inflation by issuing excessive currency or
granting excessive credit, it being under the
nistry of finance which have to approve the
sh plan.

THE CREDIT PLAN :— The so-called
ontrol by the Ruble" is effected by the 'credit plan,'
ich is drawn up quarterly by the Gosbank.

It is an estimate of the loan requ
of the various agencies in accordance
general economic plan and adjustmen
supply of credit according to sources and

The Gosbank is empowered to gra
to industry up to a certain limit defined
plan, and for purposes similarly specifi
plan. Allocation of credit is based on th
ity for fulfilling the planned targets. The
term loans are repayable in goods for the
tion of which they were granted. Sh
loans are also given if needed for the pr
to continue. The Gosbank keeps vigilan
sure that the proceeds are being used for
production, and thus, it indirectly contr
output of each enterprise. The credit pla
required to be approved by the Ministry
nce. The Gosbank is given the power of
ding credit if it is not used for planned
tion. It is also given the responsibility o
cising strict control over expenditures of it
mer enterprises. Thus it plays the doub
of financier and controller of finance. Its
of lending is a potent instrument of cont

Credit Oprations Of The Gosban

Gosbank is the basic source of short term c
the Soviet economy and it extends the cr

enterprises and institutions. Granting of credit
one enterprise to another is prohibited by law.
ns granted to enterprises generally are for
cific purposes and for fixed periods, at some
rest. This credit is ordinarily to be employed
working capital only in addition to the wor-
g capital funds already supplied by the trea-
y to each individual enterprise. The loans are
ayable in produce. The credit plan attempts
oresee for each quarter the credit requirements
enterprises; for each enterprise and for each
jor type of loan it assigns so-called credit limits
ch are not to be exceeded during the quarter
the credit plan. The Gosbank is to see that
enterprises adhere to this rule.

There is no limit to the total volume of
it that can be granted by the Gosbank in a
dit plan. This creation of credit will no doubt
e some inflationary impact on the soviet eco-
ny, but the effect is restricted by its quick
ductive nature and its system of repayment
kind, its effect being limited to the period of
loan. The price of the commodity is strictly
ulated.

While long term loans are granted by the
cial bank, the Gosbank is the central credit
ency for short-term loans, and it promotes the

execution of economic plans through it
policies. It is also the authority for
short-term credit, and the central account
ncy of the Soviet State enterprises.

The credit system works on simple p
Each state enterprise is granted by the
its minimum annual working capital requ
free of interest, which forms the "chart
of the enterprise. The estimate is caref
pared by the treasury and is generally exp
be sufficient for the purpose. Additional
refunds are allowed under special circum
The credit granted by the Gosbank is to
for carrying on stocks and other curre
over and above the minimum levels, i. e.,
nce requirements raised by temporary, seaso
extraordinary conditions.

Enterprises repay the credit to
from the sale of merchandise. The Gosb
the right of lien over the goods and, in
it can be re-imbursed from the forced sal
merchandise under lien. It controls the
the pledged merchandise until the tota
granted is repaid. The purpose of grantin
is not to earn interest but to help attain
the plan targets. For this reason, the G
controls the activities of the borrowing ent

edit is witheld from unsuccessful enterprises.
us, lending is a potent factor of controlling
oduction. The expenditures of enterprises are
controlled and its inflationary impact curbed.
us the entire economy is under "control by the
ple," the Gosbank playing the double role of
ancier and controller of finances.

Clearing Operations Of The Gosbank :–

e Gosbank acts as the clearing agent of the
ire State and Co-operative sectors of the
onomy. It being the only commercial bank
th numerous branches, inter-branch clearing
kes the place of inter-bank clearing in other
untries. Cheques are used, but they are non-
gotiable and non-assignable. A system of
rtified cheque books with restricted use limit
e creation of credit and the velocity of circul-
ion. Settlement of accounts is effected by the
cceptance system" according to which the seller
goods draws up a "demand for payment"
ainst the buyer and presents the same to the
osbank along with other documents of title to
oods. Gosbank forwards the documents to the
yer, and unless it is dishonoured by the buyer,
s current account is debited with the value
the goods.

A specialised Soviet clearing institution is
e Mutual Clearing Office known as Boiuro

Vzaimnykh Raschetov or the B.V.R. affiliated to but separate and independ the Gosbank. Member enterprises mak payments to these offices which they of adjust. The B.V.R. settle the net bal their member enterprises through the and maintain deposits with the latter for the

Functions As The Fiscal Agent Government :— A fiscal agent, the Bank the budgetary receipts and expenditures an the liquid funds of treasury. Owing to viet system of surplus budget for . main of prices, surplus funds are considerable in and the Gosbank's liability figure on the is, therefore, considerable.

Foreign Exchange Business :— the right to deal in foreign exchange, in the Gosbank, it has delegated som functions to the Vneshtorgbank. Exchan ings with foreign visitors and diplomatic have been delegated to the latter. Gosba foreign exchange from and sells it to th prises of the Ministry of foreign trade rates for the purpose of foreign trade.

Assets And Liabilities :— The sheet of the Gosbank has not been p since 1937, but it is known to consist following items.

Assets : precious metals, chiefly gold ; claims inst the Ministry of Finance for precious tals purchased on the Ministry's account; cash vault; foreign exchange and short term loans economic enterprises.

Liabilities : "clearing accounts" of economic erprise ; "current accounts" of collective farms, vernmental (budgetary) entities, non-economic anisations, and of other financial institutions ecial banks, savings banks) ; bank notes in circula-n ; treasury notes and coin placed in circula-n on behalf of the Ministry of Finance ; capital l surplus.

Monetary Planning And Control By e Ruble :— As has already been observed, the viet banking system forms an instrument of ntrol in the hands of the Soviet Government. e control over the entire economy through banking system is known as the "control by ruble," and is made effective by a set of telligently framed rules making the producers pendent on the banking system. Enterprises e strictly prohibited from extending credit to e another. Their clearing account balances are pt at the minimum fixed by law necessitating payments in excess to be made through the aring system of the Gosbank, retaining only the inimum balance of cash in hand. Each enterprise

is attached to only one branch of the
from which alone it can borrow and
which alone it can clear funds. Similar
enterprise is attached to one special bank
alone can grant long-term credit to
dealing with any other bank is permitted
system creates a personal contact between th
and the enterprise, and enables the latter
vigil on the activities of the former.

As regards balances in clearing ac
the owner enterprise has full right of d
The bank, however, has the right to
any release of funds if it apprehends any vi
of law as a result of such payment.

The payment of wages and salari
strictly required to be made in cash. Th
fund of an enterprise is estimated and s
by the bank and should exactly be sufficien
excess or deficit being regarded as a si
managerial inefficiency.

Before granting short-term loan to an
prise, the Gosbank does not consider the
worthiness of the borrower as in capitalist
ies, but it examines the working capital posi
he enterprise and its previous record of p
on according to the plan. Any excess of wo
pital, failure or irregularity in production
a disqualification, The special banks ex

imilar control to ensure that only the approved
ital projects are undertaken and completed and
t the funds are utilised for their respective
poses. They also see that other regulations
complied with by the borrowing enterprise.

The Gosbank has no separate and indepen-
t monetary and credit policy it being wholly
servient to the supreme planning body in ful-
ent of the objectives of the over-all Gosplan.
e cash and credit plans are no doubt prepared
the Gosbank, but it is entirely in accordance
h the needs and in conformity with the princi-
s laid down by the supreme planning body.
e credit needs of the individual enterprises are
vided for according to plans prepared by the
erprises themselves approved by the planning
thorities and included in the plan. Resort to
nks for credit is therefore automatic. "In brief,
decision which a Soviet banker is called upon
make before extending a loan to an enterprise
not based upon the economic success of the
nture to be financed- that decision is made by
central planners-but whether the loan will fur-
r the precise execution of the plan. Thus the
ntrol function of the bank is necessarily prior
its lending function."

The Gosbank is not the central bank in
ict sense of term. It no doubt performs certain

functions such as note issue and the
right to deal in foreign exchange, but
same time it plays the role of a finance
tion and a commercial bank. It controls th
and prices no doubt, but not so much
the control over currency and bank
strict sense. Monetary planning in the
Union is an integral part of the over-all
plan. It is the primary responsibility of the
planning body as is of the Gosbank. Th
production and distribution system bei
planned to the minute detail the pro
fluctuation of prices, seasonal or cyclical,
sent and the trade cycle has been com
controlled.

The commercial banks are not requ
keep any reserve with the central bank i
sense of the term to provide the latter a
for credit control. The Gosbank can very
described as the central-commercial bank
the aspects of central and commercial b
being merged in the same institution.

Special Banks

Prombank or the Industrial Bank is the bank for financing industrial and tra

pital construction and it deals with state-owned enterprises. It finances the capital investments of productive industry, transport, communication, electric utilities, house building, read building organisations, and also the local and provincial enterprises. The bank is responsible for the efficient construction of new enterprises.

The bank does not accept deposits, but simply makes government grant available to the concerns. In this sense it will be more appropriate to call it a government industrial finance corporation rather than a bank. It does not grant long-term credits but simply distributes the non-repayable government budgetary grants according to plan.

TORGH BANK :— This is the bank for financing capital construction of Trade and Co-operatives. It finances long term development of State Trading enterprises and State Co-operative Associations other than the Farming and Housing Co-operatives. It provides funds to state stores and co-operative organisations for building of new stores, shops and warehouses. The government organisations are given non-repayable budgetary grants while co-operatives receive long-term loans at a nominal rate of interest. It also takes care of the financial needs of the ministries of supply and foreign trade.

Selkhozbank :— This bank is fo long term financing of collective farms, construction, repair of buildings, purchases of e ments or cattle, irrigation etc.), State farm Machine Tractor stations. It finances agric both by giving non-repayable grants and r able loans. The loans, though repayable, are cancelled or written off. Thus in 1934 the S Government cancelled all loans granted to c tive farms prior to 1933. Similar cancell have been reported latter.

Tsekombank :— Known as All Bank for financing Municipal and housing truction, it finances municipal building and ho schemes. construction of municipal utilities prises such as waterways, watersupplies e supplies, bus lines etc. The cultural, educa health and recreational undertakings of local ets. It also grants loans to individuals for truction of privately owned houses. Fin is done either by grants or by loans.

Vneshtorgbank (Foreign Trade B Subordinate to the Gosbank, it takes car (1) the accounts of Soviet embassies missions abroad, (2) accounts and needs of fo ers residing in the Soviet Union, and foreig tors touring Soviet Union, (3) accounts of Soviet citizens and tourists residing and to

abroad, and (4) special financial operations of the Gosbank relating to foreign trade.

Savings Banks :— The State Savings Bank is under the direction of the Ministry of Finance. There is a wide network of savings banks throughout the country with more than 4,700 branches. (in 1951). In offices of the Gosbank, postal and telegraph offices, railway stations, factories, clubs and other public places Savings bank offices have been opened.

The savings banks accept deposits from individuals, institutions and organisations, and pays interest on the deposits. In the 1930's the rate was 3% for individuals and 1% for organisations. Since 1939 a system of time deposits has been established, the interest paid being 5% for deposits for six months or longer. In the Soviet Union the Savings bank is the only institution wherein the deposits of private citizens are accepted, and as such, it alone assumes some character of our commercial bank. The depositors are allowed the right of withdrawal at any time. By law the banks are required to invest the deposits in Soviet State bonds.

The banks use a system of clearing by means of which the depositors can pay their bills for rents, water, gas and other public utilities; and make remittance to distant places. The volume of deposits in the savings banks is gradually in

Land mortgage banking is non-exis the Soviet Union. This is because of non-ex of private ownership in land. The entire being controlled and managed by the State vate money market is not there, and stock holders are absent. The rate of interest is regulator of the money market; and it stable for long periods at a stress. The there are not to follow an elaborate sch investment.

—×—

THE JAPANESE BANKING SYSTEM

Growth Of The Japanese Banking System :— Prior to the 'Restoration' in 1868, he banking system in Japan was crude and elementary. The first task of the Government of the Restoration was, therefore, to modify the banking system. Banking houses in old Japan mostly issued their own paper money. The Government currency had very little value and its use came to be limited to payment of government taxes. The currency being in chaos, the government could not utilise the services of the banks. The Imperial Govt. faced the double problems of refarming the monetary and the banking systems.

One salient feature of the old Japanese banking system was that it was not controlled by the government. As a matter of fact, the government was unable to control owing to lack of funds. Banks mostly served the traders, and never used credit in the modern sense of the term, though there appeared to have been an extraordinary amount of personal trust, business being invariably on personal credit.

Another peculiarity was that until rec a bank in Japan was not a public institution i strict sense. Private banks were organised by p traders as proprietory institutions, and as they maintained intimate connections with cular traders or industries and often got ent with them to dangerous extent.

The bankers believed that the gover had no right to intervene in banking bus Banks did not even recognise the govern currency and were not called upon to do so. government currency depreciated as soon as issued, and was of little use. This idea con throughout the Meiji era. Banking was a and only a trade.

The Imperial government tried to dev banking system of the western type, recog banking as a public or quasi-public Banking thereafter came to be a creation State; and official units were established in the tern lines. Private banks once again cropp but under regulation. These ordinary banks become increasingly powerful eclipsing eve official banks. Thus by virtue of the model the government, and of the subsequent exp of the banking business, there grow up out o

merchant class organised private bankers who had earned experience and reputation in banking in Japan.

Mr. Allen divides the banking history of Japan into three periods. According to him, the first period stretched from 1868 to 1882, and was the age of National Banks. This served as the experimental stage. The second period, from 1882 to 1900, was the era of Central Bank, and it laid the foundation of the modern Japanese banking system. The third, according to him, continued up to the second world war, and was the era of Ordinary Banks. To these three a fourth period, from 1939 to the present day, may be added which can be called an era of reform and reconstruction.

The Imperial Government sent Prince Hirobumi Ito to U. S. A. in 1870 to study her governmental structure and the financial system. Coming back, the prince suggested the adoption of the National Bank system of U. S. A. as the model and accordingly, the National Bank Act was passed in 1872, which may be called the foundation stone of the Japanese banking system. Most of the Japanese banks of importance were established during the next thirty years. For example, the Dai-ichi Bank in 1872, the Mitsui Bank in 1876, the Yokohama Specie Bank in

1880, the Bank of Japan in 1882, the Mits and Sumitomo banks in 1895, the Hypothec of Japan in 1899, the Bank of Taiwan in the Industrial Bank of Japan in 1902, and Bank of Chosen in 1909.

It is interesting to enquire as to the American system of plural reserve was ferred to the European pattern of a single tral institution in Japan. It seems at that even in Europe, the American idea of reserve was more popular than the English of single reserve. It is important to note Bagehot in his Lombard Street favoured plural reserve system. He analysed and attention to the weak points of the Bank England and "brought to light the tremendo and danger which hung over the c because of the single reserve system." He phasised that the finance of the whole Empire hinged on one institution, and th whole financial structure of the Empire collapse like a house of cards, should th titution fail. This might be the reas Japan's preferring the plural reserve Subsequent events, however, proved th English system was better for Japan. Fo the banking crisis in U S A. in 1932, th of Japanese banks coll losed

this sad event Japan turned to the single reserve system based on a strong central bank called the bank of Japan. Following the establishment of the Bank of Japan, Government took steps to initiate special banks for long-term loans and private banks for short-term loans, and with this end in view passed a banking law to govern them. Government also took steps to liquidate or amalgamate the banks. Thus in 1920, before the banking crisis, there had been 1,987 separate banks. But liquidations and amalgamations reduced the number to 872 in 1930 and 351 in 1840. The figure was further reduced to 61 at the end of the second world war.

Pre-War Banking System In Japan:— Financial institutions of per-war Japan could be divided into two broad categories, namely, banks and other financial institutions. The latter were again of four kinds: the Deposit Bureau of the treasury, the trust companies, the credit associations, and the "Mujins" or mutual loan companies. The first group could be subdivided into three categories such as, (1) special banks, (2) ordinary banks comprising the commercial banks and exchange banks, and (3) savings banks.

The special banks were incorporated under the special banking laws with objects and functions of their own. The Bank of Japan, the Yokohama

Specie Bank, the Hypothec Bank of Jap
local and Agricultural and Industrial banks, th
of Taiwan, and the Bank of Chosen were i
within the category. The ordinary bank
designed to be commercial banks and did
finance domestic trade. The special bank
expected to provide long-term finance. Th
Yokohama Specie Bank financed commerce,
the ordinary banks financed the home
The Industrial Bank financed industries, a
Hypothec Bank and the Agricultural banks p
rural finance on large and small scales resp

But though the different types of
were expected to function in different fie
pre-war Japanese banks developed a tenden
a single bank to assume all the function
thus develop some sort of departmental
method of banking. For example, the o
banks, originally designed to be commercial
opened savings departments and underto
business as well; while on the other ha
trust companies developed commercial and s
business. This led the authorities to brin
reform. The financial panic in Japan in
and the American banking crisis in 19
after cautioned the banks to keep confi
their own fields of banking. The Bank
March 1927 was passed with the objec

empowering the Ministry of Finance to supervise and control the banks. It defined banks as all concerns engaged in "the acceptance of deposits together with the lending of money or the discounting of bills or notes, or the carrying on of exchange transactions." Thus the activities of banks were limited to banking and accessory kinds of business. This had some desirable effects on the banks. For example, the Industrial Bank and the Hypothec Bank, both engaging in real estate mortgage loans often came into conflict with each other, but after passing of the Act the former has become busily engaged in relief loans to industrial companies and the Hypothec Bank busied itself in granting relief loans to agrarian districts.

The banking panic of 1927 led the government to declare general moratorium and further strenthen the position of banks by amalgamation. Many small banks disappeared in the process. Thus during the period 1913-37, the special banks were consolidated and reduced from 53 to 13 savings banks from 648 to 72 and commercial banks from 1,457 to 377,

During the war years Japan's war loans were sold enblock to the Bank of Japan which resold them to the commercial, special and savings banks. During the war years, some of the Japanese banks, for example, the Yo[illegible] Specie Bank and the Bank of Taiwan, de[illegible] connections with the local banking systems Japanese occupied regions of China and east Asia, forming the common currency known as "the Yen Block." There also took a mushroom growth of financial institutio[illegible] finance the war efforts. The end of the w[illegible] the defeat of Japan led to the collapse of institutions and created problems of readju[illegible] of banking for the established banks to tra[illegible] nal lines of banking business. Some major c[illegible] became necessary. A series of laws were [illegible] to reform the banking system after the war.

BANKING INSTITUTIONS IN PRESENT-DAY JAPAN

Banking institutions in present-day Jap[illegible] be classified into three categories, that is, com[illegible] banks, long-term trust banks and foreign ex[illegible] banks. There are in addition, financial institu[illegible] such as the Bank of Japan which is the central the Development Bank of Japan and the E[illegible] Import Bank of Japan both of which are go[illegible] ment financial agencies, and the Mutual S[illegible]

Bank which was reorganised at the end of the second world war from the "Mutual financial guild." All the above institutions function under the title "bank", though it is customary to include only the first three classes under the caption "bank".

Commercial Banks :— Commercial banks were opened, and they now function under the Banking Law of 1927. This law defined banks as all concerns engaged in the acceptance of deposits together with the lending of money or the discounting of bills or notes or the carrying on of exchange transactions. It authorised the Ministry of Finance to supervise and control the banking system. Thus they carry on almost the same functions as the commercial banks in India. The commercial banks in Japan numbering 84 (at the end of 1954) are generally divided into four distinct types. They are the city banks, the local banks, the former special banks, and the trust banks.

The City Banks :— There are ten city banks. They are the Fuji, the Mitsubishi, the Sanwa, the Sumitomo, the Tokai, the Daiichi, the Mitsui, the Kyowa, the Daiwa, and the Kobe, banks. Almost all of them have their head offices in either of the four big cities, namely, Tokyo, Osaka, Kobe and Nagoya; and have a network of branches throughout the country.

The Local Banks :— Numbering all, local banks function within their res regions. Originally there were many of th the same region, but the liquidation and m movements have now limited their number t or two to a prefecture.

The Former Special Banks :— Hypothec Bank of Japan, and the Hokaido soku Bank both of which were in pre-wa doing long-term banking business, have no converted to genuine commercial banks th the post-war decentralisation process. A law in 1950 repealed the special laws and su them to the same law as the ordinary The Hypothec Bank now functions as a qu bank, and the Hokaido Tokisoku (Develo Bank) as a puasi-local bank, and have giv their former long-term business and bond is

The Trust Banks :— The trust have been organised after the war out of th mer trust companies, and they now carry on and banking business simultaneously. Trust include the Mitsubishi, the Mitsui, the Y the Nippon and the Daiichi banks. Thou trust banks have been classified with com banks. they differ from them for, they carr trust business as well.

The Branch banking system being pre

in Japan, all of the above banks, except the trust banks, have considerable number of branches throughout the country, the average number of branches being 70 for all, and as high as 160 for the city banks only.

The Long-Term Trust Banks :— The long-term trust banks mobilise the small savings of the community by issuing bonds and supply the industry with long-term capital for fixed and circulating purposes. Such a bank is authorised to issue bonds not exceeding twenty times its own capital. They take deposits from the central and the local government, public offices and other customers. These banks were created by the Bank Law of 1952 and is post-war novelty. The Japan Kogyo Bank (the Industrial Promotion Bank) and the Long-term Trust Bank of Japan fall within this category.

The Foreign Exchange Banks :— The Foreign Exchange Bank Law of April, 1954 created a class of foreign exchange banks to deal mainly in foreign exchange and foreign trade finance, and limited its domestic business. The Bank of Tokyo has been reorganised under the law ; and it gave up its other lines of business carried on during the pre-war years.

Besides the Bank of Tokyo, many foreign banks are functioning in Japan as foreign

exchange banks. In 1952 there were twel
foreign banks with more than thirty b
There were three American banks, name
National City Bank of Newyork, the Chase
nal Bank, and the Bank of America ; two
banks, namely, the Hongkong and Shanghai
ing Corporation and the Chartered Bank of
Australia and China ; two Dutch banks,
the Nederlandsche - Indische Handelsbank
Nederlandsche Handel-Maatschappi ; two
banks, namely, the Mercantile Bank of In
the Bank of India ; the Bank of China ; the
de Indochine ; and the Bank of Korea. These
mostly finance foreign trade between Jap
their respective countries. They are regul
the Ministry of Finance. They follow
so-called " centralised domestic ex
settlement system " under which net balan
settled through the Bank of Japan. F
exchange banks enter into correspondence co
with one another, offset mutual debts an
the balances through special deposits which
put in the Bank of Japan. Only gover
authorised banks are allowed to engage in f
exchange business. There are two types of f
exchange banks in Japan, Class A and C
the former being authorised to enter into
correspondence bank contracts with foreign

abroad, while the latter is merely allowed to enter
n exchange business via the former.

There are 24 class A foreign exchange banks, half of which are foreign banks. The other half include the Bank of Tokyo, and ten other banks. Class B banks number 21 and all of them are Japanese banks.

Bank Organisation :— The internal organisation of a Japanese bank does not materially differ from that of an Indian bank. Each bank is governed by a board of directors of generally five to ten members, who are elected by the shareholders in general meetings. The Chairman of the board is at the same time the President of the bank. He is the legal representative of the bank and its chief executive director. Auditing and supervision is done by three to five auditors elected by the shareholders in general meeting.

" Every sizable Japanese bank is organised into a head office and many branch offiices. The head office usually includes two major sections - general administration in charge of secretarial work, accounting, branch supervision, and research, and the business administration, in charge of domestic and foreign operations. Branch offices are subject to direct and strict supervision from the head office, which sends out examiners without advance notice to inspect books, and requires each branch

to report regularly on its operations and
tion and to have its position certified quart
auditors. Banking business is handled th
several departments, among which the do
foreign exchange, foreign relations, savings a
the bank engages in trust business) trust depar
are the most important." *

Banks are, by law of 1927, required
incorporated. Minimum capital is 2 millio
if located in Tokyo and Osaka, or 1 millio
if located elsewhere. For opening a new b
a new branch, the Finance Ministsr's permis
required. The Finance Minister has the p
suspending business of a bank or removi
replacing the managers and auditors of bank
can also cancel the licence of a bank in ex
cases.

Banks are required to submit half-
reports to the Ministry of Finance. They
prepare semi-annual balance sheets and audit
ments every three months. The Minister
depute his officials for inspection and super
of banks at his own initiative.

The Industrial Credit System
Japan :— The contribution of the Japanese
for the industrial development of the coun
enormous. At present Japan has a gro

*(Beckhart P. 534)

government, semi-government and private institutions specialising in industrial finance. The Industrial Bank of Japan, the Central Bank for commercial and Industrial co-operatives, the Export-Import Bank of Japan, the Japan Development Bank and the Long-Term Credit Bank of Japan are the main institutions specialising in industrial finance. Besides, there are some Urban and Rural credit societies supplying long-term funds in small scale.

The Industrial Bank Of Japan :— Established in 1902 for the purpose of financing industrial development, it was "an ambitious experiment in investment banking conceived more or less on the lines of the French institution" (Credit Mobilier).* It was organised as a privately owned joint Stock Company under the Law of Incorporation of the Industrial Bank of Japan (No. 70) of 1900. The capital was at first 10 million Yen but was raised in 1906 to 17,500,000, in 1919 to 50,000,000 Yen. In 1950, the Bank was reorganised, and since then it has been functioning under the Bank Law of 1927. Its capital has also been raised to 150 million Yen, almost half of it being now owned by the Government of Japan. It raises funds by issuing debentures. It invests its funds in purchasing government,

*(Basu, S. K.: Industrial finance in India p 253.)

municipal, and other bonds af local auth corporate debentures and shares as approved Minister of Finance; *making loans on secu such bonds, debentures and shares*; disc bills of exchange; granting loans for terms on security of permanent assets li and buildings, ships, factories etc. A cons part of its assets consists of loans and dis so that, it cannot be called a pure industri As has rightly been observed, "its operati those of a hybrid institution–in its gener ing activities it differs little from ordinary but in its medium–term and long–term fi activities it resembles a mortgage insti It also acts as an agent of the Centr for Commercial and Industrial Co-operative Bank also finances foreign trade industries

Traditionally, however, the bank w ting as an industrial bank and its f were:

(1) To make loans on the secu national bonds, prefectural and municip bonds or debentures and shares of compa

(2) To subscribe for and un national loan bonds or debentures of com

(3) To receive deposits of money o current or special account and undert custody of goods entrusted

(4) To undertake trust business relating to secured debentures.

(5) To discount bills.

(6) To buy and sell clean and documentary bills of exchange.

(7) To make loans on mortgage of estates created by virtue of special laws.

(8) To make loans on mortgage of land and buildings belonging to factories.

(9) To make loans on mortgages of ships including those under construction which shall be redeemable by annual instalments within a period not exceeding 15 years or a fixed term of not more than 5 years.

(10) To make loans on the security of shipbuilding materials or equipments.

(11) To float National loan bonds, prefectural and municipal bonds and companies' shares and debentures and to receive payments for the same and to effect the payment of principal and interests, or dividends on the above.

(12) To make call loans or loans for a fixed term on security of sites and buildings belonging to factories or of residential land or buildings lying in localities where the city planning Act is in force, provided that the total amount of such loans shall not exceed 2/3rd the amount of the Bank's paid-up capital.

During the second world war the was asked by the government to exten amount of credit to the vitally important tries. The government guaranteed the arising out of such advances; and the li debenture issue was raised and interest and cipal guaranteed. The government organis Wartime Finance Bank to relieve the Ind Bank of its burden of financing the mu industries. In 1951, 3/4th of the Bank's ad were to six major industries, namely, mac textile, metal, chemical, mining and shi more than half of the amount being for pr equipment capital, and it comprised 1/3rd entire equipment capital provided by the banking system in the country.

The Industrial Bank was reorganis December 1, 1952, with a capital of 2,770 Yen. It returned to the traditional lon lending, and it decided to discontinue the term credit operations that it assumed duri war and post-war period.

The Central Bank for Comm and Industrial Co-operatives :— established in 1936 with the object of the funds of the small co-operative asso set up under the Co-operative Associatio of 1900. These co-operative associations e

o-operative manufacturing and warehousing units nd often carry on banking business for their nembers. They are dependant on banks for their unds. This Bank was expected to provide them vith the necessary funds, and to take deposits rom them.

The Export-Import Bank of Japan :— Originally meant to be a foreign exchange bank, t has now widened its scope of operations. In 1953 the Bank's capital was raised for the purpose. But the Bank is expressly prohibited from entering into any competition with other banks in general banking business, and is expected to provide funds where other banks cannot do so. "It is authorised :

(1) to make loans to Japanese foreign traders for investment in foreign corporations or to Japanese manufacturers for the purchase of equipments required for their own enterprises in foreign countries, provided that such loans will contribute to the promotion of Japanese exports or to an advantageous shifting of the sources of imports.

(2) to make loans to Japanese exporters or manufacturers of machinery and equipment and, if necessary, other goods for export.

(3) if necessary to advance funds for the export of machinery and equipment even before

export contracts are concluded, and also t
guarantees in connection with bids involv
export of machinery and equipment abro

(4) to make loans to foreign gover
banks or firms, to facilitate the purchase o
nese exports.

(5) to make loans to Japanese im
or manufacturers to finance stipulated
that are considered essential to the econo

(6) to discount bills for ba
connection with all the above types of
and

(7) to guarantee liabilities as
with any of the above transactions. The
discounted bills, and guaranteed liabilities
for maximum term of five years, altho
special cases they may be extended for up
long as ten Years."

The Bank is purely government ow

The Japan Development Bank:- E
shed under Law No. 108 of March 31, 195
the object of promoting the economic reco
tion and industrial advancement of the co
this Bank is wholly owned by the Govern
It is allowed to grant medium and lon
credit of not less than one year's duration
other financial institutions do not owing to
or shortage of funds. "In particular the ba

(1) to make loans for acquiring, improving or repairing capital equipment ;

(2) to subscribe to corporate debentures issued for raising development funds ; and

(3) to loan funds or subscribe to debentures which would enable the payment of development loans granted by ordinary banks or other financial institutions."*

(4) to borrow funds from the government, to underwrite obligations incurred by private firms for development activities, and to borrow from abroad amounts not exceeding its capital and reserves.

The capital of the bank amounts to 17 million Yen.

The Long-Term Credit Bank of Japan:- It was established in Dec. 1952, with the object of granting long-term credit to industries. The capital of the bank amounts to 2,250 million Yen of which 1500 million Yen are paid up. Half of the capital is owned by the government and the other half by a consortium of banks and other financial institutions.

The Long-Term credit Bank Law of 1952 has created the possibility of organising banks for providing long-term credits to any sector of the economy as distinguished from the above

*(Beckhart p. 552)

specialised types of institutions. The also withdrawn the debenture issuing the ordinary banks and have thus them keep themselves confined to lending operations. Under the new banks may be owned by the govt. or vate investors, individual or institution must have the minimum capital of 50 Yen; and they will be allowed to iss tures to the extent of thirty times capital, and reserves. "They may funds for the purchase of equipment or term working capital by making loans discounting or accepting bills, and may obligations arising in connection with su They also may accept deposits from and from the national and local governm

The Agricultural Credit Sy Like the industrial credit system, the tural credit system is being run by a specialised banks. The Hypothec Bank of the Hokkaido Colonial Bank, the Central rative Bank for agriculture and fore important among them.

The Hypothec Bank Of Japan :- shed in 1896 under the Law No. 82 of a special bank, now functions under the Bank Law of 1927, since 1950.

functions continue to be almost the same. The Bank has a capital of 2000 million Yen, half of which is owned by the government and the other half by private owners. The government strictly regulates the functions of the bank. The Bank finances agricultural and subsidiary activities and lands and buildings. It also finances industries to some extent.

The Hokkaido Colonial Bank :- Established as a special bank in 1899 to finance projects for exploitation of the northernmost islands, the bank now operates under the general Banking Law of 1927. It raises funds by issuing debentures to supplement its capital fund of 700 million Yen. It grants loans against real estate mortgages to farmers, manufacturers and real estate owners and grants loans to companies origanising exploitation of these colonial islands. Of late it has developed its general banking functions more than the mortgage functions.

The Central Co-operative Bank for Agriculture and Forestry :— Established in 1923, the bank is under the Ministry of Agriculture and Forestry. It is similar in function and organisation to the Central Bank for Industrial and Commercial Co-operatives, and canalise funds of the co-operative associations, and grants loans to them. "The bank uses its resources to

provide the associations and federatio
short-term credits for periods not excee
years, to carry on their activities.
mobilises funds from the rural areas and
them to places where they are needed.

Central Banking In Japan.

The National Banks :— We have
referred to the fact that Japan favour
plural reserve system and established the
nal Banks in 1872. Prior to their est
ment, the authority of issuing money
with the government; but it had neith
capacity nor the means to build up re
When the National banks were establishe
were meant to :

1. provide a medium of circulat
stable value in the handy form of bank n
book credit, which would be easily transf

2. place its funds to be mainly
from the national wealth, at the dispo
far as practicable, of the community by
nces in the forms of discounts and bills and
of money on the security of stocks and me
dise.

Mr. Sarasas divides the history of the National Banks into two periods, 1872 to 1876 nd from 1876 to 1883. During the first period, hey were governed by the National Bank Law nd they were commercial banks with the previ- ege of note issue. Minimum capital required was 50,000 yens. A National Bank was required to leposit with the government a sum equal to 50% of its capital stock to serve as basis for note ssue, the Bank being authorised to issue notes up o the amount of such security. The deposit was to e in the form of government paper money against which the government would hand over government nterest bearing bonds of equal value to serve as he basis of note issue. The remaining 40% of he Bank's capital was to be kept in the form of specie reserve for conversion of notes. Thus, wo-thirds of the notes issued by the National Banks were covered by gold.

The high percentage of specie reserve equirement resulted in heavy loss to most of he banks. After the adoption of gold standard y the European countries, the price of gold ose high and the people wanted conversion of heir notes into gold. Only four National banks ould be established one in each of Tokyo, Yokohama, Niigata and Kagoshima. Shortage of gold compelled the banks to contract note

issue. During the period 1872-1876, th
issue contracted from 3,45,(00 yens to
yens. The government paper money was i
rtible and depreciated in value and, th
the merchants had no other alternative t
convert the bank notes. The National Ba
had to be amended in 1876 allowing the
nal Banks to issue notes up to 34 millio
against the deposit of pension bonds (or
govt. bonds) with the treasury equal to
of its capital. Further, 20% of the capital
be deposited in inconvertible government
The specie reserve requirement was lowered to
This measure improved the position and inc
the profits of the National banks. New
were established raising the total number of
to 153 in 1879, with aggregate capital of 4
000 yen and note issue of 34,500,000 yen.
on the other hand the notes sufferred in
convertibility. The reserve of 25% being in
cient, the notes became virtually inconvertibl
The National banks, being run mostly
inexperienced people, began issuing more
more notes. Besides, they got themselves en
led with different trades and business to a
rous extent. Consequently, most of them f
it difficult to pay the depositors and in
the government realising the mistake decid

withdraw the note issuing authority from them and do away with the system altogether. The Banking Act of 1883 provided that the National banks should come to an end by 1899, by which time all their notes were to be compulsorily redeemed. They would, however, be allowed to carry on as ordinary banks. Thus a decade of experience showed that the plural reserve system of National banks was not suitable for Japan. The National banks created so much money that in 1881 the ratio of silver and paper money stood at 1:81, one silver yen being equal to 81 paper yens. Government decided, therefor, to establish a strong central bank with single reserve to take charge of the currency system. The Bank of Japan was that bank.

The Bank Of Japan :— The Bank of Japan, known as "Nichon Ginko" was established in 1882 after the model of the Bank of Belgium, which itself was a prototype of the Richsbank of Germany, as a joint stock company with a capital of 10 million yens, of which 50% was to be subscribed by the government and the remaining 50% by the public. The Convertible Bank Notes Regulation was passed in 1884 and Bank of Japan began issuing notes in 1885.

The Bank was granted a charter for 30 years which was extended for another 30 years in

1912. In 1942 when the charter expired, an was passed bringing about certain changes in constitution and functions. The capital was ra to 100 million yen and the dividend limite 5% on both government and private sh Government reserved full right to appoint ex tive and policy officials. Final determinatio the note issue limit and other related ma remained the final responsibility of the Minist Finance.

Functions Of The Bank :— The B of Japan carries on almost the same function the central banks elsewhere do. It issues n acts as the fiscal agent of the government ; counts, purchases, sells and collects bills ; m advances ; acts as the banker for the governm acts as the banker for the banks and other f cial institutions ; and carries on any other b ness necessary for the maintenance of the c system and attainment of the objects of the P

Note Issue Function :— It has the authority of issuing currency notes, All ma relating to note issue are to be decided by Minister of Finance, " who sets quarterly maximum amount of notes that the Bank have outstanding beyond the fifteenth conse day, and determines the types and valuati paper and securities eligible as monetary rese

The notes are to be backed by 100% reserves, consisting in any ratio, or commercial bills and notes and other kinds of paper, government and private advances, Government bonds and corporate debentures, foreign balances, gold and silver.

Fiscal Agent :— As fiscal agent, the Bank is authorised to make advances to the government without any limit and without any security. It can also purchase and subscribe to government bonds. It is required to manage treasury funds and thus handle a considerable fund.

Banking Functions :— The Bank also accepts deposits ; effects domestic transfers ; accepts valuables for safe custody ; advances money to different customers against various securities ; purchases and sells commercial papers, banker's acceptances, government securities, gold and silver.

Central Banking Functions:– The law of 1942 defines the functions of the Bank as including " the regulation of the currency, the control and facilitating of credit and finance, and the maintenance and fostering of the credit system, pursuant to the national policy, in order that the general economic activities might be adequately enhanced." These functions are vested in the Policy Board which has the power to determine :

1. rediscount rates and rates on advances by the Bank, as well as types of paper

for rediscount and advances, and othe
tions of such operations :

2. open market policies with res
timing of purchases and sales, types of se
and paper, and other conditions :

3. legal reserve ratios to be mai
by financial institutions having co
relationship with the Bank of Japan :

4. maximum interest rates appli
financial institutions, as well as the
conditions, and margins of collateral s
on loans by financial institutions to
dealers :

5. any other matter pertaining to
control and examination of financial inst
as may be entrusted to the Board by oth
or by contractual relationships.

Administration And Control:- A
1949 amendment, the administration is v
the Executive Board consisting of the fol
officers :

1. The Governor
2. The Vice-Governor } for 5 yrs.
3. Three or more executive direc
4. Advisors.

All of the above 2 yrs. officers are ap
by the Ministry of Finance for various
such as, the Governor and the Vice-Go

for five years each, the Executive directors for four years and the advisors for two years each from different fields. The activities of the above Board is subject to supervision of not less than three auditors also appointed by the Minister of Finance.

For carrying on credit operations, as has already been mentioned, there is the Policy Board consisting of three ex-officio members, namely, the Governor, the Vice-Governor, and a representative of the Ministry of Finance and four more persons appointed by the cabinet representing the financial, industrial and agricultural interests of the nation.

The duty of the Policy Board is to "formulate monetary and credit policies and to supervise the execution of such policies by the Bank officers." This has the result of curtailing the power of the Ministry of Finance on the one hand and that of the Governor on the other. The Board has to submit reports periodically to the Diet.

Monetary And Credit Policies In Recent Years :— The Bank of Japan has been following flexible monetary and credit policies in the post-war years. Like central banks of other countries during the post-war period, Bank of Japan faced the two contradictory problems of

curbing the inflation on one hand and recons
ting the country's economy on the other.
tradition of direct financing of government def
did not easily permit a quick change to a flex
management of public debt and the purchase
sale of securities for controlling credit ra
than for accommodating the demand of the treas
Yet in the post-war years, the maturity of
monetary and credit policy of the Bank of Ja
is clearly visible, and its effect on the econo
system clearly felt.

During the period 1945-1949, note issue
the Bank of Japan rose seven times, two-thi
of it being ascribed to government financing a
one-third to other financing. In 1949 the gov
ment decided to repay the public debts. Deva
tions of 1949, coupled with the establishment o
single rate of exchange for Japan affected t
Japanese export industries. As a result, t
problem of curbing inflation and contracting cur
ncy, was made more complicated. The Ba
followed a policy of keeping the volume of no
constant and at the same time increasing th
money in circulation. In order to encourage d
hoarding of currency and to increase bank reso
ces, it raised the time deposit rates and lower
its own rates for lowering the loan rates of oth
banks. It also promised wider and easi

accommodation to banks for desirable types of financing. It increased the services of the Accommodation Service Section for combining banks for granting loans to big enterprises not within the capacity of a single bank. As a result, during 1949–50 while note issue remained constant bank loans and advances to industry increased considerably.

The outbreak of hostilities brought a sudden and unexpected rise in Japanese exports. Bank of Japan had to finance the foreign Exchange Board acquisitions of foreign currency. As a result, during June 1950 and March 1951, the total assets of the Bank rose by 72% a manifestation of extention of advances to the government and its agencies and the Foreign Exchange Control Board. On the liability side, however, the rise of currency in circulation was checked by the favourable cash position of the Treasury, whose balances with the bank rose almost six times.

All these factors created a renewed inflationary condition in Japan. To reduce the inflationary pressure the Bank in Sept. 1950 adopted some measures to promote imports and extended financial facilities to importers. To contract credit it raised its advance rates and scrutinised papers for re-discount more strictly. It also raised the time-deposit rate to encourage flowing funds to financial institutions. The prof the Bank increased. In 1953, a new law passed which made the following major cha

(a) abolished the Policy Board and i place formed an advisory council within Ministry of Finance ;

(b) restored the authority of the Mi of Finance over the Bank of Japan and o banking institutions ;

(c) abolished the restrictions on ba holdings of securities.

(d) raised the capital requirements banks ;

(e) introduced the system of cash res requirement on bank deposits.

While these provisions strengthened armoury of the Bank of Japan for credit con the expansion of credit and currency contin unabated. During the period 1951-1953, mainly to expanding bank financings of government through direct advances and also purchase of securities, assets and liabilities the Bank of Japan rose by 30%. The fig rose from 630 billion Yens to 830 billion Ye During the same period, the liquidity posi of the other commercial banks deteriorated, ratio of reserves to deposits falling to bel

40%. The assets and liabilities of the banks rose from 2,110 billion Yen to 4050 billion Yen, an increase of 90%. The discounts increased from 320 billion Yens in 1951 to 970 billion Yens in 1953, while advances increased from 740 billion Yens to 1,570 billion Yens.

"The Bank of Japan continued, despite these developments, to rely almost solely upon selective credit controls until late in 1953. During the same period it actually adjusted certain intrest rates downward to favour the financing of certain domestic activities and imports. In Sept. 1953, the Bank made more severe its system of progressive penalty rates, with a view towards restraining excessive borrowing by the commercial banks. under this system each bank was allowed a basic credit line ; the lowest. discount rate (5˙87-6˙57 percent) applied to the lower position of such a credit line ; higher rates (6˙93-7˙30 percent) applied to the full credit line ; and still higher rates (7˙66-9˙13 percent) were applied to amounts beyond the credit line. The ranges of applicability of the various rates were thereafter revised from time to time in order to bring into operation progressively higher rate. The new system seems to have had some effect."*

To these the Bank added moral suasion indicating

*(Beckhart p 566)

the banks the correct credit policy from ti
time.

In view of the continued rise in bank c
and borrowings from the central bank, the
of Japan modified, in September 1953, its
policy with a view to discouraging somewh
access of city banks to the Central Bank.
National Federation of Bankers' Association
decided to adopt voluntary measures to co
bank lending for speculative and non-ess
purposes. In May 1954, the Government of J
issued a memorandum urging the banks to
trict credit and cut down their borrowings f
the Bank of Japan. In October the Ban
Japan followed that up by revising the sys
of selective higher interest rates on its adv
to commercial banks.

In 1955, there was increase in indus
production by 8 per cent; but at the same t
money supply increasd by 16 per cent. In 1
there was further increase by 19 per cent.
Bank of Japan made use of open market op
tions for credit restraint. But all these meas
seemed to be insufficient to halt the creeping
lation. The authorities, therefore, tried to
nore effective methods of control.

Cash Reserve Requirements For Japanese Banks For The First Time :— Since the necessary legislation was passed in May 1957, cash reserve requirements were introduced for the first time in Japan from September 11, 1959. Banks with deposits of more than 20 billion yens were required to hold with Bank of Japan 1·5% of demand deposits and 0·5% of time deposits; for banks with deposits of less than 20 billion Yens, the respective ratios were 0·75% and 0·25% respectively. The method of prescribing two different requirements for bigger and smaller banks could save the banks from heavy loss of income due to locking up of considerable sums as reserves. It also tried to equalise the effect on the different banks' credit creating capacities. The Japanese authorities, however, declared that the step was not a "tightmoney measure" but a measure designed to avert excessive monetary expansion in the last quarter of the calendar year which usually takes place due to government transactions.

Again effective December 2,1959 the Bank of Japan raised its basic discount rate from 6·935 per cent to 7·3 per cent. It was stated that this step was taken as a precaution against a possible revival of inflationary pressure. The Finance Minister is reported to have expressed

the hope that the commercial banks woul
operate by raising interest rates and restri
credit.

Another step taken by the Bank wa
regulation of the ratio between loans and d
sits. The Japanese Finance Ministry issue
circular to all banks in Japan on March 2,
entitled "Some points of importance to
currently considered in the administratio
Banks." The Ministry urged that the ratio
loans to deposits should be maintained at 8
(In the first half of the fiscal year 1958-59,
actual ratio was 104% for city banks and 9
for local banks.) Notes and cheques were ex
ded from the total deposits, and notes un
written by the banks were deducted from the t
of loans. The immediate purpose of the rule w
to prevent banks from taking up "overloa
positions." Banks with higher monthly rates
loans were required to submit letters of explanati
Bank capital assets were also required to
strengthened by increasing the current ratio
floating funds to 30% or more. The actual ratio st
at 23.6% for city banks and 26.% for local ban
The Bank of Japan set down as the stand
basis for ordinary payments against receipts. T
ratio stood at 82.6% for city banks and 76.
or local banks.

On August 24, 1960 the Bank of Japan reduced the discount rate from 7.3% to 6.935%. The 7.3% rate had been in effect since December 2, 1959. The basic discount rate of the Bank of Japan was reduced on January 26,1961 to 6.57% from 6.935%, the rate that has been in effect since August 24, 1960. On January 30, 1961 the National Federation of Bankers Associations lowerd by 0.365% the lending rates and call rates of commercial banks. The long-term loan rates of other financial institutions were also reduced in response to the reduction by the central bank. The new basic discount rate was the lowest in the post-war period.

Though apparently it favoured expansion, the Governor of the Bank of Japan repeatedly emphasised that the reduction was not to be interpreted as a measure taken to stimulate economic activity, but rather as one intended to lower the general level of interest rates. It was further emphasised that the authorities considered it desirable to narrow down the interest r differential between Japan and foreign countri This would discourage the influx of short-te funds from foreign countries to take advanta of the differential in the rate of interest. Th it would affect the inflow of capital and the balan of payments. The step would also lower the co of production of industrialists, thus enabli them to compete in the market.

The Japanese Government decided on 18th July 1961 to speed up its trade and exchang liberalisation programme, as the balance of pay ments position improves. On August 1, 1961, th Bank of Japan decided to purchase on or abou August 12, 50 billion yen worth of government guaranteed debentures from the commercial banks on the condition that the banks would repurchase them by the end of November 1961. This mea sure was undertaken to offset the lerge seasonal surplus of Treasury accounts arising out of collection of revenue and taxes, and to avo

an unduly large increase in borrowings by banks from the Bank of Japan. It did not mean any change in the stringent monetary policy which is continuing.

Reference for further reading :—

(1) Sarasas : Money and Banking in Japan.

(2) Beckhart : Banking Systems. pp. 518-570.

(3) Basu, S.K. : Industrial Finance in India. pp. 253-281. (1949 ed).

PART II

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① Banque de paris
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7. Caisse Nationale de credit Agricu

8. (5 to 20 yrs)

in 1852 The credit Foncier — Mort bank — loans for Agri land ~~[illegible]~~ con

long term (10 — 75 yrs)

short term (1 — 9 yrs)

THE BANKING SYSTEM OF FRANCE

HISTORICAL INTRODUCTION :-Banking and credit first appeared in France with the Knight Templers in 12th century. That monastic order became the banker of the world during the Crusades, since the necessary transfer of funds could be made easily between different branches of the temple scattered from Western Europe to the Middle East. In the Middle ages, however, the banks were more like investment institutions than deposits banks. Such investment banking was carried on in France by the French Jacques Coer like the Fuggers in Germany and the Medicies in Italy. The first to carry on banking in France were the Jews and the Lombards who developed devices for settling accounts and the bill of exchange.

By the end of the 17th century, the idea of a state bank to assume the services of public debt and to issue note was already in mind. In

1716 according to Law's plan, what may be ca
the first public bank of France was cre
and it was designed to be a deposit bank,
issuing bank, and a colonial company at
same time. It collapsed in 1720, leaving the b
king system where it was. After half a cent
in 1776, a discount office was created and u
by the State for monetary transactions. The
creasing number of assignats issued led to
closure in 1793. In the following years, the C
des Comtes Courants (the Office of the Curr
Accounts), the Caisse d' Escompte du Comm
(The Discount Office for Trade), and the Co
toir Commercial (Commercial Banking Offi
were created. The need of a state bank was
now clear; and the Bank of France came
shape.

The Bank of France :— The Banque
France was founded by Nepoleon Bonapa
then First Consul of France, in February 18
with a capital of fr. 30,000,000 divided i
30,000 shares of fr. 1000 each, to which t
Government subscribed 5,000,000 francs. Inten
to be a national bank, the purposes for establis
ment of the Bank were : "to remedy by
combination of interests, public and private,
the displacement and disposition of those reso
ces which are the life blood of commerce a

the nation and (2 the debasement of the public credit and the stagnation in the monetary circulation"*...Although granted an official status, the Bank of France was initially a privately owned company. It discounted bills freely and issued bank notes, but without an exclusive privilege. "The exclusive right of note issue was, however, given to the Bank late in 1803, and it was required to keep such issues under constant control. It was expected to act as the banker for the State, banker's bank, and at the same time carry on ordinary banking business for its customers. In 1808 its functions were defined by a statute. The Bank continued to grow during the 19th century and occupied the position of a national institution.

During the first part of the 19th century banking was not yet fully developed in France, and it continued to be a personal type of business. The Comptoir National d' Escompte de la villa de Paris, the first joint-stock bank, was established in 1848 in British model. Many such banks were organised during the second part of the 19th century. The Credit Industrial et Commercial in 1859, the Credit Lionais in 1863, the Societe General in 1864, the Credit Mobilier in 1852, the Credit Commercial de France in 1894 and the Bank National de Credit in 1913.

* Mackenzie Banking System pp. 128.

The functions of commercial banks were no fully understood and many banks tried to ca on both commercial and industrial bankin the same time. This tendency was not wit consequences. Thus, the Credit Mobilier fa in 1867 due to its speculative dealings. T Union Generale failed in 1882, and the Co tier d' Escompte de Paris in Gr1889. adu however, the banks developed a tendency to s cialise. Specialised banks for agriculture, ind try and short-term lending came to be establish and the tendency was maintained during t twentieth century. Commercial banks ceased be tied to investment operations. Just before t second world war, there were approximately 2,1 banks in France with more than 9,000 offices

Present Day Banking System France :—Government intervention and natio lisation : Government intervention in banking relatively recent in France. The first substan intervention dates back to 1930, when the g vernment announced certain disqualifications f becoming a banker, though it was yet to def banking business. In 1936, the governm appointed a commission to devise a system banking control. In 1941, a bank Cont Commission was formed to prepare comprehe sive statutes for the purpose of banking contr

During the period 1941-45 some controls were exercised in respects of opening new banks or branches of existing banks. Some regulation of the nature of business were also undertaken. All these steps proved the limitations of piecemeal regulation and paved the way for effective nationalisation of the banking system.

On January 1, 1946, the Bank of France and the big four banks, namely, the credit Lionais, the Societe General, the Comptoir National d' Escompte and the National pour La Commerce et Industries were declared nationalised. In May, 1946, the law relating to the organisation of the credit system was modified and the activities of the deposit banks formulated. The National Credit Council was formed, and a hierarchy was created with the Ministry of Finance at the top and the Bank of France below it, above other institutions.

It should be noted that the nationalised banks were not merged into one, but subjected only to some measures of control, leaving their legal autonomy in tact. But their Boards of Directors were thenceforth to be appointed by the Minister of National Economy, by the Trade Unions and the Ministry of Finance, thus ensuring representation to various national interests.

The transfer was effected by transferri the bank shares to the State, the sharehold receiving in exchange amortizable interest be ring bonds.

None of the local and regional banks we however, nationalised. The question natura arises is, Why only four deposit banks alo were nationalised leaving the other banks inde pendent ? The answer seems to be, that th government thought this to be sufficient to fu fill its purpose. The plan of nationalisation wa obviously to bring under its control the mea to influence the distribution of credit. The fo nationalised banks held among them as high a 57% of the total deposits of the country ; an had a network of branches throughout the cou try. The greater portion of their resources ha been invested in treasury bonds, and thus, the were already rendering some sort of public se vice. The other banks were obviously o lesser importance from the point of view o national economy.

Another consideration might have been th creation of a private sector competing with a public sector and thus ensure the advantages o both. A private competitive sector was retaine with the object of preventing the nationalise banks from becoming much too bureaucratic in

policy. Indeed, the idea of a competitive private sector side by side with a nationalised public sector is becoming more and more popular not only in the field of commercial banking, but in other fields as well. It is because of this reason that in France, the business practices of the four nationalised banks have not materially changed after nationalisation from the traditional lines. However, there appears to be one break with the past in the growing practice of rediscounting commercial bills by the big banks.

The third factor might have been the question of finance. The nationalisation of all the commercial banks would necessitate astronomical figures in money which could not have been procured without inflationary consequences on the economy.

Constituents of the System :—The French Banking system differs in composition from that of ours. Banking and financial institutions in France can be broadly classified into three categories : (a) Private institutions ; (b) Semi-public financial institutions ; and (c) Government financial institutions.

The private institutions include commercial banks and investment institutions. The four nationalised commercial banks are also included in this category. This group is now under the supervision of the Bank Control Commissio

The semi-public sector includes institu which have received from the State a spe status and a few previleges. The Central ba of the French Union countries, which do no easily into any classification, and other insti tions which have been created by the State perform a particular kind of banking service public interest, are included in this group. So of them are specialised banks supplying re estate credit, agricultural credit, small busin credit and credit for foreign trade. The Savi banks, the postal cheque service and the Muni pal Credit banks are also included in the grou

The public sector is definitely of a pu nature. Its institutions represent the gover ment in all kinds of credit transactions. Th Credit National, the Caisse des Depots Commission, the Caisse Nationale des March de l' Elat and few other institutions recent created for financing of reorganisation and equi ment of important branches of industry a included in this sector.

It should be noted that it is really diff cult to devise a logical classification of bankin and financial institutions of France, and that th above classification is somewhat arbitrary.

Banks Defined :—The Law of June 13, 1941 defines banks as "financial firms or establishments, the usual function of which is to receive from the public as deposits or otherwise, funds which they employ for their own account either in discounts or in credit transactions, or in financial operations."

From the above definition, it is possible to distinguish commercial banks from investment houses and other financial institutions. Banks are classified by the Law of December 2, 1945 into (a) deposit banks ; (b) investment banks ; and (c) Long-term and Medium-term credit banks.

Deposit Banks :—They are the commercial banks accepting deposits from their customers and granting short-term credit, maintaining liquidity. Commercial banks are of different size and importance. According to the Law of May 17, 1946, deposit banks are those which receive public deposits either demand or for a period not exceeding two years. A deposit bank is not allowed to participate in any enterprise to the extent of more than 10% of the capital of the enterprise, or to the extent of more than 75% of the bank's capital fund. They can, however, participate in banks and other financial establishments or building societies "if these

appear necessary to their business." Depo
banks are subject to general credit regulati
of the central bank.

The most important commercial ban
are the four nationalised banks, and two oth
banks which make the big six of French bank
As has already been mentioned, the nationalise
banks controlled 57% of the total deposits an
still now maintain the position of importan
The greatest among them is the Credit Lio
nais, a model deposit bank. Its total asse
amounted to 373,368 million francs in 195
Created as a local bank with a capital of 2
million francs, it became the greatest bank i
course of time.

The second place goes to the Socie
Generale with assets amounting to 317,027 mil
on francs in 1951. Created under governme
auspices with a capital of 120 million fran
it engaged in various industrial participatio

The third is the Comtoir National d
Escompte de Paris with total assets of 212,9
million francs in 1951.

The fourth is the Banque Nationale po
le Commerce et I' Industrie with assets amou
ting to 238,970 million francs in 1951.

All these banks used to discount tra
bills, allow advances against securities, recei

demand and time deposits and open current drawing accounts, before nationalisation. They also used to issue drafts and make transfers on account of customers, attend to purchase and sale of securities through brokers, receive valuables for safe custody and carry on arbitrage business before their nationalisation. After their nationalisation, it has been already observed, that their commercial character has not been changed and legal autonomy left undisturbed. The only visible change is the presence of representatives of various economic and social groups in their Boards of Directors.

Assets and Liabilites :

Both before and after nationalisation, Discounts formed the highest figure in the asset side of the balance sheet amounting to more than 50% of the total assets. Next comes the loans and advances being more than 15% of the total assets. While acceptances from about 3%, investments make only less than 1% of the total assets. On the liabilities side, current accounts form nearly 50% of the total liabilities, while chequing accounts form nearly 30%, and time deposit accounts form less than 3% only.

The types of accounts differ somewhat from our accounts in terms and conditions. In

France chequing accounts and current accou are distinguished. Chequing accounts are th used by the bulk of despositors in their affa of personal nature and are generally non-borro wing accounts. Though it is customary to ca them chequing accounts, the use of cheques is no means limited to them alone, being allowed current accounts as well.

Current accounts are opened by pro ssional persons and institutions for convenien of their credit transactions. They refle commercial operations and are built up prin rily through the discounting of bills exchang

Besides these, there is the time depo account and other accounts which include miscellaneous variety of accounts opened correspondents, advances from the Bank of Fran for temporary needs, deposits due to affilia concerns, stock brokers etc.

Discounts include treasury and trade bills:

Of the big six commercial banks, the Cre Industrial et Commercial and the Cre Commercial de France were not nationalise But these two institutions differ from nationalised banks. The Credit Industrial Commercial "groups a number of subsidia companies which are mostly regional banks a

extends their activity to the national territory. At the end of 1950, the C. I. C. had nearly 540 offices out of the 911 belonging to all the regional banks." The Credit Commercial de France has, of course, a limited area covering the Paris region, the southwest, and the main trading towns of France.

National Banks:—On the basis of area of operation, French banks can be classified into National banks, Regional banks and the Local banks. All the banks discussed above have more or less a network of branches throughout the country, and may be termed national banks.

The Regional Banks:—The Regional banks are commercial banks carrying on business in one particular region. Thus they do not have any chance of competing amongst themselves, though they have often to compete with large establishments. Important regional banks are: the Credit du Nord, the Societe Marseillaise de Credit, the Societe General Alsacienne de Banque, the Banque de Bretagne at Rennes, etc. They perform all the commercial banking operations enumerated above.

Local Banks:—Confining their operations to particular localities, the local banks are holding their own mainly because of the advantages of local association and intimacy. They grant credits to local customers. In recent y they have developed a tendency to widen th areas and thus become regional banks as latter have tended to become national bank widening their areas. They carry on all commercial banking functions ; but their sources are limited.

Important local banks are : the Ban Federative Rurale at Strasbourg ; the Ban de Savoie at Chambery ; the Banque Lay nier et Cie at Annecy ; the Banque J. Joir Tourcoing ; the Banque Nicolet et Lafanc at Greenoble ; the Banque Guilhot et Cie Agen, etc.

The specialised Banks of Paris are lo banks operating in the Paris market and h tended to specialised in particular lines of cre Some of them have specialised in money ma operations, some in commercial, and some agricultural operations.

Banques de Affairs :—The Banque affairs or Investment Banks, have developed course of history and have been recognised such by the Law of May, 1946. Article 5 the Law says : "Investment banks are those wh principal activity is the undertaking and car ing out of participations in existing or new terprises, and the opening of credits of any len

for public or private enterprises which are benefiting, have benefited or will benefit by such participation. In such enterprises may be invested only their own funds or funds deposited with them for at least two years duration or to be withdrawn only upon previous notice." They may open deposit accounts only of their own personnel, or for enterprises to which they have made loans or in which they have taken participations, or for persons or corporations acting to their professional capacity, or for subscribers to stock in corporations in which they have participations.

Thus the investment banks and the commercial banks can be clearly distinguished from the nature of deposits they can accept and the nature of business they can undertake. The investment banks are authorised to accept deposits in connection with their participations, but not allowed to accept individual deposits or open chequing accounts except in very limited cases. The investment banks are subject to supervision of a government Commissioner appointed by the Minister of Finance and of Economic Affairs, with the approval of the National Credit Council.

In recent years the investment banks are trying to increase business in current and chequing accounts and other commercial ba functions. They have increased their hold commercial bills; and they hold a larger p of government and industrial securities. T also maitain deposits with other commercial b

Important investment banks are: 1 Ba de Paris et des Pays - Bas; 2 the Union E peene Industrielle et Financiere; 3 the U des Mines; 4 the Societe de Participations Etudes; 5 the Banque Parisienne Pour l' In trie, etc.

As the commercial banks, investment b have also raised their capital in recent y One peculiarity with the investment banks i large proportion of capital to other liabi

Medium-Term and Long-Term Cr Banks:—The Law of 1946 defined the Med Term and Long-Term banks in the follo terms: Medium- and long-term banks are whose principal activity consists of gra credit of at least two years' term. They not accept deposits for less than a two period without the authorisation of the Med and long-term credit Committee of the Na Credit Council. They are subject to the s limitations as the commercial banks rega their participations.

These banks were organised to fill up the gap between the short-term credit granted by the commercial banks and the fixed capital requirements raised by different means by the concerns. Besides having large capital funds, they raise funds by issuing bonds of different maturities generally varying from two to five years.

There were eight such banks in 1951 specialising in different lines of credit. Some of them grant only medium-term credit while some others specialise in financing instalment sales. In recent years, the expansion of these banks has been checked owing to the development of public and semi-public institutions for the same purpose. As in other countries so in France private institutions have been found to be insufficient for these purposes and have therefore been supplemented or even supplanted by public institutions.

Other Financial Institutions:—Other financial institutions belonging to private sector include those enterprises and persons which do not register themselves as banks but carry on banking business such as: "serving as commission agents, broker or intermediary in the buying and selling of government and private issues and commercial bills; providing short- or medium-term credit or foreign exchange; discounting, hypothecating or cashing commercial bills, c ques or government issues. They are not al wed to accept deposits and they generally op rate with their own capital funds. Some them are known as finance companies wh hold funds of their subsidiaries and act holding companies. Instalment credit compa and discount companies are some of the na under which these enterprises work. According the nature and extent of their operations, th are subject to control from different bodies.

Semi-Public Financial Institutions:– Semi-public financial institutions include cert specialised credit institutions, the popular ban foreign credit institutions, the savings banks a the postal cheque service.

Specialised Credit Institutions : Mortga Banking :–

The Credit Foncier :—It is a priv corporation, but is under the control of th State. Its activities require approval of Minister of Finance. Established in 1852, received a subsidy of 10 million francs from th government and consequently its capital rais to 60 million francs. Its capital was raised t 375 million francs in 1938. In the beginni its functions were to grant loans on mortga

to property owners, to governmental units, and to the merchant marine. Later, it was authorised to finance the operations of a subsidiary, the Sous-Comptoir des Entrepreneurs, a concern making loans to building constructors. It was also authorised to borrow from the public on the security of premium bonds repayable in 50 or 60 years, and bearing interest at fixed rates. In addition to its mortgage business, it developed a considerable amount of banking business discounting commercial papers, making loans on securities and conducting current accounts.

Presently, however, the essential function of the Foncier is to grant long-term credit on mortgage of property with or without buildings and to supply long-term credit to public bodies. Since, 1914, its mortgage credit is gradually waning and loans to governmental units gradually rising. The trend continued during the second world war. Its mortgage loans rose from 6,300 million francs in 1938 to 29, 128 million in 1951, while its loans to governmental units rose from 13,300 million francs to 93,081 million francs during the same period. Its contribution to construction finacing is considerable, The Law of 1950 permitted the Credit Foncier to extend loans either of medium- or long-term mortgage loans for building construction, and for the same purpose it can open account the name of the Sous-Comptoir des Entre neurs, the subsidiary specialising in the b ding construction. It has also developed me um-term lending in the post war years. Lo term loans are generally repayable within 10 75 years, with a usual maximum of 30 yea Short-term loans from 1 to 9 years are also ten granted.

Agricultural Credit Institutions:—C operative credit does not appear to have m much headway in France. As early as in 18 realising the necessity of co-operative instituti for providing agricultural credit, a law w passed authorising the formation of agricultu credit companies consisting of members of th farming syndicates, to assist their members procuring agricultural loans. Such compan were empowered to accept deposits on curre accounts or deposit accounts and to borro funds to augment their working capital. The companies were co-operative companies own by the members. This measure did not hav much to its credit.

In 1899, another Act was passed auth rising the formation of the Caisses regional de credit agricole mutuel (regional banks f mutual agricultural credit) and the Bank

France placed a loan of 40 million francs, free of interest, at the disposal of those banks. It was laid down that the total advance granted by such a Caisses regionale must not exceed four times the amount of its capital, and the term of loan must not be more than five years renewable period.

Further, the Bank of Franc promised to discount bills drawn on the local co-operative societies, and endorsed by the Caisses regionales.

In 1920 another law was passed subjecting all organisations, regional or local, to the authority of a national society. The local societies can grant loans only to their members and cannot accept deposits. They are members of regional societies of the respective regions. The surplus funds of the local societies are deposited with the regional societies which in turn deposit them with the treasury or with the Caisse Nationale de Credit Agricole which is the apex institution of the agricultural credit system. The regional societies take decisions on the applications for loans submitted to the local societies and transmitted by them, and help the members.

The Caisse Nationale de Credit Agricole is under the control of the government, its director being appointed by the Minister of

Agriculture. The Caisse National exercises constant supervision over the regional societies, and approves the appointment of their directors. It redisounts the obligations of the regional societies and distributes the funds among them when received from the Bank of France. The government advances to it funds for important agricultural schemes. It floates loans on 5 to 20 years bonds.

Industry

The Credit Popularie or Popular Banks :—Organised by the Law of 1917, the system of popular banks was "designed to aid small business and industry which for lack of sufficient collateral was not able to obtain Bank credit, by taking into account moral and psychological factors such as the honesty and ability of the borrower." Government encouraged them by granting funds and exempting from certain taxes.

The popular banks are generally organised in the form of co-operative societies with small capital funds. They try to build up reserves by limiting their dividend. They grant loans to meet the business needs of their members. They are subject to government control. Popular bankers have an association of their own known as the Popular Bank Syndical Chamber wherein the Minister of Finance is

represented by a Commissioner. There is also a central committee and a central fund for clearing purposes.

At the end of 1951, there were 53 main offices, 318 permanent agencies, and 414 part-time offices of popular banks throughout France. The resources of the system amounted to 72,501 million francs, including deposits of 69,093 and capital of 2,612 million francs.

Side by side with the popular banks, there are the Mutual Guarantee Societies which arrange for mutual guarantees within a branch of industry. The Caisse Centrale de Credit Hotelier, Commerciale et Industriale, the Caisse Centrale de Credit Co-operatif, the Credit Maritime Mutuel are some other institutions for specific purposes organised within the framework of the popular credit system.

Foreign Exchange Instituions :—There are three main institutions financing foreign trade. The oldest is the Banque Nationale Francaise du Commerce Exterieur, established in 1920, and backed by the government since. The Banque Francaise du Commerce Exterieur and the Compagnie Francaise d' Assurance were established in 1945 and their activities widened in 1949. The Banque Francaise du Commerce Exterieur has a capital of 500 million francs subscribed by the Bank of France and a consortium of other big banks ; and it is managed by a Board of Directors of 15 members appointed by the Ministers of National Economy and of Finance, and two government commissioners. It carries on all the transactions necessary for financing of foreign trade. It grants short-term credits by discount or acceptance and medium-term credits for foreign exchange transactions. Its rules have been adapted to the needs of foreign trade. In 1949, it was authorised to rediscount export bills to an increasing limit and the eligibility rules of the Bank of France were relaxed for the purpose.

The Compagnie Francaise d' Assurance pour le Commerce Exterieur "provides government insurance against catastrophies, political risks, and unusual monetary and commercial risks inherent in importing, exporting, or any kind of foreign trade."

Postal Savings Banks :—There are two types of savings banks in France. The ordinary savings banks are the Caisse Nationale d' Epargne which is a government institution established in 1881, and attached to the post office. A considerable amount of banking business is being done through the French Post Office. Current accounts are opened ; drawings,

transfers and payments may be made ; and cheques are collected for the account holders.

The ordinary savings banks are under the control of the government. They pay higher interests on the deposits than the commercial banks ; but there is a ceiling on deposits, which was fixed at 3,00,000 francs and 1,500,000 francs for individuals and institutions respectively. Deposits are withdrawable on demand. The savings banks are to redeposit with the Caisse des Depots et Consignations all funds except their till money and what is kept in accounts with the Treasury and the Bank of France. The Caisse pays interest on these deposits and invests the funds in purchasing French and foreign securities. The Caisse also pays interest to the depositors.

The Law of June 1950, however, authorised the savings banks to make loans on their own account to local governments to the extent of 50% of their excess of deposits over withdrawals.

The Postal Cheque System :—This system was begun in 1918 to further the use of cheques making the post office a national clearing house for payments. Amounts may be transferred from one account to another by order, or by cheque. The postal cheque may also

be crossed like an ordinary cheque. Po
Traveller's cheques encashable at any post off
Postal chequing accounts however, do not ca
interest, and as such, postal savings banks d
not compete with the commercial banks.

The Government Financial Instit tions:—The government financial institutio include the Caisse des Depots et Consign tions, the Credit National, the Caisse Natio des Marches de L' Etat, and the governme agencies for financing of recostruction and equi ment, all of them owned and managed by t government.

The Caisse des Depots et Consignations:— Established in 1816, it is the oldest of the g vernment financing institutions. Originally was designed to receive funds under adjudica tion and deposits of certain public institutio and public officials, it now manages the fun of the savings banks, of various private insu rance agencies, and of the social security sys tem.

The Caisse invests its funds in long term loans and capital participations, and has "an obligation to obtain a return on fun invested for long periods as well as for th sight deposits of savings banks. It purchas

securities issued or guaranteed by the government, and has the right to invest in industrial securities as well. It grants loans to public bodies, to government departments, municipalities and government-owned institutions, to finance public works. It also finances low-cost housing and rural reconstruction works and advances loans to the treasury. It grants short-term loans out of the sight deposits accepted by it. Not limiting its activities to the management of government obligations, it lends its support to the economic activities requiring medium-term credit. Thus the Caisse is one of the most powerful government banks in France, and has gradually been widening its field of activity. Its director is appointed by the President of the Republic on recommendation from the Minister of Finance.

The Credit National:—It was organized in 1919. Half of its capital was subscribed by the banks and the other half by a group of industries. Its main function was "to aid in the payment of war damages and the reconstruction of war-damaged enterprises. It raises funds by issuing bonds, but not allowed to accept deposits, discount bills or deal in securities. The government has entrusted it with certain tasks and has assumed some control over it. It was to aid reconstruc[tion] of the country after the second world war. [In] 1940 it was assigned the task of accepting [for] the government the bills drawn on it by [the] creditor enterprises and paying the bills [at] maturity out of funds supplied to it by [the] treasury for the purpose. These acceptances [of] the Credit National are widely held by [the] banks in their portfolios.

The Credit National also handless [the] different classes of advances of the treasury [to] the enterprises under different schemes. Sin[ce] 1943 the National has been authorised to [dis]count or to buy the bills representing mediu[m] term credits made by the banks up to f[ive] years' maturity with a repurchase provision.

The Credit National has the previlege [of] rediscounting bills at the different banks suc[h] as the Caisse des Depots et Consignations, [the] Bank of France, etc.

The Caisse Nationale des Marches de l['] Etat :—Established in 1936, it is a governme[nt] institution with some amount of financial au[to]nomy and managed by a Board of direct[ors] representing the different Ministries.

Originally it was designed to supply fu[nds] to producers for production of goods for [the] government orders; it does not lend directly [to]

customers but enables them to obtain bank credit in mainly three different ways such as providing its signature to bills and making them discountable with the Bank of France, giving guarantee or acceptance to the bills and thus making them rediscountable with the Bank of France. It thus helps in making medium and long-term loans available to deserving and approved industrial concerns.

Government Agencies for financing Reconstruction and Equipment :—Several government agencies have been created for this purpose, all of them functioning according to the general directives by the modernisation and equipment plan. The Commission des Investissements, the Commissariat General au Plan de Modernisation et D' Equipment, and the National Credit Council are meant for general purposes, of reconstruction and development of the industries, while the Fonds de Modernisation et D' Equipment and the Caisse Autonome de la Reconstruction are for specific sectors of the economy.

The Commissariat General au Plan de Modernisation et D' Equipment was established in 1946 for the purpose of increasing production and trade, to raise the efficiency of labour and provide full employment in the country,

to raise the standard of living; and for re-
ring the productive equipments damaged dur-
the war.

The National Credit Council prepa-
the credit aspect of the Plan and estimat-
the needs, suggested the creation of the Fon-
de Modernisation et d' Equipment which opera-
as a special account of the Treasury an-
grants credit to enterprises making investme-
under the modernisation equipment plan. Loa-
are also granted to enterprises undertaking ne-
constructions either directly or through oth-
credit institutions concerned.

The Caisse Autonome de la Reconstru-
tion was established in 1948 to provide fun-
for the repair of war damages, out of fun-
raised by bond issues and budgetary grants. It-
Board of Directors include the Governor o-
the Bank of France and a representative o-
the National Credit Council.

The Commission des Investissements wa-
established in 1948, for the purpose of mai-
taining a balance between the demand an-
supply of funds; and it therefore, has to ke-
account of all the enterprises and their cre-
needs and for that purpose act in close coll-
boration with other credit institutions in th-
country.

1 Deposit banks : (a) Regional bank (b) Local banks
2. National banks
3. Investment-banks: loan advances for two yrs duration deposit- for two years
4. Medium & longterm bank:
5. Credit Foncier : — 1852 – 10 million, 1958 – 93081 million longterm 10-75 yrs - short-term 1-9 years.
6. Popular Bank : — 1917 — 72501 million 4 banks Co-operative Type
(a) Societe generale (b) Loinnais bank (c) Escomptee de paris (d) Nationale Pour le Commerce et l Industrie. (a+b+c+d) short Term loan.

Central Banking

7. Foreign exchange bank
8. Credit national – Bank + Industry = capital All functions except note
(9) Agricultural credit inst – Regional bank for mutual agricultural credit.

The Bank of France :—We have already discussed the establishment of the Bank of France. It was founded in February, 1800 as a privately owned company. Its capital was 30,000,000 francs which was raised to 185·5 million francs in 1857. In 1960, the capital was raised to 12 million francs. The capital remained unchanged since 1857. The increase was effected by a partial conversion into state-owned capital of the reserves that have been accumulated during the last 50 years.

We have already learnt how the Bank of France gradually became a central bank assuming the functions gradually. This has resulted in the change of the status changing the administration of the Bank. Originally it was managed by a central committee of three members elected by the Regents who were in turn elected by the 200 largest shareholders. After 1806, its Governors and Vice-Governors

were nominated by the Minister of Fin
The management of the bank was chang
1936, 1940 and 1944. In December, 1945
Bank of France was nationalised. Its shar
now the property of the government, the s
holders being paid off in government b
registerd and negotiable, redeemable over t
ty years.

Nationalisation has changed its adm
tration as well. There is a General Counc
its management consisting of:

Four ex-officio members, namely,

1. the Governor of the Credit Foncier.
2. the Director of the Caisse des Depo Consignations.
3. the Director of Credit National.
4. the Director of the Caisse Nationale Credit Agricole.

14

Seven members appointed by the Minister Finance as recommended by the approp Ministers, such as, Commerce, Industry, A culture, Labour, Colonies, Foreign af Economic affairs, etc.

One member elected by the employees of B of France.

A Discount Committee for scrutinising papers brought for rediscount, and an Aud

Committee have been formed. The General Council publishes the reports and carries on the day to day administration of the Bank.

Functions :—It has the monopoly of note issue; it acts as 2 banker to the government and makes advances to the Treasury; it acts as 3 the custodian of the foreign exchange reserves of the country; 4 rediscounts bills of the commercial banks; acts as the 5 controller of credit and applies the various weapons of credit control; 6 controls the different public and private banking and financing institutions. In short, it performs all the functions of a central bank.

Note Issue Function :—The Act of 1803 gave the Bank of France the exclusive right of note issue in Paris. The previlege was enlarged in 1848 and the Bank was given the right throughout France proper. By a law of 1857, the lowest value of note in circulation was fixed at fr. 50. In 1871, the denominations fr. 10 and fr. 5, were also allowed. Until 1928 the amount of the note issue was subject to a ceiling limit, maximum fiduciary system of note issue being followed. In that year the system was changed to the fractional reserves system. The Bank of France was required to keep reserves equal to 35% of the notes in circulation and demand deposits in gold coin or bullion.

In 1939 the reserve requirement was aboli and the reserves steeply fell from 59% in 19 to 3·3% in July, 1950.

The Heavy Franc :—One of the m important events in the French monetary hist is the introdution of the "Heavy Franc" a n silver five-franc piece, of which 35 million w delivered to the Bank of France. Again t franc silver pieces as well as one-franc nick pieces have been minted. Thus the "Hea Franc" has been substituted for the former fra

The New Franc :—On January 1, 19 the new currency unit, the "New Franc" eq to 100 old francs became the only legal ten in Metropolitan France and the Departm of Algeria and Sahara. The old coins a notes remain in circulation, and will gradu be replaced by new coins and notes. As fr January 1, 1960, all cheques and post office tra fers etc., were to be made in terms of n currency unit. Companies and other conc have been given time to revalue their bala sheets within three years.

In return for the previleges of note is the Bank of France has to render certain s vices to the government, namely,

to perform without charge certain fiscal o rations for the Treasury, including all secu transactions.

to provide for the general public such services as the cashing of government pay cheques.

to pay to the Treasury a part of its profits computed on the basis of the rediscount rate and the note circulation.

to pay to the Treasury the profits arising from the redemption or retirement of notes in circulation.

The Bank of France is required to make advances to the Treasury. These advances are generally of the following kinds :

1. Permanent advances without interest.
2. Temporary advances repayable by the Treasury, (but which in practice have been absorbed in the successive revaluations of the Bank's reserves.)
3. Occasional advances in the form on negotiable Treasury notes etc.
4. Advances for the Exchange Equalisation Fund of the Treasury.

The Bank maintain gold and foreign exchange reserves as cover for the note circulation, though the percentage is extremely small now a days.

Central Banking Functions :—As a central bank, the Bank of France rediscounts bills brought by the commercial banks and thus makes the Bank Rate effective. Indeed, the bank rate has become one of the important weapons control. Only bills of less than 90 days' maturity bearing at least three good names are eligible for rediscount. They should further represent genuine and important trade deals.

The traditional rediscounting method has often been supplemented by the Bank of France as and when necessary. A fixed period, (generally thirty-day) loan is granted to the banks at rate usually equal to the rate of rediscount against collaterals.

The Bank of France also carries on open market operations, purchasing and selling in the open market government and private short bills "to affect the volume of credit and regulate the money market," but not for the purpose of earning profit.

Since 1948, the Bank has been purchasing first-class banker's acceptances drawn financing international trade, and bills guaranteed by the Caisse Nationale des Markets de l'Etat. Consequently, now a days, the discount portfolio of the Bank is inflated by commercial bills. It includes French bills, foreign bills, bills guaranteed by the Caisses, and bills for mobilisation of medium-term credit.

The Bank often fixes the maximum limit of discount for individual banks and asks them to

hold certain percenage of their deposits in government securities.

Banking and Credit Control :—While in the Anglo- American banking mechanism, creation and disribution of credit is primarily left to the commercial and other banks, in France, certain institutions have been created for directing and regulating distribution of credit for the best interests of the country. These institutions issue directives from time to time to the banks and finacial institutions regulating distribution of credit. This undoubtedly is a novel idea to be followed by others.

The two important bodies created for the purpose are, the Bank Control Commission and the National Credit Council. The two bodies act in collaboration with the L' Association Professionelle des Banques which was created by law in 1941.

L' Association Professionelle des Banques :—Its membership is compulsory for all listed banking and financial enterprises of the country. The Association enters in the official list new banks when alone the new bank can function. It studies banking conditions of the country, maintains good relations among its members and co-ordinates their credit policies and activities. It can take disciplinary actions against any bank in case of non-compliance wi its directives.

The Association also acts as a liaiso unit of the Bank Control Commission and th National Credit Council. These latter bod consult the Association before finalising any st regarding credit. All decisions and directives a first sent to the president of the Associati whose duty it is to circulate them among th member banks and effect compliance with them Thus the Association is more or less a suppl mentary and executive body of the two gover ment bodies mentioned above.

The Bank Control Commission :—Th body plays an important role in the organis tion and distribution of credit in the countr It has the following important functions amon others :

(a) To see that all the banking laws hav been complied with by the banks and oth financing institutions ; and call for any repo return, information and explanation for the pu pose.

(b) To regulate the commercial banks an for that matter set the fundamental rules fo functioning of the banks such as regarding, sol vency, liquidity, cash ratio, investment etc. I

can take disciplinary action against violating banks.

(c) To arrange and classify the banks into different categories on basis of their functions.

(d) To appoint auditors for the nationalised banks.

(e) To standardise the by-laws of the banks.

(f) To standardise the by-laws of the banks with a view to standardise their activities.

(g) To hear appeals from banks against decisions of the National Credit Council affecting its interest.

(h) To take disciplinary actions against the banks as and when it deems necessary, and suggest removal from the official list.

Thus the Commission has Co-ordinating, regulatory, supervisory, consultative, and disciplinary functions, with corresponding powers. It has an important role in the credit organisation of the country.

The National Credit Council :—We have already referred to this body earlier. Established in 1945, it is "for the purpose of controlling the nationalised banks and of establishing a general credit policy for the country." The General Credit policy, which is finalised by the government, is put into operation thro[...] this Council, which, however "prepares all [...] decisions regarding credit and money." It [...] ther regulates the banks and settles disp[...] among them.

It decides the desirability of a bank [...] be included in the official list, and appeal [...] from its decision before the Bank Co[...] Commission. Its fixes maximum and minim[...] limits of interest rates and other charges [...] deposits and loans respectively. These may [...] termed jurisdictional functions of the coun[...]

Consultatative functions of the Coun[...] includes giving opinions on credit situati[...] necessity of banking legislation, credit distri[...] tion and allied subjects when consulted by di[...] rent appropriate bodies, including the Bank [...] France which execute them.

Credit Control functions of the Coun[...] include centralisation of the banking risks eff[...] ted by collecting all information about lo[...] business loans granted by different banks of [...] country with all particulars. The Council h[...] devised regular reporting system by the ba[...] on this aspect. This helps the Bank of Fra[...] to assess the risks run by the Banks. Centr[...] sation of credit information also enables [...] Bank of France to intervene in time if nece[...]

It is interesting to be observed that the method of superimposing certain government bodies over the banking system is unknown not only to the banking systems of other countries but also to pre-war banking in France. These bodies have been believed to have proved their necessity and vitality in improving the credit organisation in France; and may therefore be expected to be regular features in other countries as well in course of time.

MONETARY AND CREDIT POLICY IN RECENT YEARS

Credit Control :–The Bank of France uses the usual weapons for control of credit. After the war, France had to face the same problems as in other countries, namely, the problem of excess money and credit due to the war. Under the direction of the National Credit Council, the Bank of France has been following a flexible monetary and credit policy suited to her needs. In 1946 several directives were issued to the banks warning them of the dangers of creating

too much credit for speculative and stoc
piling purposes. During the year 1946 the to
bank credit rose from 392,000 million francs
600,000 million francs, that is, by 53%. Th
increase in loans was almost equal to increa
in deposits. In 1947 money in circulati
rose by further 189,000 million francs an
deposits rose by 98,000 million francs.

The National Credit Council immedi
ately applied the brakes and directed th
banks to contract credit and base their loa
not only on safety or repayment but on "th
double assurance that the funds were indi
pensable to the borrower and that the
use would serve an economic need." All loa
applications were subjected to scrutiny b
the service for centralisation of credit risks. Th
Credit Council, in its annual report for 194
declared its objectives of monetary and credi
policy as follows:

"Restoration of confidence of savers and lender
in the long-range value of their holding
Return to tested and traditonal practice
for the investment of individual saving
in channels most favourable to the moder
nisation of equipment and the expansio
of production and general well-being.

Progressive adaptation of bank resources - capital and deposits - to the new needs of economic evolution."

Increase in production and check on bank credit definitely had favourable effects on the prices. In 1949 the lending rules could be some what relaxed to encourage production in certain lines. Credit policy was directed towards adjusting the volume of credit to the level of employment and economic activity. Banks were directed to satisfy the needs of enterprises efficiently producing equipment and consumption goods resulting in increase in exports to hard currency countries.

The fight against inflation continued during 1950 and after, though the restrictive credit measures were slightly liberalised and prior permission of the Bank of France was removed in case of small loans.

During 1951, a tendency to renew the expansionary trend led the National Credit Council to adopt further restrictive measures, and accordingly, the discount rate from 2·5%, at which rate it stood since Junes, 1950, to 3% in October 4, 1951. The Bank of France raised the ceiling limits on rediscounting and agreed to rediscount short bills under agreement of repurchase by the banks. Sanctions from t Bank of France for certain types of loans w reimposed.

The Bank of France also imposed a pen ty on banks exceeding their ceilings of ind dual credit from the central bank by 10 p cent or more. This cautioned the banks utilising the credit facilities from the cent bank. Thus, the combination of quantitat and qualitative credit measures helped t Bank of France in arresting the inflation upsurge.

During 1954 the credit policy was lib ralised mainly through a reduction in the d count rate. On September 17, 1953 the disco rate of the Bank of France was reduced fr 4 per cent to 3·50 per cent, and on February 1954, it was further reduced to 3·25 per ce The rate was further reduced to 3 per cent December 2, 1954.

In 1955 there was rise in industrial a agricultural production in France the form rising by 11 per cent. Due to consequent rise in production and investment bank cr recorded a substantial expansion, of 14 per ce But at the same time the foreign exchange r serves of the Bank of France rose by $751 millio In 1956 bank credit rose by 23 per cent. O

of the important reasons was budgetary deficit. The wholesale prices as a result recorded a rise of 4·5 per cent, and she suffered loss of reserves of about $450 million. There a rose the necessity of credit restraint and the discount rate was raised from 3 to 4 per cent on April 11, 1957 to restrain excessive investment and consumption and to correct balance of payments disequilibrium. Moral suasion and consumer credit controls were also resorted to.

In 1957, the expansion was rather slow, the money supply increasing by only 2 per cent. In 1958 the rise was only 1 per cent. The slight increase was due to the combined effect of several factors. Rules as to instalment purchases were, therefore, relaxed. The penalty rate for exceeding ceilings was reduced from 12 to 10 per cent. Discount rate was reduced in stages.

The striking improvement in her reserve position enabled her to declare non-resident convertibility of her currency towards the close of 1958. The convertibility move was accompanied by a devaluation of the French Franc by 17·55 per cent.

Following the devaluation of the Franc, prices began to rise sharply but remained static thereafter. The sluggishness in the demand for credit in early 1959 as well as the considerable improvement in the balancc of payments enabl the authorities to relax gradually the credit re trictions. In February 1959 and again in Ap 1959 the discount rate was lowerd by 0'25 p cent to 4 per cent. The penalty rates for Ba of France rediscounts over and above th commercial banks' rediscount ceilings were al reduced in a number of steps.

There was large increase of credit towar the end of 1959, and though restrictive mea sures were not adopted, the Bank of Fra instructed banks to be cautions in granting new credits.

Thus the credit has been controlled b the Bank of France through change in the in terest rates, the imposition of rediscount ceilin and requiring the commercial banks to in vest 25 per cent of their sight liabilities in Tre sury bills. The Annual Report of the Bank France for 1959 stated that economic develo ments in France during 1959 had shown th the comprehensive measures adopted in 1958 restore equilibrium had been successful. Bu pointed out that the measures of monetary pol might be insufficient to reduce excess credit future, the excess liquidity resulting from external surplus, and to counteract domes inflationary pressure.

On July 9, 1960 the Bank of France again reduced the penalty rate for crossing limits of credit, which was already lowered on March 1959 and earlier. On April 23, 1960 the discount rate which had been lowered by $\frac{1}{2}$ per cent on October 16, 1958, and by $\frac{1}{4}$ per cent on Feb. 5, 1959, was further reduced by $\frac{1}{4}$ per cent to 4 per cent. At the same time the penalty rates that banks have to pay for central bank credit above their individual rediscount ceilings which had been lowered on March 19 were reduced from 6 per cent to $5\frac{1}{2}$ per cent, for rediscounts exceeding the ceilings by less than 10 per cent, and from 8 per cent to 7 per cent for rediscounts exceeding the ceiling by 10 per cent or more. The advance on securities was reduced from 6 per cent, the rate established on March 19, to $5\frac{1}{2}$ per cent. This sliding scale system of penalty rate is a novelty in the French banking system and it appears to have been succsssful there.

Control of Consumer Credit :—Another effective method adopted was the system of controlling the consumer credit for durable goods. In 1958, when the persistence of inflationary pressure, necessitated the continuance of restrictive measures, the National Credit Council set in February a ceiling on the amount of short and medium term credit made by banks to the private sector at the average of the short an medium-term credit outstanding on Septemb 30 and December 31, 1957. The National Cou cil also fixed the down payments for instalme purchases of selected durable goods. On July it lowered from 25 per cent to 20 per cent th minimum down payment for instalment purchas of household appliances, radio and television se motorcycles, scooters and bicycles, and from per cent to 25 per cent the down payment re quired for purchases of other goods includi automobiles. At the same time, maximum cr dit terms were extended from 12-15 months 18 months for most instalment purchases; the were set at 24 months for purchases of autom biles during the period August 16 - Novem 15, 1959, and at 21 months for purchases automobiles during the period Nov. 16 - Feb. 1 1959-60.

On October 7, 1960, the discount rate the Bank of France was reduced from 4 per ce to 3½ per cent. The penalty rate for exceedin ceiling by less than 10 per cent was lowe by ½ per cent to 5 per cent. The rate for adva ces on securities, charged by Bank of France, w reduced by ½ per cent to 5 per cent. The Min ter of Finance commented, that the lowering the discount rate would stimulate priv

investment and sustain the growth of industrial production without endangering the balance of payments. On October 6, 1960, the National Credit Council decided to extend the maximum repayment period for instalment purchases of different goods. It also decided to issue new regulations authorising the Governor of the Bank of France to require commercial banks to maintain a minimum ratio between some of their assets and their deposit liabilities. Among the assets that might be included in the ratio are cash holdings, balance with the Bank of France, holdings of Treasury bills (for an amount at least equal to 25 per cent of their liabilities) in excess of their holdings and medium term credit. The new ratio would be put into effect only if the monetary authorities consider that measures against as excessive expansion of credit were required.

The Annual Report of the Bank of France for 1960 reported that the money supply expanded by a little more than 14 per cent in 1960, mainly due to net rise in official holdings of gold and foreign exchange and increase in credit to business. The large surplus in the balance of payments, and the absence of difficulties in financing the Treasury's cash deficit, enabled the authorities to relax credit restrictions further.

The ceilings placed on rediscounts of short term paper by each commercial bank with the central bank, which had been lowered by 35 per cent in 1957, were slightly raised. Restrictions in instalment purchase were further relaxed. Penalty rates on ceilings were reduced. Since 1956, commercial banks had been required to hold Treasury bills for an amount at least equal to 25 per cent of their liabilities. From January 31, 1961, the minimum ratio of their deposit liabilities which commercial banks have to invest in short term Treasury paper was reduced from 25 per cent to 20 per cent, and the banks were required to hold a minimum of 30 per cent of their deposits in the form of cash, Treasury bills and medium-term paper.

Thus the different restrictive measures have successfully functioned in France. The Governor of the Bank of France, in his Annual Rrport for 1960, rightly claimed that the success achieved in 1959 in fostering economic expansion and maintaining at the same time an appreciable balance of payments surplus had been further consolidated in 1960.

The money supply expanded by a little more than 14 per cent in 1960, the main factor being a further substantial rise in net official

holdings of gold and foreign exchange and a considerable increase in credit to business, especially during the last quarter. The large surplus on the balance of payments, and the absence of difficulties in financing the Treasury's cash deficit, enable the monetary authorities to relax credit restrictions further and to reduce interest rates, so as to stimulate economic activity. The ceilings placed on rediscounts of short-term papers by each commercial bank the central bank, which had been lowered by 35 per cent in 1957, were raised in a number of cases, and restrictions on instalment credit were further relaxed. On October 6, 1960, the basic discount rate of the Bank of France and the penalty rate for rediscounts exceeding the individual bank's rediscount ceiling by less than 10 per cent were lowered by $\frac{1}{2}$ per cent to $3\frac{1}{2}$ per cent and $4\frac{1}{2}$ per cent, respectively ; subsequently, the rates charged by commercial banks were reduced by the same amount. As a result of the favourable monetary situation, the general system of credit control in France was modified in early 1961, without putting any strain on the banks or the Treasury. From January 31, 1961, the minimum ratio of their deposit liabilities which commercial banks have to invest in short-term Treasury paper was reduced from 25 per cent to 20 per cent, and the banks were [re-]quired to hold a minimum of 30 per cent [of] their deposits in the form of cash, Treasury b[ills] and medium-term paper.

The increase in credit to business [was] due largely to a sharp rise in short-term [and] medium-term credits. The liquidity of [the] commercial banks declined in the second half [of] the year. The banks increased their purch[ases] of Treasury bills at a rate equal to the rise [in] their sight deposits.

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THE GERMAN BANKING SYSTEM.

The German banking system was one of the oldest banking system in the world. The Humburg Giro Bank which was like a state bank and functioned for nearly 250 years was established in as early as 1619. The Bank of Prussia, the first bank of issue was established by Frederick II in 1765, and it continued until 1875 when the Reichsbank, or Imperial Bank of Germany was formed. The Bank Act of 1875 was passed with a view to unify the banking system, regulate note issue, provide better management of the Reichsbank, and settle the relationship between the Reichsbank and the government. This Act continued until 1914, when certain changes were made regarding note issue.

The German Credit Act of 1934 obtained elaborate provisions regarding the liquidity of banks' resources, and their relation to deposits, advances and securities. It contained a cau against mixed banking.

The German Banking System befo 1914 :—Before the first world war, the Germ banking system consisted of : the Reichsba the central bank of the country ; the banks the Federal States ; the Joint Stock Banks ; t private Banks ; and the Savings banks. T Reichsbank was the central bank of the cou try and carried on central banking functio including note issue. There were 32 banks the Federal States which were all banks of iss but gradually gave up this function leaving t Reichsbank as the only bank of issue. Th Joint stock banks developed deposit banking bu continued investmeut banking as well, thu carrying on mixed banking. The private, co operative, and savings banks tried to financ agriculture and small traders.

German Banking During Inter-Wa Period :—During the inter-war period the struc ture of German banking remained almost th same as in the pre-war period. The Reichs bank's capital was raised in 1924 and 1930 to 150 million R.M. paid up. The Bank serve as the banker to the German Government and undertook all receipts, payments and interna remittances on behalf of the State. Temporar

financial needs of the Government were met by it against Treasury bills within certain limits. The Government also participated in the profits of the Bank. Though until 1935, four Federal state Banks continued to issue notes, in that year the Reichsbank was given the exclusive right of note issue, against cover at a sliding rate. In addition to the reserve against note issue, it was required to maintain a special reserve equal to 40 per cent of its deposit liabilities.

The Bank conducted ordinary banking business. It discounted bills, received deposits and made advances like commercial banks. It also rendered subsidiary services to its customers.

The joint-stock banks carried on a considerable amount of deposit banking and other commercial banking business. They opened 'current accounts' kept properties in safe custody, offered remittance facilities, and engaged in foreign exchange business. They also purchased and sold stocks as agents of their customers.

Participation In Industry :—The German joint stock banks generally accepted deposits repayable after fixed periods of seven days, three months or longer. By far larger proportion of their deposits were, therefore, time or fixed deposits. This enabled the banks to invest in industrial concerns ; and they became, in ma instances, direct participants in industry, wh had been a peculiar feature of German bank

During that period, ideas were curr that the German banks closely collaborat granted advances even for fixed capital purpo and even frequently started new industri However, Dr. S. K. Basu has shown that th ideas were not strictly correct. Dr. Basu divid the history of German banks into four period 1848-1870 ; 1870-1913 & 1913-1939. Duri the first period (1848-1870), according to hi the German banks were pre-eminently banks f loans to industry. They not only granted loa but also participated in capital and promo industrial concerns. "Ordinary banking busi of receiving deposits and making short-term lo from these deposits was considered by th merely as a side-line. Their main business co sisted in investing the shareholders' money industrial and commercial enterprises, the obj being to reap as large a profit as possible f the shareholders. A considerable portion their resources was invested in industrial secu ties. The banks in that period, therefore, "p took more of the character of investment companies than banks properly so called"*.

* Basu, S. K, : Industrial Finance in India. pp. 11

During this period the banks could afford to do so because they carried on business with their own capital and reserves and were not dependent on deposits from the public.

During the second period (1870-1913), the banks developed deposit banking but continued to invest as usual in industrial securities. A part of the deposits were used in financing the industries as promoters, financiers and managers. It is, therefore, from this period that the German banks undertook the objectionable form of mixed banking.

During the third period (1913-1930), the banks developed lending to government as the main form of business and "became reluctant to tie up their funds for long periods and concentrated far more on regular banking business than formerly." Investment banking declined during this period. This was partly due to increase in deposits and partly due to the bank failure in 1931, which was followed by enactment of the German Credit Act of 1934. This Act attacked mixed banking, brought the banks under government control, and compelled the banks to maintain a fairly high standard of liquidity by curbing investment banking and giving up speculative and real estate businesses.

In the language of Dr. Basu, "First, a minimum cash ratio of 10 per cent was required to be maintained. The second, ratio provided for was between the sum of commercial bills (having a currency of not more than three months) and eligible bonds, and total liabilities which was not to exceed 30%. Thirdly, stocks and bonds not admitted to German stock exchanges that were owned by a credit institution were not to exceed a certain percentage (in no case less than 5%) to current liabilities to be fixed by the Supervisory Board. Permanent participations and investments in property and buildings should not exceed the capital and reserves of the credit institution. Lastly, the prewar banking practice in Germany, under which short-term facilities granted to industrial companies were intended to be converted into an issue of new shares, was also discouraged."

Thus, the German Credit Act turned the tide of German banking and brought it nearer English banking than it was ever before. True that the system of bank participation in industry was responsible for rapid development of German banking during the inter-war period. But the banking crisis of 1931, in which a large number of banks closed their doors, showed the vulnerability of mixed banking, and the danger

of granting long-term industrial and real estate loans out of short term deposits.

Technique of German Industrial Banking :—The banks followed the following procedure in financing industries : The bank would, when asked for finance, call for particulars of the industrial concern and depute some expert to investigate ; and if his report was favourable a scheme would be drawn up for financing the concern in detail. The bank would, in some cases itself subscribe to a part of the shares, or even the whole of it if required, with the idea of issuing them to public at a later date.

The bank would then open a "current account" for the industrial concern in which money sent to and received from the client concern were debited and credited, and balance struck peridically. Interest was reckoned on both sides of the account. Thus, instead of there being several debts, there was only one debt, may be on either side, to be settled. The current account credits, though generally for short term, were also often utilised for long periods, such as, for replacement of machineries etc. The credits were generally without securities.

The opening of the current account was only the beginning of the relationship. The bank after that closely followed the interest of the client's business. Current account advances might be renewed, issue of bonds and shares undertaken, direct participation in subsequent issues could be effected, and even co-operation in management including formation of syndicates or consortiums jointly with other banks were visualised. The system of interlocking directorates enabled that bank to put one of its directors or managers in the Board of Directors of the client company, while on the other hand directors of client enterprises were also invited to sit in the Board of Directors of the Bank.

While the fates of joint-stock banks thus depended on the prosperity of the client concerns, the current account assets amounting to as high as 40 per cent in some cases, the banks were also benefited by the advice and practical outlook of the magnets of industry. At the same time, because of the connection, the bank obtained as a rule the whole of an industrial company's banking business at remunerative rates; and it could, working from inside the client concern, always safeguard its own interest.

This type of industrial banking, however, had its drawbacks. In periods of economic depression, banks' assets lent in this way may be

'frozen' and become either entirely unrealisable or realisable at a considerable loss.

That actually happened to the German banks during the depression of the thirties; and measures had to be adopted against those practices.

Since the passing of the German Credit Act, therefore, the German banks ceased to be industrial banks in the pre-depression sense of the term. They diverted their lendings into state controlled channels, and to the financing of government projects. Thus their help was rendered to industry via the government.

Co-Operative Banks :—There were two distinct groups of co-operative banks in Germany, namely, the Volksbanken and the Landschaften. The former included Schulze-Delitzsch and Raiffeisen banks, both named after their organisers on co-operative principles. While the Schulze-Delizsch banks were desinged to assist small traders and businessmen otherwise unable to obtain funds from banks, Raiffeisen banks were to grant credits to agriculturists.

The co-operative banks had small capital divided in shares owned by members, generally one each. The banks granted small loans to members, received deposits from members as well as outsiders.

The Landschaften or Land banks we formed on co-operative principle to grant lo to farmers and landowners for cultivation an improvement, at rates of interest lower th those of commercial banks, for longer period often for a number of years, against mortga of land. Loans were granted only to member either in cash or in bonds and debentures whi could be negotiated and converted into cas They charged low rates of interest; and the raised funds by issuing redeemable debentur

Besides the above co-operative land mor gage banks, there were other mortgage ban in Germany granting loans against mortgage improved real estate, or land in process of de velopment. Besides private mortgage banks, se veral savings banks and insurance compani carried on mortgage banking as regulated b the law of January 1900, which defined mor gage banking as "granting mortgage loans o land, combined with the issue of bonds bas on the acquired mortgages." The mortga banks might not receive deposits amounting more than 50 per cent of their paid-up capi tal, and could not issue bonds exceeding times their paid-up capitals and reserves. Th Realty Register, maintained in each locality, co tained particulars of land and encumbrance, an

thus helped the banks in deciding to grant loans.

Sparkassen, or Savings Banks :-Savings banks accepted deposits on 'deposit' and 'cheque or drawing' accounts. They organised a cheque transfer and clearing system. They financed industry in different ways.

Municipal Savings Banks were formed by local or municipal authorities who were also responsible for their administration and liabilities. These banks generally granted loans for municipal purposes for varying periods, against interest. Prior to the war, there were about 2,640 savings banks with a total deposit of R.M. 14·6 milliards. (14·600,000,000).

During the inter-war period German banks showed a tendency of favouring amalgamation of banks and concentration of banking. Several smaller banks were amalgamated with bigger banks. This move followed the depression during which a number of small and medium-sized banks failed. This also led the banks to observe the Cartel System more strictly. This famous system of German commercial banks, precluded one bank "from offering to the public better terms as regards rates of interest, commission and charges than another bank doing business of the same nature." Private an Savings banks being out of the cartel could f higher rates.

Following the financial crisis of 1931, th German government helped the banks in diffe rent ways such as, granting loans, guaranteein obligations, and in some cases, purchasing share Superivision over the banks was tightened. Th effort to build up the bill market was streng thened.

German Banking After The Secon World-War :—After defeat in war, Germa was divided into two parts : (a) Western Ge many with an area of 2,46,000 kilometers ; an East Germany with an area of 1,07,000 kilo meters. The former was placed under the con trol of the allied powers, while the latter unde the control of the Soviet Union.

Western Germany formed the Federa Republic of Germany. Its economy is almos similar to that of England, essentially an indus trial one, and dependent on foreign trade.

Commercial Banking System of Wes tern Germany :—The West German commercia banking system has not undergone any struc tural change after the war. Banks can be broad ly divided into four groups : (a) the Credit Bank

(b) the Savings Banks ; (c) Credit Co-Operatives ; and (d) Special Credit Institutions.

Credit Banks :—Credit banks include : the nine 'Successor Institutions' of the three big banks, (namely, the Deutsche Bank, the Dresdner Bank, and the Commerzbank) the State, Regional, and Local Banks, and the Private Bankers.

The three big banks had as many as 352 branches and sub-branches in 1948 in which year a law was passed compelling the banks to form 'successor institutions.' In 1952, another law was passed dividing the State into three banking zones and permitting each of the banks to form three incorporated independent successor institutions in one of the three zones. As a result we now find nine independent incorporated successor institutions carrying on business, three in each of the banking zones, and opening branches within the zone. The nine successor institutions now control 55% of the total banking business of the country.

Besides the nine successor institutions mentioned above, there are about 79 credit banks grouped into State, Regional, and Local banks. They control about 33% of the total banking business of the country.

There are 284 Private bankers throughout Western Germany. Majority of them being very small in size, they control about 12 per cent of the total banking business. They are mostly confined to the towns of Dusseldorf, Frankfurt, Cologne, and Munich.

Besides the nine successor institutions which are by law required to be incorporated institutions, majority of the credit banks are joint-stock companies. Private Bankers are partnership firms with one or more partners being personally liable. Most of the joint-stock companies are with unlimited liability.

The credit banks are commercial banks in our sense. They accept deposits from industrial undertakings, traders, private individuals, and public authorities, on time, demand, and savings deposits. They control more than half of the total deposits of the country. There has been a gradual increase in deposits in recent years. Credit banks have also been trying to increase their savings business in recent years.

They grant short-term loans, current account credits, acceptance credits and long-term loans as well. They purchase commercial and Treasury bills and maintain balances with the central Bank.

Short-term credits are generally for not more than six months. German credit banks are not yet entirely free from the pre-war mixed banking ideas ; and a considerable part of their 'current account' credits are really intermediate financings, and their repayment depends on raising of alternative funds in the capital market. Current account credits form nearly fifty per cent of all the credits granted by the banks. During the immediate post-war years, dependence of industry and trade on banks increased. "In Germany, as in other countries, the system of war finance resulted in the fact that trade and industry found themselves indebted to the banks in a considerably reduced degree. The credit banks held state loans rather than industrial credits as their main asset, whereas trade and industry, as well private individuals, owned substantial bank balances. Once these liquid funds had been essentially exterminated by the currency reform of 1948, the situation underwent radical change. Trade and industry were again forced to fall back upon bank credits in a very high degree."* The major part of the short-term loans are granted to trade and industry, and they are often renewed.

* Backhart. pp. 330

Industrial financing by credit banks:- True to their tradition, the German credit banks still indirectly finance industries. Speaking on this point, Mr. H. Irmler observes: "The more important German credit banks, and especially the large banks, have always engaged both in short-term credit operations and in transactions in security underwriting and floation. Short-term transactions were often related to the more hazardous business operations in the field of industrial finance. Industrial financing was often carried out in such a manner that short-term credits on current account were first granted and were subsequently consolidated by the issue of shares and bonds; thereupon the credits again disappeared from the bank's balance sheets. The major part of the industrial loans floated in Germany has been placed on the capital market with the assistance of the credit banks. Accordingly, these banks have always been deeply interested in the capital market."*

Savings Banks :—There are about 875 savings banks with about 8,000 branches which can be classified as follows: 252 town savings banks; 90 communal and local savings banks; 363 district and regional savings banks; 21 district and town savings banks; 125 public

* Backhart. p. 333

savings banks; 13 private savings banks, and 11 other savings banks officially guaranteed. The Towns, Comunal, and District savings banks are generally incorporated institutions with unlimited liability. The savings banks have been organised into regional associations, and they have formed the so-called Central Giro Institutions. The savings banks are required to keep reserves with the Land Central banks. The savings banks maintain reserves with the Giro institutions which act as provincial banks and grant long-term loans to the communal associations.

The savings banks issue bonds for raising necessary funds. They accept savings deposits and grant medium and long-term credit out of them. Some of the savings banks have developed banking business and accept short term current deposits and grant short-term current account credits like the credit banks. Loans against mortgages of land, not exceeding 50 per cent of the total savings deposits, are allowed by law. Credits to municipalities must not exceed 25 per cent of the total deposits of a bank. Limits have also been placed on loans to individual borrowers. Major part of the savings bank loans are to medium and small sized agricultural farms and handicraft industries.

The postal savings bank offices are situated in postal offices wherein deposits and withdrawals are made. The postal savings banks are under the management of the Ministry of Post and Telecommunications and the funds are invested by a committee wherein there is a representative of the central bank of the country.

Credit Co-Operatives :—There are about 12,000 credit co-operatives controlling about 10 per cent of the country's banking business. They can be classified into Urban and Rural according to area of operation. While the Urban credit co-operatives finance small urban traders, artisans and businessmen, the Rural credit co-operatives serve the rural population. Their structure has not undergone any material change since the inter-war period.

The Urban credit co-operatives are the Schulze-Delitzesch banks, also called Volksbanks or people's banks, of which there are about 700 in the country. The Rural Credit co-operatives are the Raiffeisen banks, also called Raiffeissenkasse.

Both the urban and rural co-operative banks have formed central institutions of their own, in which they keep their reserves, and through which they clear their payments.

Mortgage and Real Estate Credit Banks :—There are 32 mortgage, and real estate credit banks. They grant long-term loans against mortgage of urban or rural lands. They are authorised to issue mortgage bonds to the extent of the mortgages acquired by them, which are earmarked to cover the mortgage bonds.

Special Credit Institutions :—There are four special credit institutions providing different types of credit for different terms.

The Landwirtschaftliche Rentenbank :— This bank provides such agricultural loans to farmers as cannot be granted by the credit co-operatives and mortgage banks. It grants loans for long-term against charge on land, on which 0·15 per cent is payable by the farmers annually.

The Industriekreditbank A.G. :—Founded in 1949, this bank grants industrial loans, medium and short-term, which the credit and mortgage banks are reluctant to grant. It is authorised to issue debentures for raising funds. It has a capital fund of DM 18 million, contributed by industrial concerns.

The Kreditanstalt fur Wiederaufbau :— This institution is better called a Reconstruction Loan Corporation and it provides loans to all reconstruction projects where other credit instiutions fail to provide. It is incorporated under public law with a capital of DM 1 million, half of which has been contributed by the Federal Government and the other half by the Lander Bank. It can also borrow funds and issue debentures for raising funds. It grants loans not directly but through the borrower's regular bank.

The Bank fur Vertriebene und Geschadigte A.G. :—Having a capital of DM 3 million entirely subscribed by the Federal Government, this bank is for granting credit to refugees and refugee enterprises with a view to help refugees being rehabilitated into the economy. It is also authorised to issue debentures.

The Central Banking System

The reorganised central banking system in the Federal Republic of Germany is a "Two-Level System." The central institution is the Bank deutscher Lander, located in Frankfurt-am-Main. There are 9 Land Central Banks, one in each of the "Landers" of Bavaria, Bremen, Saxony, Hesse, Baden-Wurttemberg, Lower

North-Rhine Westphalia, Schleswig-Holstein, the Freie und Hansestadt Hamburg, and Rheinland-Palatinate. Each Land Central Bank is the central bank for the Land and act as "Bank of Banks" and as fiscal agent of the government of the Land. The Land central bank functions within the area of the Land.

The direction and management of each Land Central Bank is in the hands of its Board of Managers, and is not subject to direct instructions from the Land government. However, the President of the Land Central Bank is appointed by the Prime Minister of the Lander. The function of a Land Central Bank is to regulate the circulation and supply of money and credit in the area ; to promote the solvency and liquidity of credit institutions ; and to act as the sole fiscal agent of the Lander. It acts as a central bank for the commercial banks within the Lander ; rediscounts their bills ; acts as the custodian of reserves of the commercial banks and grants them accommodation.

The Bank deutscher Lander is the central bank of the Land Central Banks. Its capital of 100 million D.M. is owned by the Land Central Banks. In place of the old Reichsbank of undivided Germany, the "two-level structure" of the Bank deutscher and the Land Central Banks has been established. But though the system appears to be a decentralised one, it is really not so. By a novel arrangement, the Bank deutscher Lander is the central bank with central banking functions, though legally the Land Central Banks are independent units. This is because of the fact that "the whole system is strongly anchored in the Bank deutscher Lander" by a system of interlocking directorates and division of functions. Thus the Board of Directors of the Bank deutscher Lander consists of the Presidents of the Land Central Banks; and the President of the Board of Managers of the Bank deutscher Lander decides the banking policy to be followed in all the Lander areas. It decides all questions as to the discount rate policy, open market operations, minimum reserve requirements and all the relevant matters relating to monetary and credit policy. The Land Central Banks are bound to follow the resolutions adopted by the Board of Directors of the Bank deutscher Lander.

The Bank deutscher Lander is not subject to "direct instructions" by the government. Article 1, Para 3 of the Law establishing the Bank clearly lays down that "except as otherwise provided herein or by law, the Bank

shall not be subject to the instructions of any political body or public non-judicial agency." But as laid down in Article 2, the Bank is bound to consider the general economic policy of the Federal Government and support such policy within its task; in case any resolution of the Board of Directors of the Bank deutscher Lander is inconsistent with the government's general economic policy, the latter can suspend the operation of such a resolution for a period not exceeding eight days. There are of course, representatives of the government in the Bank, but they are not allowed to vote in the Board meetings, though they are allowed to bring motions.

Thus it is clear that the Bank deutscher Lander is the bank for the Land Central Banks and is the centrally directed bank of issue. It has the sole right of issuing notes within the territory of the Federal Republic of Germany. It assists the foreign exchange department in formulating the foreign exchange policy of the Federal Republic, besides acting as its fiscal agent. It is the lender of last resort to the Land Central Banks, which can discount bills and take advances from it. Bank deutscher Lander requires the Land Central Banks to keep legal minimum reserves with it, as the commercial banks of the different Lands keep reserves with their respective Land Central Banks.

The Bank deutscher Lander is authorised to "purchase from, or to accept as collateral for advances to, the member Land Central Banks all those titles, such as bills of exchange, Treasury bonds, and securities, which the latter under legal provisions for their establishment are authorised to purchase or to accept as collateral for advances. Furthermore, the Bank may grant to the Federal Republic of Germany advance to a limited extent."*

Monetary and Credit Policy :—The Bank deutscher Lander has the same weapons of credit control as other central banks of the world ; and in 1951 it also issued certain general guiding rules for observance by the commercial banks relating to proportions between credit and total assets and between liquid funds and liabilities. It also regulates the rediscount limits for the commercial banks with their respective Land Central Banks. Commercial banks in Germany are indebted to central banks.

The credit policy of the Bank deutscher Lander is characterised by its alertness and integration of the different weapons. The scope

* Backhart. p. 354

for open market operations being rather limited owing to the absence of a functioning capital market, it has repeatedly made use of bank rate policy and variation of reserve ratios along with moral suasions and regulation of rediscounting limits.

Since the currency reform in 1948, the Bank has repeatedly changed the discount rate. Immediately after reform it was fixed at 5%. In 1949, following the policy of credit relaxations, it was lowered in two equal steps to 4%. At the outbreak of the Korean war, to curb excessive demand for credit, the rate was raised to 6%. Simultaneously, the rate on advances was raised from 5% to 7%. This rate of discount, it should be noted, was highest in Germany since 1913. At the disappearance of the Korean boom, the discount rate was again lowered by 1% in May, 1952 and by 0·5% each in August, 1952 ; January, 1953 ; and June, 1953 thus bringing it to 3·5%.

Along with the change in the discount rate, the advance rates of the individual Lander Banks are also revised, this rate being always kept 1% higher than the discount rate.

The Bank deutscher Lander has also repeatedly made use of the power to vary the minimum reserve requirements along with changes in discount rates. Thus in December 1948 the requirement against demand deposits was raised from 10 to 15% with a view to mopping up of the embarassingly large excessive reserves of the commercial banks, a legacy of the currency reform. In 1949, for the same reason for which the discount rate was lowered the minimum reserve requirement was also lowered. At the experience of the Korean war boom minimum reserve requirement was again raised by 50%, as the discount rate was raised. In May 1952, it was again lowered.

The West German system of reserve requirements has some peculiarities : (i) It prescribes different rates of requirements for "bank places" and "Non-bank places" (ii) It prescribes different rates for 'time deposits' and 'savings deposits'. Bank places are places at which there is a Land Central Bank or branch of one.

The West German Central Banking system is hardly in a position to engage in open market operations owing to the lack of functioning capital market which however is rapidly developing. Open-market operations for regulating the money-market are taking place mainly in treasury bills of the Federal Govt., Federal Railways or certain bills of public authorities

There has been an effort at tightening of monetary policy which was most pronounced in Germany in 1955. In that year production rose rapidly and the number of unemployed fell and Germany became awere of inflation and acted to maitain a restrictive pressure on demand. Discount rates were raised three times, reaching $5\frac{1}{2}\%$ in May, 1956. This expansion was due to foreign demand and domestic investment and was a continuation of the spectacular gains made each year since the currency reform in 1948. In 1956, the activities slackened and the discount rate was lowered to 5% in September, 1956 and again to $4\frac{1}{2}\%$ in January, 1957. The main reasons for these decreases were the slowing down of the investment boom, the seasonal decline of economic activity during the winter months, the moderate lending policy of the banks, and the desire to reduce the differentials between interest rates in Germany and in other countries. At the same time, however, the Bank Deutscher Lander engaged in extensive open-market operations to counteract the excessive liquidity of commercial banks resulting from the balance of payments surpluses. Restrictions on capital exports were relaxed, and the inflow of short-term capital from abroad was discouraged. In

April, 1957 further measures of monetary poli were taken to counteract in part the effects o increased liquidity of the banking system.

In 1958 in persuance of the anti-recessi policy, the discount rate was reduced thr times bringing it to 2·75%. There was an in- crease in the liquidity of the commercial ban and open-market sales were carried on to mo derate this effect of increased liquidity. An ther object of the reduction of the discount ra was the lowering of the lending and borro wing rates of the commercial banks in respo to the change in bank rate with possible rea tions on domestic investment and internatio capital movements.

On September 3, 1959 the Central Ba Council of the Deutsche Bunder bank,* wi the Minister for Economic Affairs present, de cided to increase the discount rate of the Bu des bank from $2\frac{3}{4}$% to 3%, effective Septem 4. In raising the Discount rate it took in consideration the sharp increase in business a tivity in the previous months; there was reason to favour market demand by adheri to relatively low short-term rates. Furtherm the raising of the rates was in accordance w the prevailing trend in the foreign money-mar

* Bank Deutscher Lander is also Called the Deutsche Bunder

Even after the increase of the German rates, short-term interest rates abroad were still higher than those in Germany.

Also as of September 4, the discount rates at which the bank sells short-term paper were increased by different rates applicable to different classes of papers.

On October 22, 1959 the Central Banking Council of the Deutsche Bunder bank increased the discount rate of the Bunder bank from 3% to 4%, effective October 23. At the same time minimum reserve requirements were increased by an average of 10%, effective November 1. Increasing signs of economic development required that demand which then exceeded production capacity in many instances - should be slowed down by measure of credit policy. The Council opined that it would be better to counteract in time, through effective measures, the tendencies towards excessive economic activity, rather than to wait and allow forces to rise which could lead to dangerous developments in the wage and price sectors, and later to decline in economic activity. On October 23 the discount rates at which the Bunder bank sells short-term papers were increased by different rates applicable to different papers.

The movement in German minimum re- serve requirements, which on October 22, 195 were increased by 10% at the time of th increase of the discount rate from 3% to 4 was carried further in December 17, 1959, rai- sing it by another 10%, effective in Januar 1, 1960. Further it was decided that any in- crease in the foreign liabilities of banks aft November 30, 1959 which are subject to th reserve requirements would again be charg with a maximum requirement permitted b law for each restrictive reserve category i. e. 30% against incrase in sight liabilities, 20 against increase in time liabilities and 10% again increase in savings deposits. The purpose o these special reserve requirements was to check the inflow of foreign short-term money. Th official announcement said that the purpose the new measures was to check, and if possib even to reverse, the increase in bank liquidi which seasonally occurred after the beginning the new year, and thus to induce the ba to show some restraint in extending new cred The re-introduction of the special reserve quirements against foreign liabilities show that it was trying hard to counter the unde rable effects of its stricter monetary po which was, however, indispensable for dom

reasons in order to maintain the purchasing power of Deutsche mark on the international movements of short-term and long-term capital. By these measures only the inflow of the foreign money can be checked; the Bunder Bank can- not prevent short-term investments abroad by German banks from declining and it is possible that genuine capital exports, in as much as they are not independent of domestic interest and liquidity considerations, may be detrimen- tally affected.

Explaining the raising of the discount rate from 3 per cent to 4 per cent Mr. Karl Blessing, President of the Deutsche Bundesbank* said that it was necessary to act promptly and effectively in order to prevent an excessive in- crease of demand with its dangerous consequen- ces for wages and prices. Regarding the ex- tent of the rise in one step, he said, it was better to take the necessary measure in one step, in order to prevent the uncertainty that is linked to the step-by-step procedure.

Mr. Blessing emphasised that considering the change in the German economy, the old policy of low rates had to be changed, since the first aim of the Bank was to maintain mo- netary stability and maintenance of the purchasing

* Same as Bunder bank

power of the deutsche mark. The overful employment position of the country had a dangerous potentiality in that an upward movement of wages and prices might start at any moment if the demand goes on rising.

Answering the critics, Mr. Blessing admitted that the rise in discount rate might affect the capital market and the balance of payments, but reiterated that the Bank could take into consideration capital market and the balance of payments aspects only if they did not interfere with the principal aim of the Bank, which was to maintain the purchasing power of the deutsche mark. He also referred to the 1955-57 situation of tensions between the measures aimed at internal stability and balance of payments developments. The raising of the discount rate, he said, does not stimulate capital exports and may result in repatriation of funds back to Germany. But he was sure that under the situation, the policy was right.

Thus, in effect, Mr. Blessing tried to prove two things. (a) When there is a tension between internal stability and external stability as an objective to monetary policy, in his opinion, it is better and safer to prefer internal

stability, which means maintaining the purchasing power of the currency ; (b) The same measure may not be a cure for the same difficulty if the circumstances are different at different times.

By a decision of February 18 of the Deutsche Bundesbank, minimum reserve requirements in Germany were to be raised to a level of 20% above that prevailing in October 1959, to be effective from March 1, 1960. It should be remembered that the requirements had been increased by 10% in both October and December earlier. Effective March 1, 1960, the rediscount quotas of the commercial banks were reduced by 10% for amounts up to DM 5 million and by 30% for amounts exceeding DM 5 million. Provision was also made for granting additional rediscount quotas in special cases, applying severe standards. By another decision of May 5 of the Deutsche Bundesbank minimum reserve requirements in Germany for sight deposits and deposits at notice were to be raised by 15% and for savings deposits by 10%, above the requirements prevailing in October 1959, from June 1, 1960. This was the fourth in a series of increases in minimum reserves requirements that began in October 1959.

It was estimated that the measure would neutralise about D.M. 1 billion of the banks' liquid funds at the Bundesbank, and that the total decline in bank liquidity attributable to the four measures would be DM. 4·5 billion. From October 30, 1959, to April 23, 1960, however, accruals of foreign exchange at the Bundesbank reached 2·55 billion and sales of open market paper by the commercial banks to the Bundesbank amounted to about DM. 1·7 billion. Thus the four increases in minimum reserve requirements only off set the large increase in bank liquidity.

Not content with the above measures, the Central Bank Council of the Deutsch Bundesbank, with the Federal Minister of Finance, Dr. Etzel, and the Federal Minister of Economic Affairs, Dr. Erhard, agreed on the following measures on June 2. These measures were taken in order to counteract the still substantial expansion of credit and thus to check the monetary tensions which arose from the disproportion between total economic demand and production possibilities. In order to prevent, as far as possible, the obstruction of this policy through the inflow of foreign money, prohibitions against crediting interest on foreign deposits and the sale of money market paper to foreign residents were re-instated.

The Bundesbank expected that the raising of the discount rate would affect not only the debtor interest rates, but also the deposit interest rates, of the credit institutions.

The following were the measures :—

1. The discount rate of the Deutsche Bundesbank was raised from 4% to 5%, and the rate for advances on securities was increased from 5% to 6%, effective June 3.

2. The selling rates for money market paper were raised by amounts ranging from 3/4% to 7/8%; therefore, the selling rates for such paper, which formerly ranged from 3 7/8% to 4 3/4% now range from 4 3/4% to 5 1/2%.

3. The increase above the average position of the months March to May in domestic liabilies, subject to minimum reserve requirements will be subject, as of July 1 to the maximum reserve requirements permitted by law.

4. The discount quotas will be reduced by 15% (hitherto $10\frac{1}{2}$%) for amounts up to DM 5 million, and by 40% (hitherto 30%) for amounts exceeding DM 5 million, effective July 1.

5. Effective immediately, the crediting of interest for foreign sight deposits at German banks is prohibited. Interest on foreign time deposits

domestic credit policy against foreign influe
mainly to discourage the inflow of foreign m
ney and their effects on bank liquidity. T
Bundesbank also emphasised the need
supplementing credit restrictions by other a
cyclical measures, especially in fiscal sector.

On November 10, 1960 the Cen
Bank Council of the Deutsche Bundesb
lowered the discount rate from 5%, the ra
established on June 2, 1960, to 4 per ce
At the same time the rate for advances on se
rities was reduced from 6 per cent to 5 p
cent. The lowering of the discount rate w
entirely motivated by external consideratio
the contemporary lowering of the disc
rates in various foreign countries had m
it unavoidable for preventing excessive inf
of foreign exchange with the consequence
excess demand in the country.

From November 11 the Bundesba
selling rates for short-term paper were a
lowered to a range of 3 7/8th per cent to
5/8th per cent in anticipation of the low
of the discount rate. These rates had b
lowered twice after November 1, when th
ranged from 4 3/4th per cent to 5½ per c
With the measures adopted on Nov
ber 10, the C... policy assu

a new look. The Central Bank Council, however, realised that the purpose of lowering of the discount rate, viz, a strong outflow of foreign exchange, could not be achieved as long as the Bundesbank continued the domestic tight money policy. Experience taught it that it is impossible to achieve both aims, cheap and tight money, for any length of time.

On December 1, the Central Bank Council of the Deutsche Bundesbank, for the first time since 1959, decided to ease slightly the regulations concerning minimum reserve requirements. The special reserve requirements fixed on June had been abolished from December 1. Though the step was taken for simplifying the technicalities of minimum reserve requirements, it also involved a question of principle, and indicated some revision in the Bank's monetary policy. Consistently with the changing outlook, on January 20, 1960 the Central Bank Council of the Deutsche Bundesbank lowered the discount rate from 4 per cent to 3½ per cent. At the same time, the rate for advances on securities was reduced from 5 per cent to 4½ per cent and the Bundesbank's selling rates for short-term paper were also lowered by ½ per cent, to a range 3 1/8 - 3 7/8 per cent. From January 1, the minimum reserve requirements for domestic liabilities was lowered by 5 pe cent of their October 1959 level. All the measures were reported to have been motivat solely by the interest rate differntial betwe Germany and abroad ; and they were aime at stemming the continuing inflow of forei exchange and easing the export of short-ter capital. The reduction of reserve requireme had the effect of increasing the liquidi of the commercial banks benefiting the priv sector and the capital market.

With a view to lower the short-ter interest rate, on February 9 and 14, 1961 th Bundesbank lowered the selling rates for mone market paper by 1/8th per cent, to a rang of 2 7/8th per cent to 3 5/8th per cent. O February 13 the Bundesbank also abolished th dollar swap premium.

The Bundesbank announced that th most decisive motive for the said measures wa the economic situation characterised by exce ssive demand. "The bank does not turn blind eye to the fact that some economic se tors - especially those in which excessive dem has stemmed mainly from the building up of stocks - show some sign of calming down. Th bank warns, however, not to overemphasise the

signs, since from all available economic indicators it appears that the economic boom has not yet reached its upper turning point. As things stand now, the aim of economic policy is still to check the increase in total economic demand, in order to bring it into better balance with production capacities, which are rising more slowly than demand, and to check the increase in prices", a bulletin of the Bank said.

The bank has always emphasised the fact that it would have welcomed a fiscal analytical policy that would have supported and eased the burden of its credit policy. The experiences of recent years have shown, however, that such fiscal support for the bank's credit policy can hardly be expected. The public authorities are subject to political considerations and restrictions that make it very difficult for them to adjust their budget policy to the business cycle as rapidly as would be necessary to influence the cyclical economic development. Furthermore, the situation has been aggravated by the fact that the general expansion of credit has grown considerably during the past year ; this expansion together with the balance of payments surpluses on current account is now the most important monetary factor behind the excessive economic demand. In order to fulfil its entrusted task of maitaining the purchasing power of the Deutsche mark, the Bundesbank has to endeavour to check the credit expansion of the commercial banks. A restriction of the credit potential of the banks which in turn is highly dependent on their liquidity position, is therefore indispensable.

The raising of the minimum reserve requirement was also motivated by the fact that without such a measure the free liquid funds of the banks would increase, especially if the cash deficit of the federal budget should increase, as expected, toward the end of the fiscal year (March 31). The extent of the rise in reserve requirements shows, however, that the Bank not only intended to offset the expected increase in the liquidity but that it also intended to restrict further the liquidity position of the banks, in order to bring the banks' policies more into line with the restrictive policy of the Bundesbank. That these measures may lead to a repatriation of the bank's foreign deposits is a fact that is regrettable from a balance of payments point of view, even though the actual amount of repatriation will also depend on the interest rates prevailing abroad. The desire of the Bundesbank to keep such repatriation

as low as possible and also to prevent the eventual inflow of foreign short-term money was one of the factors why it was considered undesirable to combine the restrictive credit measures with a further increase in the German discount rate. On the other hand the possibility of a further increase in the German exchange reserves had to be accepted since the bank could not abstain for external considerations from taking such restrictive measures which for domestic reasons are highly necessary. The dilemma of the German authorities will be reduced however, to the extent that foreign countries counteract the tendencies toward overexpansion ; thus the appearance of an undesirable monetary gap between Germany and abroad, as well as the creation of an undesirable demand pull from abroad, will be prevented.

References for further reading :—

1. Backhart – pp. 311–371.
2. Mackenzie – pp. 163–201.
3. S. K. Basu – Industrial Finance in India, pp. 9–13.

THE ENGLISH BANKING SYSTEM

The Englishmen are a highly develop industrial and commercial community with a de veloped economic system. The variega financial requirements of the country are m by the equally developed banking system the country. In the field of central banki Bank of England was the pioneer, and th world learnt from it the techniques of cen banking. "At one time central banking w identified with Bank of England banking; an the Bank of England was copied in the statu of central banks elsewhere down to its mi test rules and practices . . . . ", observes S. K. Basu.

What is true of central banking is less true of commercial banking. While in Commonwealth countries the English system commercial banking is the ideal, the other co tries have also learnt more or less from developed commercial banking system of Engla

which has proved to be one of the most stable banking systems of the world. In recent years there have been some changes in the operating methods due to changing conditions of trade and commerce ; but basically the structure of the system has not changed.

The English banking system can be divided into four parts : the commercial banks including the savings banks, the central bank, the various ancillary institutions, and the Government-sponsored specialised credit institutions.

The commercial banks in England are commonly referred to as 'joint-stock banks', though somewhat inaccurately, for, the Bank of England which is the central bank of the country is also a joint-stock bank.

The Bank of England is the central bank of the country. Originally it was a privately owned institution, but was nationalised in 1946.

The ancillary institutions include the acceptance houses, the discount houses, the clearing house and the bill dealers. They also play an important role.

During the recent years, the English Government has established several specialised credit institutions to cater the needs of industrialists and agriculturists. The Industrial and

Commercial Finance Corporation, the Fina
Corporation for Industries, the Agricul
Mortgage corporation, the National Film F
nance Corporation, the Export Credit Gu
tee Department, and the Estate Duties In
ment Trust are important among them.

Commercial Banks :- The hist
English commercial banks can broadly be
ded into two periods : the era of private ba
and the era of joint-stock banks. The
1826 divides the two eras. Contemporary
and even prior to the establishment of
Bank of England in 1693, private banks flour
in England, represented mostly by golds
They received money on deposit and lent
same at interest. Under the Bank of Eng
Charter of 1708, a private banking partn
could not include more than six partners. W
in London the Bank of England
could issue notes, there was no such
the provinces, and consequently, numerou
nerships were formed to take advanta
of note issue throughout the

the depositors and note-holders. The Government deciding to effect banking reform, amended the Bank of England Charter removing the restriction on the number of partners in banking partnerships. This led to the formation of joint-stock banks throughout the country, and gradual decline of private banks. Mostly small, with one office only, they found it difficult to compete with the bigger joint-stock banks; and were compelled either to close down or merge themselves with the bigger joint-stock banks.

Joint-Stock Banks :— The joint-stock banks flourished first in the provinces and later on in London itself where the Bank of England had the sole note issuing authority. Situation of the clearing house and the Bank of England along with other factors, made it advantageous for banks to open offices in London. This generated a tendecy towards amalgamatian of provincial banks with London banks. This process of amalgamation and centralisation resulted in formation of huge banking combinations, such as the "Big Five", viz., the Midland, the Westminster, Barclays, Lloyds, and the National Provincial.

Branch banking is another result of the same ... The Big Five have their and the Cox & Co. together with H. S. King & Co. in 1923. Barclays Bank, originally a private bank sometime before 1729, absorbed the United Counties Bank, Ltd. in 1916, and few other small banks. The Westminster Bank, Ltd. is the result of amalgamations with the London and County Bank, the Parrs Bank Ltd., and few others. The National Provincial Bank, Ltd., is similarly the result of a number of amalgamations and absorptions.

The 'Big Five' together possess about three quarters of the total banking resources; and own about the same proportion of bank offices of the country.

In addition to these 'Big Five', the Glyn Mills & Co., Messrs Cyutts & Co. of London, and the Martins Bank, the District Bank Ltd., the County Bank, the Union Bank of Manchester, and Yorkshire Penny Bank are important among the provincial banks, and were themselves the results of similar amalgamations

The process of amalgamation had to be halted owing to its possibility of creating monopoly, if carried beyond desirable limit. In 1918, the banks agreed to submit further proposals, if any, for amalgamation to the Treasury for approval. This has virtually stopped the process of amalgamation.

The following table shows the size and position of the different Banks.

English Banks with capital and number of branches, at the end of 1953.

(Amounts in millions of pound sterling.)

Name of Bank.	Number of branches	Capital & Reserve.	Deposits.	Note.
Barclays	2,094	36	1,389	
Lloyds	1,710	32	1,206	
Midlands	2,121	31	1,444	
National Provincial	1,350	22	871	
Westminster	1,104	20	854	
Totalof Big Five	8,379	141	5,764	
Coutts	6	2	53	
District	539	7	252	
Glyn Mills	2	2	71	
Martins	593	10	331	1
National	26	3	79	
Williams Deacons	212	4	143	
Total of London Clearing (11 banks)	9,757	168	6,694	1
Total of other banks	10	2	43	

Certain pieces of legislation affected the course of development of the banking system. We have already seen, how the amendment of the Bank of England Charter in 1825 has resulted in creation of the joint-stock banks. The Bank Act of 1844 laid down that in the event of a provincial bank opening an office in or near London, it thereby forfeited the right of issuing notes. The clause was not applicable to Scotland. This is why we now find only one clearing bank continuing to issue notes while all others had to give up the right.

The English Companies Act of 1879 allowed the joint-stock banking companies to be incorporated with limited liability, except for the notes issued. This separation of risk from management led to healthy growth of the banking system.

The Business of Joint-Stock Banks :—

On the nature of banking business transacted by the English joint-stock banks, Mr. Kenneth Mackenzie writes : "All the English banks receive money on deposit, and on Current Account operated by cheque. In London the banks allow interest on deposit account at varying rates which are regulated by the Bank of England rate of discount. The county banks have hitherto allowed a fixed rate of $2\frac{1}{2}$ per cent on deposits, which is independent of bank rate.

While it is the general custom of London banks not to allow any interest on current accounts, in the provinces a percentage is allowed, and a commission charged on the turnover.

Advances are made against approved securities and bills are discounted for regular customers. The London bankers not only discount bills, but lend money to the discount brokers for this purpose. They also make short loans to stockbrokers against stocks, generally for not longer than a fortnight at one time.

Money may be remitted by draft or transfer, through the Bank's agents or correspondents, to any town in the United Kingdom. The banks can also open a credit at any city abroad where there is a bank on behalf of their customers. They also grant drafts and make remittances when required to all parts of the British Empire, and issue Letters of Credit, which for the use of tourists in foreign countries, are available in any town where there is a bank.

Securities and valuables are received for safe custody, and the banks collect and receive

payment of Coupons, also Dividends and Interest Warrants on behalf of their customers."*

Almost all the joint-stock banks have Savings Departments and open Savings accounts. Deposits of one shilling or more are received, and pass books issued. Interest is paid on deposits at fixed rates which vary with the Bank Rate.

Mr. Mackenzie mentions two recent developments in joint-stock banking. "During recent years, and more particularly since the close of the war, transactions in foreign exchange have become a feature of British banking. Most of the banks in London and the principal cities have offices, or departments provided for this purpose. The business consists in purchase and sale of foreign currency . . . . In negotiating this class of business for their customers and the public, banks are now taking into their own hands transactions which in pre-war times were dealt in mostly by foreign banks and exchange brokers."†

Another extension is the adoption of trust business on behalf of the customers. This means acting as Attorneys, assuming the office of Trustee or Executor under Wills, and discharging the corresponding duties.

* Banking Systems, pp. 32-33. † Ibid, p. 34.

Like the commercial banks in other co tries, the English banks also render differ subsidiary services, such as, purchasing sha and stocks through brokers for their custome submitting Income-tax returns and claims, p curing references, payment of subscriptions a premiums, procuring foreign office passports, a the like, either gratuitously or for a charge.

The English banking system is reputed be one of the most efficient systems of t world. Working with effecient personnel an supplied with the latest mechanical and lab saving appliances, of late it has taken to m chanisation of accounting.

Credit Transfers :—On March 6, 19 a general credit transfer system by which member of the public, whether or not he ho a bank account, can make payments at any the 10,000 branches of the London clear banks, was introduced. Under the system, c may be paid in at any bank for transmis to any bank account anywhere in the U. A charge of 6d. per transmission is to be m and the transmission is to be completed wi two days. This will augment the income o banks.

Assets and Liabilities :—The as structure of the English commercial bank

influenced by the concept of 'liquidity' understood in both its shiftability and profitability aspects. Assets are marshalled in order of liquidity, beginning from the most liquid to the most illiquid.

The most liquid assets are the notes and coins held in the bank's vault, and deposits at the Bank of England. These two together constitute the cash reserve of the Bank. After them comes balances held in other banks, including cheques for collection. Next comes the money at call or short notice consisting of loans made to the discount market for periods varying from overnight to a fortnight. Bills discounted comes after money at call or short notice, and is regarded as extremely liquid, because they can be quickly sold in the discount market. However, by convention, the commercial banks do not sell commercial bills once they buy them, and prefer to wait till maturity. Instead of that, they generally sell the Treasury bills if the Bank of England buys them. The commercial bills are generally bought from the discount houses; and as far as practicable, bills already near maturity are bought.

Next two items, considered less liquid than the above four, are investments and advances.

Investments include government and other bonds purchased either directly from the government or from the stock exchange. The banks can always sell them in the stock exchange if necessary.

In war-time, and up to 1952, the banks were compelled to purchase Treasury Deposit Receipts which they could not sell except by discounting at the Bank of England at the prevailing Bank Rate. The T. D. R.s were considered to be less liquid than bills and more liquid than investments by the Banks. The issue of T. D. R.s has now been stopped.

Advances comprise short period renewable loans made to commercial firms. They are considered to be less liquid than investments as they cannot be sold in any market, and the bank must wait till repayment.

On the liabilities side, the two most important items are capital and reserves, and deposits from customers. While capital is subscribed by the bank's shareholders, the reserves are built up out of profits by the bank.

Deposits are mainly of two kinds: deposits on current account and deposits on deposit account. While the former is payable or transferable on demand, the latter requires notice before withdrawal.

The Changing Assets Structure of Commercial Banks :—The assets and liabilities structure of the English joint-stock banks has been changing in course of time, and four different patterns in the structure are discernible, two in the pre-war, and two in the postwar periods, namely, twenties, thirties, forties and fifties. The following items in the commercial banks' balance sheets belonging to different periods will make the change clear.

London Clearing Banks
Final Quarter, 1928

Liabilities	£ million	per cent of current to total liabili.	Assets	£ million	per cent of total deposits
Current, deposit and other accounts.	1,807	50	Coins, notes, and balances at the Bank of England.	200	11·1
			Money at call and short notice	153	8·5
			Bills discounted.	254	14·1
			Investments	258	14·3
			Advances.	959	53·1

Final Quarter, 1938

Liabilities	£ million	per cent of current to total liabili.	Assets	£ million	per cent of total deposits
Current accounts	1,249	51	Coins, notes, and balances at Bank of England	237	10·5
Deposit & other accounts	1,004		Money at call and short notice	152	6·8
			Bills discounted	264	11·7
			Investments	641	28·4
			Advances	966	42·9

Final Quarter, 1950

Liabilities	£ million	per cent of current to total liabili.	Assets	£ million	per cent of total deposits
Current accounts	4,159	66	Coins, notes, and balances at Bank of England	517	8·2
Deposit & other accounts	2,116		Money at call and short notice	566	9·0
			Bills discounted	1,422	22·7
			Treasury Deposit Receipts	476	7·6
			Investments	1,516	24·2
			Advances	1617	25·[illegible]

Final Quarter, 1954

Liabilities	£ million	per cent of current to total liabili.	Assets	£ million	per cent of total Deposits
Current accounts	4,314	64	Coins, notes, and balances with Bank of England	546	8·1
Deposit accounts	2,430		Money at call or short notice	462	6·9
			Bills discounted	1,303	19·3
			Investments	2,360	35·0
			Advances	1,860	27·6

From the above figures, the following trends are clear :

On the liabilities side, the proportion of current deposits to total deposits is gradually rising and the rise was spectacular during the war period, and continues during the post-war period.

On the assets side, the volume of cash reserves consisting of notes, coins and balances with the Bank of England is gradually falling.

Money at call or short notice fell from 8.5 per cent in 1928 to 6.8 per cent in 1938, rising to 9 per cent in 1950 and again falling to 6.9 per cent in 1954. Bills discounted is gradually rising. These three assets are considered to be most liquid by the commercial banks and they together constitute the liquidity ratio of the commercial banks. The ratio was 36.9 per cent in 1928, 29 per cent in 1938, 39.9 per cent in 1950 and 34.3 per cent in 1954.

The Treasury Deposit Receipts were a war-time security and existed up to 1952. Their purchase was compulsory. Investments are spectacularly rising in course of time, rising from 14.3 per cent in 1928 to 35 per cent in 1954. Advances on the other hand is showing a steep fall from 53.1 per cent in 1928 to 27.6 per cent in 1954.

During the twenties, there was no competition among the commercial banks for deposits, and the rate of interest was generally 2 per cent under the Bank Rate. The published cash ratio was 11 per cent and seldom fell below 10 per cent.The Big Five of the joint-stock banks resorted to 'window dressing', and published statements on different dates. They would have more cash on the day statements

than usual, by calling loans and witholding advances to the discount market. Consequently there was an army of reserve cash travelling from bank to bank, and thus, enabling each of them to show higher cash reserves than they usually held, in their statements. When, however, the half yearly statements had to be published on the same date by all the banks, the discount market advances were withdrawn and the market had to seek accommodation in the Bank of England.

During the twenties, advances were quantitatively much more important among the assets and contributed maximum earning of the Banks. While in London advances were in the form of loans, overdrafts were more popular in the provinces. Interest was charged generally at 1 per cent lower than the Bank rate. The bill rates varied with demand and supply, but was influenced by the Bank rate, through which the Bank of England could control the market rates. The banks could replenish their cash reserves by recalling loans to the discount market.

During the thirties, the banks appear to have paid attention to the liquid ratio, the ratio of the three most liquid assets, namely, cash, money at call, and bills discounted, to total desosits. The importance of the Secondary Reserve Ratio or Liquid Ratio was clearly understood, and they tried to maintain at least 30 per cent of their total deposits in the form of these three liquid assets.

Thus, the two liquidity conventions observed during the pre-war period were : (a) that cash ratio should never fall below 10 per cent of the total deposits, and (b) the combined ratio of the three liquid assets to deposits should not fall below 30 per cent.

Until 1946, the cash ratio seldom fell below 10 per cent because of the practice of 'window dressing' resorted to by the banks. This practice attracted much criticism, and consequently, was abandoned at the end 1946, when, on suggestion of the Bank of England, the banks agreed to publish their monthly statements on a common date (the third Wednesday) and to show the actual cash ratio. They agreed to maintain the ratio at 8 per cent instead of the former 10 .per cent.

The thirties was the period of cheap money policy, of low long- and short-term interest rates, first introduced in 1932. The Bank Rate was kept unaltered at 2 per cent from June 1932 to November 1951. The market rate of interest were correspondingly low ; and the

banks held more government bonds in the thirties than in the twenties. The importance of bank advances declined during the period partly because of the changing pattern of industry and trade, and partly because of the changing interest rate under the impact of cheap money policy.

During the forties, the banks held equally plenty of Treasury bills because they were issued in large numbers and because they were less risky form of investment. The Treasury Deposit Receipts, which yielded 1 1/8 per cent upto 1945, and 5/8 per cent thereafter were, however, not very popular with the banks, partly because they could not be sold in the market to other holders, and partly because they were compulsory. Another reason of their unpopularity might have been the fact they were an emergency instrument with little hope of permanancy. Inspite of lower yield, the bills were much more popular. Thus Government bonds became more important for banks during the forties.

Along with the increase in investments, the importance of advances declined, partly because of repeated requests from the Chancellor of the Exchequer as well as from the Governor of the Bank of England, and partly because of the declining importance of the private sector in the economy. It might also be due to the increasing liquidity position of the people who accummulated liquid funds during the war period and held part of them in hand. This also resulted in the over-all increase in bank deposits to 55 per cent, as against 49 per cent of the total national income in 1935.

The cash ratio has fallen to 8 per cent by 1950 after the practice of 'window dressing' was abandoned. This, however, did not mean an actual fall in the cash ratio, but only indicated the true ratio. On the liability side, the fall in the percentage of time deposits might be due to the lowering of interest rates due to cheap money policy, and partly for increasing liquidity preference on the part of the depositors.

During the fifties, current account deposits fell slightly to 64 per cent, partly because of the rise in interest rates after 1952 following the rise in Bank rate, and partly because of the declining liquidity preference. Bank advances further declined, lending to trade and industry still declining while lending to government relatively rising. With the establishment of government-sponsored institutions for financing

industries, the importance of banks as capital-intermediaries has perceptibly declined in the post-war years reducing the importance of advances in their balance sheets. They still lend to industry and trade but that is only via the government. This has no doubt put the banks in a state of rigidity in their business; but in an economy with developing public sector this is inevitable.

In recent years the British commercial banks are providing term loans, not exceeding £10,000 to small businessmen for fixed capital purposes. These loans usually have a maturity of 3 to 5 years in the case of plants and equipments and 10 years or more for business purposes; and they are generally repayable in equal half-yearly instalments, and at interest 3% higher than the Bank Rate subject to a minimum of 6%. They have also been granting loans against export credit guarantees. But this line of business has not become very popular.

The Radcliffe Committee has recommended that the British banks should grant term loans as an alternative to a running overdraft for creditworthy commercial and industrial customers. Term loans appear to have become more popular with the British banks after the report.

Organisation and functions of the discount market :— The discount market is a peculiar feature of the English banking system, and has traditionally played a very important role, lying near the heart of the system.

The market consists of twelve firms which can be divided into three classes – discount houses, the bill-brokers, and the running brokers. The running brokers act as agents for commission and do not discount on their own account. Some of the firms are joint-stock companies while others are private enterprises. The Alexanders Discount Co., Ltd., the National Discount Co. Ltd., the Union Discount Co. of London Ltd., and the Gillet Brothers Discount Co. Ltd., are the famous discount companies.

"Traditionally the work of the discount houses has been to buy, hold, and often to sell bills of exchange." They also operate in the market for government bonds with less than five years' maturity. With the gradually falling importance of commercial bills, the discount market has been dealing more and more in Treasury bills. Indeed, the commercial bills now occupy a very minor position compared to that of the Treasury bills. It is this change of emphasis from bills to bonds that has led to the conclusion that the discount market is no longer

synonimous with the bill market, though *the* discount market is at the same time *the bill* market. Continuing importance of the discount market is often doubted.

The discount market deal mainly in two kinds of bills : commercial bills and Treasury bills. A commercial bill is a promise to pay a sum of money at a future date, and is issued in connection with some commercial operation. It is a bill of exchange drawn by the creditor and accepted by the debtor, maturable at a future date. The creditor, instead of waiting till maturity for the money, discounts the bill with a discount house. The purchase of a bill at a high discount rate and its re-sale at a lower discount rate yields a profit to the discount house. As a bill approaches maturity, the discount rate for it falls lower and lower and enables the discount house to make a profit. Besides, change in the Bank Rate often enables the discount house to earn a profit due to changed interest rate.

Commercial bills vary in quality, with the credit standing of the acceptor, nature of the transaction giving rise to the bill, and the nature of security, if any, behind the bill. Varying degrees of risk justify varying rates of discount. The discountability of a bill increases when its acceptor is a known firm of financial standing or a commercial bank. Therefore, some debtors get their bills accepted on their behalves by the 'acceptance houses' or some commercial banks, for commission. Such bills are discounted at low rates by the discount houses or bill-brokers; in other words, they are purchased at high prices. The discount houses, in their turn, can easily rediscount them with the Bank of England, or can borrow against them from it.

The Treasury bill is a promise by the Government to pay a fixed sum of money at a prescribed date three months ahead. It is an instrument by which the Government can borrow money from the public for three months. Treasury bills are issued through the 'tap' and by 'tender'. While issues through the 'tap' are subscribed by the Government departments, the issues by the 'tender' can be taken up by anybody, the highest offers being accepted. Along with other firms and individuals, the discount houses, who act as a syndicate and offer the same rate, offer their rate. The rate of the discount market is generally the lowest. The higher offers are always accepted in full; but they are insufficient to lift the whole issue. Therefore, the offer of the discount houses is

accepted to the extent necessary to exhaust the whole issue.

The rate offered by the discount market is deliberately kept low. This is possible also because of an agreement on the part of the London clearing banks not to compete in the 'tender' for Treasury bills, and to purchase them from the discount market. This suits the commercial banks for, they are reluctant to hold bills for longer maturity to run and prefer bills near maturity. The discount market, therefore, hold the bills for a time before they are sold to the commercial banks at prices higher than their respective purchase prices.

The discount houses generally have larger amounts of capital than the bill-brokers. The discount houses also accept deposits and generally pay higher interests than the commercial banks. While both the discount houses and the bill-brokers function with their capital funds, their main source of funds consists of borrowing at call or short notice from the London commercial banks, at very low rates of interest, for, they are recallable by the banks at short time or notice. Calling back of money at call by one bank will not create problem for a discount house for, when one bank calls in, others may be willing to increase such loans to the market. The real difficulty comes only when all the London banks simultaneously call back their loans from the discount market. This may happen when all commercial banks find their cash reserves depleted due to open market sales by the Bank of England or for some other cause. The way out is provided by the Bank of England itself by rediscounting 'fine' trade bills or Treasury bills for the disconnt houses at the Bank Rate. Alternatively, it may also lend for seven days to the discount houses against such bills as security, at a rate traditionally $\frac{1}{2}$ per cent higher than the Bank Rate.

In rediscounting or lending to the discount market, the Bank of England imposes its own terms, and thereby controls the banking system. The loans or rediscount proceeds received by the discount market are paid to the commercial banks, for raising their cash reserves. Thus, the discount market remaining as an intermediary, provides a channel through which the Bank of England replenishes the cash reserves of the commercial banks. It is this fact that keeps the discount market near the heart of the English banking system. It is this fact again that enables the Bank of England to carry out some of its traditional control measures not directly over the commercial banks

but **via** the discount market.

As a matter of tradition the English commercial banks, when in difficulty, do not seek help direct from the Bank of England. Doing so is considered by them to be a sign of weakness and inefficiency. Therefore, instead of taking help directly, they get assistance from the discount market which in turn is assisted by the Bank of England.

It should be noted that during the war and the immediate post-war years the traditional barrier between the Bank of England and the commercial banks was broken number of times, when the Bank of England by-passing the discount market bought Treasury bills direct from the commercial banks and provided cash to them. Despite these instances, however, the tradition still continues, and is likely to continue in normal times.

The London Clearing House:—Established in 1775 by the private banks, the London Clearing House admitted the joint-stock banks to membership in 1854, and it now has the following eleven banks as members: Barklays, Lloyds, Midland, National, Provincial, Westminster, Martins Bank, Williams Deacons Bank' National Bank, Glyn Mills & Co., the Couts & Co.' and the District Bank, In addition to these, the Bank of England collects cheques which it reserves from its customers through the clearing house, but requires the cheques drawn on it to be presented at the Bank. The members of the Clearing House clear their own cheques as well as of other banks for a commission.

The object of the Clearing House is to clear the cheques of the several banks on each other at one place instead of presenting them at the counters of respective banks by the holder banks. The mutual claims are set off and the net balance is settled by issuing a cheque on the central bank. There are three clearings every day for three different categories of cheques, viz, Town, Metropolitan and County cheques.

Specialised Credit Institutions:—During the interwar and post-war years, the Government of the United Kingdom has sponsored certain institutions for providing such agricultural and industrial credit as would not otherwise be forthcoming from the normal sources. The Agricultural Mortgage corporation, the Industrial and Commercial Finance Corporation, the Finance Corporation for Industries, the National Film Finance Corporation, and the Export Credit Guarantee Department are the specialised credit insittutions so organised.

The Agricultural Mortgage Corporation:—Established in 1928 with the help of an interest-free government loan of £650.000, its capital of £750,000 was subscribed by commercial banks. It also issues debentures for raising funds.

The Corporation grants loans, against mortgage of property to farmers, for purchase and improvement of agricultural or horticultural farms or properties, repayable in equal half-yearly instalments spread over varying periods, not exceeding sixty years.

The Export Credit Guarantee Department:—This Department insures against British exporter's risk of loss arising out of insolvency of foreign importers or some situation beyond the control of the exporter. More and more policies are being issued covering newer and newer export risks in recent years.

The Industrial and Commercial Finance Corporation:—In the words of Dr. S. K. Basu, "The Industrial and Commercial Finance Corporation, the I.C.F.C. as it is called, is the product of the prevailing belief in the existence of the 'Macmillan gap', that is, in the field of financial requirements lying in between the short-term facilities ordinarily furnished by the banks and the long-term facilities available to the larger established business through the medium of the stock exchange or the issuing house. Whether there was a 'gap' in 1931 when the Committee reported may or may not be true. Even if the gap had existed, its actual extent may also be disputed. But there are reasons to believe that a version of the Macmillan gap existed in 1945, in the sense that there was an inadequancy of funds in this particular sector of this investment field.

Thus the object of the corporation is to provide such finance to small and medium sized industrial and business concerns, mainly private limited companies engaged in manufacture, as are not available otherwise. As Lord Piercy observed, the Corporation is intended "to supply capital to concerns which find it necessary to raise capital for development from outside sources, concerns, more precisely, whose requirements fall within the limits of £5000 and £200,000".

The Corporation has a share capital of £15 million of which £500,000 has been subscribed by the Bank of England, and the balance by the clearing and Scottish banks in proportion to their deposit liabilities. Besides, it has power to borrow up to £30 million.

Financing of Post-War Industry. p. 6.

Though the Corporation has been sponsored by the Government, it is operating as an independent organisation managed by a Board of directors on strictly commercial basis.

There is enough of flexibility in the Corporation's method of business, and it grants assistance to needy concerns in different forms, such as, debentures and secured loans; unsecured loans; redeemable preference shares; non-redeemable preference shares; participating preference shares; and ordinary shares, as is suitable to the needy concern. It maintains a suitable staff to carry out the operations and to see that the Corporation does not become the proverbial 'dustbin' into which all undesirable businesses are dumped. Indeed, it is the policy of the Corporation to assist only those concerns which have fair chance of success. In other words, as Lord Percy said, it is no part of the Corporation's policy to carry financial lame ducks but help ducks that can swim.

The finance Corporation for Industry Ltd.:-In the words of Sir John Anderson in his speech in the House of Commons, the purpose of the F. C. I. "is the provision of temporary or long-period finance for industrial businesses of the country with a view to their quick rehabilitation and development in the national interest, thereby assisting in the maintenance and increase of employment". While the I.C.F.C. is concerned with small and medium-sized concerns, the F.C.I. is interested in providing large-scale industries such financial assistance as would not otherwise be forthcoming through normal channels or by capital issue.

The F.C.I. has a capital of £25 million divided into 2,500,000 shares of £10 each, of which only 2% has been called up, subscribed by the Bank of England, Insurance Companies and Trust companies in the proportions of 30, 40, and 30 per cent respectively.

Central Banking In England

The Bank of England :—The Bank of England, the centre and pivot of English banking, was established by a charter granted by Lakhs William III in 1694, with a capital of £1,200,000, for the express purpose of lending money to the Government, in exchange for the privilege of exclusive right of note issue in London, and within a radius of sixty-five miles of the city of London. Its capital, raised by public subscription, was gradually increased from

timo to time, and more and more money lent to the Government until in 1945 its capital was raised to £14,553,000, and its reserve fund amounted to £3,000,000, the amount lent to the Government being £11,015,100. 110 la

The other commercial banks were granted the right of issuing notes only if they were established outside a 65-mile radius from London in 1826, in which year the Bank of England was also allowed to open branches in other parts of England. By an Act passed in 1833, the notes of the Bank of England alone were declared legal tender throughout England. By the Bank Act of 1844 the note issue of all other banks were limited to the amounts in circulation at that time, which again might lapse in case of the bank's amalgamation with other banks.

Though originally it was one of the commercial banks of the country, it gradually came to occupy a predominating position among the English banks due to various reasons. Its notes alone were legal tender commanding greatest confidence and widest circulation. Other joint-stock banks found it advantageous to keep accounts with it. It also became the banker to the British Government. In 1854 the clearing banks decided to settle their net balances through the Bank of England. Its note issue function, it being required to maintain a minimum gold reserve against its note issue and to redeem its notes in gold on demand, made it necessary to protect the gold reserves and, for that purpose, prevent undue expansion of credit and avoid banking panic. Indeed, the close relation of currency and credit was understood by the Bank during the crises of 1847, 1857 and 1866. To regulate currency, it had to control credit by altering the bank rate; and to avoid banking panic it had to provide funds to the needy commercial banks. Thus, as a result of the previleges granted by the original and subsequent charters, the Bank of England gradually came to hold the position of predominance, and became the central bank of the country,

The Bank of England, though occupying the central position, was owned by private individuals, its directors being chosen by the shareholders; and the government had neither any part in its management nor any share in its profits. The Bank was administered by a Court consisting of a Governor, a Deputy-Governor, and twenty-four other directors elected by the body of shareholders from among themselves. The Governor and the Deputy formed the chief

executive which, with the Committee of Directors, attended daily to the various matters of the Bank. The General Court met for regular business every Thursday to discuss all matters and mainly to consider the question of altering the Bank Rate, for which it alone had the prerogative. A statement is prepared and published showing the exact position of the Bank accounts up to the preceding night.

By the Bank Act of 1844, the Bank was divided into two Departments, namely, the Banking Department and the issue Department. While the Issue Department was to issue notes, the Banking Department was not allowed to issue notes except those received from the Issue Department, to which the former had to transfer Government securities amounting to £14,000,000, for equal amount of notes received. The Issue department could not issue notes in excess of this statutory fiduciary limit, except against the deposit of coin and bullion equal to the excess.

The Act of 1844 further provided that if a bank of issue from any cause relinquished this right, the Bank of England might in such a case increase its fiduciary issiue in a fixed proportion of two-thirds of the amount thus withdrawn. All profits accruing from such increase were to go to the Government. By operation of this clause, the limit of issue was actually raised from time to time.

Note Issue Under 1928 Act :—The Currency and Bank note Act 1928 amalgamated the Currency Note issue with that of the Bank of England, and gave the latter the exclusive right of issuing notes of £1, 10s, £5 and upwards, which alone would be legal tender throughout the United Kingdom. It also raised the fiduciary issue to £260,000,000 as a maximum, which could be raised or lowered as agreed by the Bank authorities and the Treasury. Sanction of the Parliament would be necessary if an increase temporarily sanctioned by the Treasury was not reversed within two years.

Note Issue Under the 1939 Act :—The Bank Notes Act of 1939 introduced a new principle of regulating note issue. It provided that the note issue should always be equal to the market value of gold and other assets held by the Issue Department. So, under the Act the note issue could be expanded without increasing the gold holdings provided there was rise in the market price of gold. A rise in

the price of gold amounts to depreciation of sterling in terms of gold and other currencies linked to gold; if this allows additional issue of notes, it in effect reverses the principle of gold standard laid down in the 1944 Act, which provided that additional notes could be issued only against additional gold of equal amount valued at a fixed price of 85s an ounce. The fiduciary limit was raised from £260 million to £300 million. But the system of Parliamentary sanction remained. If as a result of rise in the market price of gold there is exessive increase in note issue, the Parliament can refuse to sanction any rise in the fiduciary issue, and may even reduce it.

By the Currency Defence Act of Sept. 1939, gold worth approximately £280,000,000 was transferred from the issue Department of the Bank to the Exchange Equalisation Account; and the fiduciary limit of the Bank was increased from £300,000,000 to £580,000,000. The limit had to be further raised from time to time. By 1944, it rose to £1, 200,000,000, and by 1949, it reached £1,300,000,000. In 1955 the limit was £1,700,000,000.

The 1939 Act betrays advancement in monetary management and shows the redundancy of any gold backing to note issue in case of inconvertible currencies.

Nationalisation of the Bank of England :—The Bank of England continued as a privately-owned joint-stock company until 1946 in which year it was nationalised by the Bank of England Act, 1946. After remaining for 251 years as an independent institution, it has now come under Government ownership and control. The shareholders have been bought out in exchange for Government stock bearing interest of 3% such amount of stock being issued to each shareholder as would earn him annual interest equal to his annual dividend from his share, calculated on the basis of the average of 20 years preceding 1945. The stocks are redeemable at par by the Treasury any time after April 1946, giving three month's notice.

Nationalisation, however, has not transformed the Bank into a Government department. The 1946 Act merely laid down few provisions for the internal management of the Bank. It still continues to be governed by its own charters, managed as before nationalisation; and the Bank employees are not regarded as civil servants.

Of late the relation between the Bank and the Treasury had been very close; and the Act simply '**de jure**' recognises a '**de facto**' state

of affairs. All the aspects of central banking which are not clearly incompatible with public ownership and management have been retained in tact. The delicate central banking mechanism remains unimpaired.

Section 4 of the Act, however, provides that the Treasury can issue directions to the Bank on matters of public interest, after consultation with the Governor. In matters of doubt, the word of the Chancellor of the Exchequer will prevail. This is in accordance with the notion of public control. On the other hand, the Bank of England, if it thinks it necessary in public interest, may, with the authority of the Treasury, make recommendations to, request information from, and issue directions to other banks on all matters except concerning the affairs of a particular customer. Thus both the Bank and the Treasury have become stronger than ever before under the arrangement.

Regarding the responsibility for different functions, there has not been any clear demarcation, though the ultimate responsibility of the Treasury appears to have increased. As Dr. Basu observes, "More than a decade has passed since the nationalisation Act was introduced but the working relationship between the Bank of

England and the Treasury is still incapable of a precise definition or expression into formal language." The Governor of the Bank reported before the Radcliffe Committee that the management of the money market including the fixing of the Bank Rate was the first responsibility of the Bank, and that the law imposed the responsibility on the Bank unless the Treasury issued directives on them. On the other hand, he said, government borrowing and debt management, financing of public bodies, and control of hire purchase were the direct responsibility of the Treasury. But it was clear to the Committee that a precise separation and definition of functions was impracticable and might even be unwise. What was required was that there should be close co-operation and collaboration between the two. Consultation should be for finding out a solution and not for shifting of responsibility. Ultimate responsibility surely lies with the Ttreasury.

Monetary and Credit Policy:—Though the Bank of England was established in 1694 it was not until the publication of Bagehot's Lombard Street in 1873 that the Bank's policies were clear and its special position understood. It is this book that "clearly, and to the satisfaction of everyone, laid the foundation

of modern central banking theory."* In 'Lombard Street' Bagehot tried to answer two main questions: (a) How the Bank should behave in crisis? (b) How to shoulder the burden of supporting the financial structure in times of difficulty in face of London's growing responsibility as an international financial centre? Of course, both the questions were basically the same, and no final solution could be given for all times.

Lombard Street established the special position of the Bank. "It is not just like any other bank; it is the holder of the single reserve, the ultimate source of support for the country's financial structure in times of difficulty." It suggested increase in the Bank's reserves, so that an enormous amount could be drawn for both internal and external purposes. Solution to insufficiency of reserves was found in the weapon of Bank Rate. The two were in the nature of alternative remedies in the sense that bigger reserves made the flexibility of Bank Rate less necessary and more effective Bank rate made less reserves necessary. Hawtrey in his 'Century of Bank Rate' explained the necessity and the technique of Bank Rate. However, for three reasons the Bank found that

* Sayars · Central Banking After Bagehot, p. 18

the Bank Rate was not reflected in the market rate : (a) the growth of joint-stock banks have meant increasing reliance of the bill of market on them and less dependent on the Bank of England. (b) Increasing self-reliance of the market has severed the contact of the Bank with it, and (c) the Bank had to think of earning some profit for the shareholders. The business of the "Old Lady of Threadneedle Street" gradually declined and new business went to the joint-stock banks. As a result, for 20 years after 1858, the Bank Rate was following, rather than leading, the market rate with consequences on the Bank's reserves. This led to the carrying on of Open market operations to suppliment the Bank Rate. By taking money off the market by borrowing through Messrs. Mullens & Marshall it could force market rate to the desired level and make the Bank Rate effective. This of course involved costs in interest on the sums borrowed.

During the 1920s, the Bank of England actively controlled the monetary system by a combination of open market operations and changes in the Bank Rate ; and this period may be called a period of active monetary policy. The commercial banks had an agreement by which they charged a rate lower than 1 per

cent below Bank Rate for loans to the discount market for its basic needs, though the day-to-day needs were charged at slightly higher rates. The rate paid on time deposits was generally 2 per cent below the Bank Rate, thus guaranteeing the banks earning of 1 per cent. At the same time, the discount houses were not willing to purchase bills at rates lower than what they were required to pay to the commercial banks on their loans. Therefore, the rate on bills also could not fall more than 1 per cent below the Bank Rate.

Since the later part of the nineteenth century, the Bank of England had been willing to purchase bills at prices corresponding to Bank Rate, and this provided a ceiling to the range of fluctuation of the market rates. Within this range market forces operated and varied the bill rates, rising when the supply was large ; falling when the supply was small. Thus the Bank by its action could easily influence the market rate for bills. The sale of bills were a means through which the Bank could make the Bank Rate effective, by forcing the bill rate up. Similarly by purchasing bills it could force the market rate down. In the twenties the open market operations of the Bank of England were in bills ; and were carried on for influencing the interest rates on bills. The market rate was varied both for internal credit and balance of payments reasons.

The aim of monetary management up to this period was the preservation of such a relationship between the gold reserves and the volume of money as would not result in large scale conversion of notes and consequent fall in reserves. The conversion of notes into gold again depended on the balance of payments position of the country. Therefore, other things remaining equal, a deficit in the balance of payments causing a net export of gold made the Bank of England contract credit by raising the Bank Rate and carrying on suitable open market operations so that the relationship between reserves and quantity of money is restored; and the outflow of funds reversed through rise in the market rates of interest, short and long-term, cheapening of wages and prices, and attracting foreign funds to take advantage of higher interest rate. A surplus balance of payments resulting in inflow of gold would require the opposite measures.

Between 1924 and 1931, the Bank Rate oscilated between $2\frac{1}{2}\%$ and $6\frac{1}{2}\%$. In 1929 it rose to $6\frac{1}{2}$ per cent after which it declined. The crisis in gold reserves came in 1931 September

when the Bank Rate was raised to 6 per cent; but the crisis could not be averted and England abandoned the gold standard suspending convertibility of its notes.

During the thirties, England followed "cheap money policy" and kept the Bank Rate at 2 per cent until 1951. This was possible for Bank Rate lost its importance as a factor influencing the balance of payments; and the idea of regulation of the volume of currency in accordance with the gold movements was given up. As an alernative objective of monetary policy attention was focussed on the problems of depression and unemployment. The cheap money policy was adopted in an atmosphere of falling income and unemployment in 1932. The motives were: raising of the money incomes of the people, attainment of full employment, reduction in Government expenditure on public debt, and maintenance of internal price stability. The insulation of the economy from international economic fluctuation was also an important factor influencing the decision. Thus the emphasis was shifted from external stability to that of internal price stability and full employment.

During the thirties, the Bank Rate remained stationary at 2%, and the Treasury bill rate fluctuated between about 1/4% and 1 1/4%.

and short loans rate to the discount market. The bill rate was also correspondingly alterd. This also marks the adoption of a flexible monetary policy to suit modern flexible conditions.

Since 1951 the banks have been lending to the discount market at rates 1 3/4 per cent below the Bank Rate, which means that the market has now wider range than the pre-war 1 per cent. Again, while during that period the Bank was willing either to buy Treasury bills or fine trade bills at the Bank Rate or grant seven-day loans against such securities at rate ½ per cent above the Bank Rate, since 1951 it granted such loans at the special rate ½ per cent below the Bank Rate, and since 1953 at the Bank Rate. Thus these loans are cheaper now by ½ per cent than in the inter-war period. The Treasury bill rate can now fluctuate much lower than in relation to the Bank Rate.

The raising of the Bank Rate is only one of the means of "package deal" approach followed by the Bank of England. 'Package deal' includes such measures as requests and directives for curtailing investments and hire-purchase.

Flexible operation of monetary policy enabled the Bank of England to relax some external credit control measures which were earlier adopted in 1952 restricting granting of certain overseas

credits. The flexible monetary policy also enabled the Bank of England to lower the Bank Rate from 4 per cent to 3½ per cent, following the improvement in the country's gold and dollar reserves. The special rate at which the Bank of England made seven-day loans to the money market against Treasury bills was also revised in 1953.

During 1954, the same flexible monetary policy continued to be pursued, and it was directed towards easing and cheapening of cradit. The 3½ per cent Bank Rate, being higher than interest rates in foreign markets, specially New York, attracted foreign funds. To discourage the inflow, and to bring the official rate into alignment with market rates, the Bank Rate was reduced to 3 per cent in May 1954. By the end of 1954, fresh inflationary upsurge made itself felt weakening the pound sterling. To meet the situation the Bank Rate was raised in two stages to 4½ per cent, the highest rate since 1932. This was further reinforced by the reintroduction of the restrictions on the hire-purchase terms and credit for the same with a view to restrain demand for durable consumer goods. As a result of these combined steps, there took place an upward adjustment in the market rates. The Treasury bill and other short-term rates eased.

Though there was no net rise in money supply in the country during 1955, the inflationary upsurgé continued resulting in rapid growth of consumption and investment relatively to resources. Bank credit, recorded a rise of 17 per cent, and the prices of basic materials rose by 7 per cent, while share prices rose by about 15 per cent. The consequences of inflation were felt in the external sphere when imports increased by 15 per cent creating balance of payments difficulties. U.K's deficit with the rest of the Sterling Area resulted in her loss of gold and dollar reserves amounting to $ 642m. Weakening of sterling also led to outflow of short term capital from U.K.

To arrest inflationary pressure, the Bank rate was raised from 3 per cent to $3\frac{1}{2}$ per cent, then to $4\frac{1}{2}$ per cent, and again to $5\frac{1}{2}$ per cent in January 1955, February 1955 and February 1956 respectively. Later it was raised to 7%. The Governor of the Bank of England urged upon the banks for a 'significant and positive reduction in bank advances, interpreted at 10 per cent by the banks.

There was also a tightening of the hire purchase credit restrictions. Besides the selective credit controls, fiscal measures including additional taxation, withdrawal of tax concessions,

reduction in Government expenditure and schemes to stimulate savings were adopted. Capital issues were also tightened. As a result of all these measures, there was some improvement in the domestic credit and balance of payments positions. But there was recorded a 3 per cent rise in bank credit and 1 per cent rise in money supply. The wholesale prices recorded a rise of 4·5 per cent, and cost of living rose by 6 per cent.

The 'directive' method of credit control was relied on by the Chancellor of the Exchequer who advised the banks, in July 1956, to pursue the policy of credit contraction till the situation improved. Besides, to encourage savings, a new series of savings certificates was issued on more attractive terms.

In 1958, the slowing down of economic activity in England called for a shift in the monetary policy of positive restraint to that of active ease. The Bank rate was lowered five times in the year, in stages, from the 'crisis rate' of 7 per cent to 4 per cent. The reductions were also influenced by improved balance of payments position with consequent restoration of confidence in sterling on the one hand and the necessity of stimulating economic activity which showed some indication of sagging.

The directive issued to banks in 1957,

"requiring them to maintain average bank advances in the ensuing twelve months" was withdrawn in July 1958, and a new set of instructions were issued to the Capital Issues Committee which relaxed control, by raising the limit below which its approval was not necessary from £50,000 to £50,000, and removing the restriction on bank finance to raise new capital. As a result of these measures, the bank credit rose by 12 per cent in 1958, as against a fall of 1 per cent in 1957. The total money supply rose by 2·5 per cent, as against a fall of 1 per cent in 1957.

The rise in credit also enabled a broadening of consumer credit. The controls over hire purchase of durable consumer goods as well as plants and equipments were removed in September 1958.

A seemingly recessionary tendency led to the Chancellor of the Exchequer announce, on November 3, that investment in the public sector for 1959–60 would be increased by 10 per cent over the limit imposed for 1958-59. A substantial tax concession was also granted in the budget of 1 959-60.

In 1959, no change was made in the Bank rate, though there was an increase of 5·3 per cent in production. The prices of industrial output remained almost constant. The Governor of the Bank of England warned the bankers in November 1959

that the rise in bank credit required watching if it continued to rise at the same pace. In January 1960, the Bank rate was actually raised from 4 to 5 per cent, when it was seen that bank credit rose by 32 per cent in 1959, the money supply increasing by 3·8 per cent.

Supplementing the monetary with budgetary policy, the tax concessions granted in the budget of 1959-60 were substantially reduced in the budget for 1960-61. At the same time, special incentives were also offered to small savers, in (1) a more attractive prize scheme for premium bonds, (2) higher holding limits for permium bonds and National Savings certificates and (3) a new issue of 5 per cent defence bonds with higher holding limits.

The Bank of England Quarterly bulletin, first published in March 1960, reported that a system of Special Deposits by the commercial banks with the Bank of England was introduced and controls over hire-purchase terms were reimposed. Yields on gilt-edged securities rose and price of securities began to fall. The Bank's attitude towards new lending hardened. A further rise in bank rate was decided, following a deficit on her current and long term capital accounts in the balance of payments. This led to a considerable inflow of funds.

Procedure of the Special Deposit Scheme :— The Quarterly Bulletin of the Bank of England, December 1960 describes the procedure of the Special Deposit system as follows: "Decisions to call for Special Deposits are made by the Court of Directors of the Bank, and normally decisions on changes in Special Deposits are made at the regular Thursday meetings of the Court. The announcement of a call makes it clear that it is made with the approval of the Chancellor of the Exchequer. The percentages of each bank's funds to be lodged in Special Deposits are normally applied to the latest monthly figure of total gross deposits and the resulting amounts are then rounded to the nearest multiple of £10,0000. A special interval is left between the announcement of a call and the date by which the making of the Special Deposits is to be completed; within these limits, each bank decides when and in what instalments to lodge its deposits. The banks are, however, asked to provide such forecasts as they can give of the likely size and timing of their instalments, to assist the Bank in managing the money market, and, in particular in judging the amount of Treasury bills to be offered and allotted at the weekly tenders. Interest is payable on Special Deposits at the multiple of 1/16 per cent nearest to the average Treasury bill rate at

the weekly tender of the preceding week. The amount of Special Deposit is adjusted each month to take account of the latest figures for each bank's gross deposits; the amounts involved in such adjustments are usually of modest size."*

Speaking on the effectiveness of the above measures, Lord Goddard, Governor of the Bank of England said that the monetary policy in the United Kingdom in 1960 achieved a considerable part of its objectives. He observed that there were limitations on the effectiveness of monetary policy and that credit restriction takes a long time to work through the system. According to him, it is a great mistake to expect monetary policy to carry loads which should be carried in other fields of government policy; by itself it can ensure neither the internal stability of a currency nor equilibrium in the balance of payments.

The pressure on liquidity on commercial banks was maintained during 1960, and at the end of the year, the aggregate of clearing banks' liquid assets was 31·9 per cent of deposits, as against 34·2 per cent in 1959. The ratio fell further to 30·4 per cent by the middle of 1961. The conventional minimum level is, however, 30 per cent.

The monetary policy has been supplemented

*International Financial News Survey, February 3, 1961 by budget policy. Mr. Lloyd, the Chancellor of the Exchequer, rightly observed that monetary techniques have some disadvantages. The same level of bank rate is not always the appropriate for both international and domestic purposes. The hire-purchase regulations cannot be extended to all the industries. Under the circumstances, though no monetary technique should be dispensed with, quicker and more effective measures should also be devised. He accordingly levied a special surcharge or granted a special rebate (neither to exceed 10 per cent) on all the main customs and excise revenue duties and the purchase tax. He also levied a surcharge on employers, similar to a payroll tax, subject to an upper limit of 4 shillings a week for each employee. They are expected to affect purchasing power to the level of £200 million in a year.

The Changing Objectives And Techniques Of Monetary Policy :-- The following are the Lessons learnt from the working of the British Monetary system :

After 30 years of the Macmillan Committee's 'Enquiry into the British Monetary System' has come the report on the working of the Monetary system prepared by the Committee under the Chairmanship of Lord Radcliffe. The

report generally approves the present financial structure while recommending several changes in the relationship between the Bank of England and the Treasury. As observed by Sir Oliver Frank, it would be easy to suppose that the objectives of monetary policy have not changed in the last 30 years. In fact this view is a mistaken one. There have been important changes in following lines.

(1) There has been a large shift in the relation of Govt. to the general economic life of the country. Once employment or unemployment was not the responsibility of the Govt.. But since the war Govts. have taken explicit responsibility regarding the employment policy. Balance of payment and the general economic growth are responsibilities of the state. The Govt. takes responsibility for broad decisions of policy in relation to the economy and it has gone into management.

(2) Before the war the assumption was that the different objectives of monetary policy were harmonious, that if one was pursued, others would be helped also. But post-war experience shows that the ends of monetary and economic policy are often in conflict and there is need for striking a balance. How much of full employment without disturbing the price stability and balance of payments ?

(3) Finally, monetary policy and mone-tary measures were once thought to be by them-selves prime regulators of the economy. Th importance of the budget and fiscal policy is no more and more recognised. It is a very importa regulator of general demand. In fact we no have to choose between different types of mea-sures, whether monetary, fiscal or direct contr which may in any given situation be alternati and sometimes complimentary in their effe

The growth of the public sector has crea-ted peculiar problems in monetary policy. S much of the nation's expenditure is now do by Govt. that each increase or decrease is powerful factor in regulating general deman This means that it has become more importa than it was in relation to monetary measure Secondly, there is a great deal more investme in the public sector than used to be the cas But the public sector is not directly susceptib to changes in the monetary policy in the sam way as the private sector. Decision in the pu-lic sector is a matter of adminitsrative decisio rather than governed by prices in the mark So the range of operation of monetary measu-res has been somewhat narrowed. Lastly th growth of the public debt has created new pr blems in the interest rates policy.

The Report of the Radcliffe Committee observes that the successful use of monetary poli-cy depends in the end upon a clear perception of a few underlined concepts which are basic to financial conditions in the modern economy.

The Report set out five main ideas on the effectiveness of monetary policy.

(1) Monetary measures are aimed at the level of demand, but by their nature they are incapable by themselves of having an effect sufficiently prompt and far reaching for their purpose, unless applied with a vigour that itself creates a major emergency. They are not so much a policy in themselves as a part of one general economic policy which includes among other instruments fiscal and monetary measures and direct physical controls. There is no pres-cription which determines the proportion in which at any one period these measures should be combined.

(2) The factor that monetary policy should seek to influence or control "is nothing less than the state of liquidity of the whole economy." The behaviour of the economy is influenced by the relative liquidity of potential spenders at any one time and thus, at one remove, by the liquidity of those who might act as lenders to them or subscribes their funds.

All types and groups of financial institutions have to be considered if they complete in a single market for credit.

The Committee thought that there was a general liquidity of the economy. The country was full of money— a legacy from wartime. There was also a complicated network of financial institutions in Britain all of which in one way or another are lenders of money. There is no sharp division between the market for credit and the market for capital. There is a unity in the entire market for money and the borrower had always alternative sources to which he could turn. In all these ways, the scope of monetary measures was limited or their effectiveness in this period somewhat lessened.

The committee came to two negative conclusions. The supply of cash (in notes and coins) is not a prime instrument of monetary policy. The Bank of England stood passive as regards the supply of cash and was concerned only to see that the needs of the public were met.

Was the supply of money i. e., cash plus bank deposit, the main instrument of control? The committee thought it was not. The supply of Money was a factor not to be neglected. But it could not be the main basis of monetary ... The quick financial assets of one sort

or another can readily be turned into money, so that the amount of money itself is not an absolutely limiting factor. Spending is not limited to the amount of money in existence. It is related to the amount of money people think they can get hold of whether by receipts of income, by realising investment or by borrowing. This led to the central role of the rate of interest.

(3) The proper way for monetary policy to affect financial conditions and eventually, through them, the level of demand is to influence the structure of interest rates. This influence can be exerted through the management of the national debt, which is an instrument of singular potency. In the opinion of the Committee, debt management has become the fundamental domestic task of the central bank. The monetary authorities can't be neutral in handling this task. They must have and must consciously exercise a positive policy about interest rates, long as well as short, about the relationship between them.

The Committee attributes "to operations on the structure of interest rates a widespread influence on liquidity and a slower, more partial, influence on demand for capital," but believes there is no room for advocating the merits of any one form of control at the expense of another." What is needed is a constant and profound diagnosis of the state of the economy and a clear perception of the likely effects, indirect as well as direct, of any particular measures.

(4) Apart from the interest rates and prescribed ratios as to the distribution of assets, the committee considers only three monetary regulators deserving of serious attention "under conditions that are less than those of real emergency." They are control of international capital movements, control of the terms of hire-purchase credit, and in certain circumstances, control over lending by financial institutions other than the banks (for the purpose of financing purchases of houses etc.).

(5) The last main idea listed in the report is concerned with the external assets and liabilities which are an integral part of the British economy and its financial system and by their movements, have a direct influence upon the state of its liquidity. Higher international reserves are needed to secure more freedom in the pursuit of one or more its national objectives.

The influence of monetary measures: The Committee expressed its views on the way in which monetary measures work in the British economy as follows :

"(1) The immediate objectives of monetary action is to effect the level of total demand.

(2) Although aimed at the total demand, any monetary measure will have inescapable "directional effects"; these have to be taken into account when the choice of monetary measures is considered though upon occasions they may be regarded as positive advantages. "The directional effects" arise because monetary measures operate upon total demand by means of that disturb some institutions and some people more than others, and necessarily have more effects upon some channels of activity than upon others. Sometimes "directional effects" are deserved for their own sake (a cut in imports for example, imposed in order to improve the balance of trade), but more often they are disadvantageous, e. g., when the application of a general monetary, restriction creates hindrances to economic innovations.

(3) In theory, monetary action may work upon total demand by changing the "interest incentives" that is by raising or lowering the cost of holding stocks or more clearly capital goods with a long life but the committee believes that "only very limited reliance can be placed on this. A more important influence is the availability of funds to borrowers through

particular channels. An interest charged is one of a number of factors to be weighted in the balance when an investement decision is being made, and even a sharp change in this item easily be obscured by other factors; but if the money for financing the project cannot be got on any tolerable terms at all, this is the end of the matter.

(4) Monetary action, therefore, works more certainly upon total demand by altering the liquidity position of financial institutions and of firms and people desiring to spend on real resources; the supply of money itself is not the critical factor. Decision to spend on goods and services— i.e., those which determine the level of total demand — are influenced by the liquidity of the spenders; this in turn depends not only on the amount of cash they already control but also on their ability to borrow additional cash.

(5) For this reason, the Committee received the "private sector" (the joint stock banks and other financial institutions) and found that the sources of liquidity are multifarious and the case of substitution high.

[6] This conclusions might suggest the need for a highly complexed system of controls of liquidity. The committee, however, believes

that the use of such controls would be ineffecient (as well as administratively burdensome) because the further growth of new financial institutions would allow the situation continually to slip from under the grip of the authorities. The review of the private sector shows, the Report says, that movements in interest rates have significant effects on the liquidity structure.

(7) The authorities thus have to regard the structure of interest rates rather than supply of money as the counterpiece of the monetary mechanism. This does not mean that the supply of money is unimportant, but that its control is incidental.

(8) The behaviour of the banks is of special interest to the monetary authorities, because as the most accessible lenders, they are peculiarly important in the total liquidity position. But this special interest is concentrated on the level of bank advances rather than the level of deposits. If a monetary authority "in a tight corner" decides to strike directly at the banks, it should strike at bank advances.

(9) If the monetary authorities are unable for any reason to manipulate the interest rates freely, they may decide to strike directly at other vulnerable points in the liquidity structure. The capital issues control and the control of hire-purchase finance are in recent examples of such measures in the U. K. But further they go in using these controls, the more the authorities are imposing on the economy particular directional effects on the level of general demand.

A change in the general structure of interest rates operate upon the economy in two ways — the "interest incentive effects" and the "general liquidity effect."

A change in the interest rates can bring about a change in the incentive to purchase capital goods, whether stock of commodities or plant and equipment. Its effect is marginal only in the inflationary periods. What happenes to the lenders of money when interest rates were moved, the general liquidity effect? When the interest rates went up, the capital assets of the lenders lost value and they became to some extent less willing to realise them and to lend. When interest rates went down capital values went up, balanced sheets looked healthy and financial institutions began to look for opportunities for lending. This was a real effect but neither decisive nor rapid in its operation.

A general movement of the structure of interest rates does have a real effect. It creates a diffused difficulty of borrowing. It makes some people change their plans. But it works gradually. Sudden strains on the balance of payments. Because of inadequacy of effects, quick effects are needed and the gradual pressure of heightened interest rates may not be enough. The credit squeez, i. e., restraint of lending

by banks, the controls of capital issues and restrictions on the terms of hire-purchase. When external situation demanded rapid action, Govt. had to supplement the movement of interest rates by these ways and of them the most significant was restriction on hire-purchase. While control of bank lending may drive the borrowers to alternative sources of credit sharp increase in initial down payment, a shortening of time within which the subsequent serial payments had to be made, have quick effects of a once for all character."

Thus, in effect, the Report says that monetary measures alone cannot be relied upon to keep the economy in nice balance; subject to major strains from within and without they can only help in achieving the objectives.

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BANKING SYSTEM OF THE U. S. A.

The U.S. banking system is one of the most developed banking systems of the world. In recent years, the U.S. commercial banks have been developing new lines of business worth imitation by other countries. The system of insuring bank deposits has already been adopted by our country. The Federal Reserve system has been the veritable laboratory for forging the latest weapons of credit control.

Development of the American Banking System :-- Banks in America grew towards the end of the 18th century. The Bank of New York and the Bank of North America were established in 1781 and the Bank of Massachusetts in 1784, as private commercial banks. The First Bank of United States was established in 1791 by an Act of Congress. The Second Bank of United States was established in 1816 and it failed in 1836.

Thus before the Civil War, there were private as well as Government banks. The banks were banks of issue and their notes were not notes but virtually irredeemable paper money. There was rapid growth of banks. It was known as the period of bad banking. In 1838, New York introduced the 'Safety Fund System' under which the banks were to contribute ½ of 1 per cent to the State Fund. This was in the nature of a mutual insurance scheme, but the safety fund was quite inadequate to check bad banking. There was widespread evasion of capital requirements. Inspite of a system of bond deposits with the U.S. Comptroller, there was increase in note issue; and the 'preliminary panic' came in 1833, and the widespread panic in 1837 caused by inflation and speculation in bonds. Consequently there grew the anti-bank sentiment which continued up to 1862.

The National Banking System :— The National Bank Act was passed by the Congress in February, 1863 'to provide a national currency secured by a pledge of U.S. Stocks and to provide for the circulation and redemption thereof.' It provided for a system of commercial banks chartered by the National Government and having the power to issue bank notes secured by the pledge of U.S. Govt. bonds.

Under the provisions of the Act, not less than 5 persons could organise a bank. Minimum capital requirement was on a sliding scale varying with population to be served by a bank. 50 per cent of the capital was to be paid before incorporation, and not less than 1/3rd of the capital worth of Government bonds must be deposited with the U. S. Treasury and bank notes taken in exchange before beginning operations. Notes were to be carefully printed to prevent counterfeiting. Refusal to redeem notes was penalised by forfeiture of the securities.

The Act also provided for cash reserves on the basis of notes and deposits, varying with location. For this purpose the banks were classified according to location. The banks in Chicago, St. Louis and New York were called 'Central Reserve City' banks and were required to keep cash reserves equal to 25 per cent of their deposits and notes. Banks in 16 cities (later the number was raised to 60) were called 'City banks' and were required to keep 25 per cent of their notes and deposits in reserve, but they were allowed to deposit ½ of their reserves with the Central Reserve City banks. Banks located in all other places were called 'Country banks' and were required to keep 15 per cent of their notes and deposits in reserve, but they

were allowed to deposit 3/5th of their reserves with the 'City' or 'Central Reserve City' banks. The Act also provided for a Bureau for Supervision whose duty it was to supervise the banking system.

Defects of the National Banking System :- The National banking system continued for 50 years (1863 to 1913). The National Bank Act created a safer form of currency but not a uniform national currency. It also did not create any central banking institution. As a result, the system suffered from various defects.

1. No uniform currency :- During this period there was no uniform reliable currency in circulation. There were 34 different State banking systems resulting in an amorphous mass of unco-ordinated unit banks spread over the country issuing notes. The currency was ragged and doubtful and the circulation was in inverse ratio of solvency. There were thousands of varieties of bank notes, some good and some poor; some genuine and some counterfeit; some representing promises of existing banks and some of banks already closed. This state of affairs caused constant annoyance to all. It was rightly observed that the National banking system served as an engine of inflation. The currency notes circulated at various rates of discount.

Shaped

Periods — ① 1900 – 1920 — No of failures 1358
② 1921 – 1929 — " " " 4945

2. No Leadership and team work :- The different State Governments had different State banks independent of each other. Each State also had a group of National banks under it. In 1912 there were about 30,000 banks of which 28,000 were commercial banks owned by residents and doing local business. This banking multitude with duel control was characterised by depression, exploitation, uncertainty and insecurity. In times of panic, the different parts of the system being without leadership, worked at cross purposes. There was no centralised control and regulation. It was appropriately dubbed as' wild cat banking; and the multitude of different kinds of currency, some of which were absolutely worthless were called 'wild cat currency'. The National Banking system was really a misnomer.

3. No effective regulation of credit creation : —There was no other restriction of bank credit except the requirement of maintaining reserves. This again did not equally apply to the Stats banks and trust companies. The classification was more or less meaningless as there was no difference in function. The system of one class of banks keeping part of their reserves with another class resulted in fictitious and pyramided reserves on the basis of which credits were created. There being no provision for

rediscounting of papers, commercial or Government, and no market for bills, there was a scramble for প্রতিযোগিতা. reserves among the banks.

4. Scattered snd immobile Reserves :— The reserves were widely scattered. Most banks had 'deposit reserves' which they were allowed to count as legal reserves, i. e., funds invested in stocks and call loans. As Mr. Kemerer observes, they were not reserves at all, for the deposit reserves were merely deposits, which the keeping banks gave as loans to stock exchanges and their clients, and the bank kept its own reserves against them. They were again lent by the third bank and so on. In times of emergency, therefore, the deposit reserves could be realised only to the extent the call loans could be successfully called, and this meant the extent the stock exchange securities could be sold. In times of threatened panic, however, the securities could not be sold on any extensive scale except at a considerable loss. The banks consequently had to depend solely on their cash reserves, which, therefore, had to be maintained at high levels. The reserves were not only scattered and immobile in consequence, there was also no national conservator and mobiliser of the reserves as is the case with a central bank.

5. Credit Inelasticity :— One important postulate of good banking is the ability to adjust the

supply of deposit currency and bank notes to the variation in trade demand, increasing it at the time of heavy demand and decreasing it when demand slackens. This was absent in the system. The National bank notes were notoriously inelastic. Because of expenses and requirement of holding stocks the banks were reluctant to alter the volume of notes issued by them. Because of withdrawal of deposit reserves the bank notes and deposits tended to decline during business expansion and expand during business recession, a tendency correctly called 'inverse elasticity' The rate of interest and the value of securities widely fluctuated in consequence.

6. Difficulties in transfer and clearing :— The different banks charged at different rates for collection and clearing. Consequently, while the local cheques were easily cleared, the out-of-town cheques had to follow the 'routing system' to economise the cost of clearing. This involved unnecessary delay and expense.

7. Foreign Exchange difficulties :— Foreign trade was financed through London and this meant dependence on London, and involved undue complexity and expense.

8. Frequent crisis :— Because of all these factors there were frequent banking crisis during the period in which many banks had to suspend payment and even close down. Thus during the crisis of 1873, there was a general suspension of specie payments by banks throughout the country, and the stock market remained close for a week. During the panic of 1893, following the collapse of the stock market, there was widespread run on the banks throughout the country, forcing them to suspend payment. During the crisis of 1907, there was a crash in the New York Stock Exchange in March, resulting from the calling back of loans by New York banks as a result of run on them, which spread throughout the country compelling banks to suspend payment.

In 1908, the Aldrich-Vreeland Act formed the National Currency Associations which were a makeshift substitute for central banks, with note issuing power. It also appointed a National Monetary Commission to make a study of the French, English and the German banking systems. The Commission after making the study submitted its report in 40 volumes. The Commission was more impressed by the German system of mixed banking and industrial participation.

The Federal Reserve Act, 1913 :— In accordance with the recommendation of the National Monetary Commission, the Federal Reserve Act was passed in 1913 "which did not change the existing structure but superimposed on its peculiar chain of central banks, unified in some measure by a central board in Washington." As Prof Sayers says, this Federal Reserve System was viewed as a provider of elastic currency and a dispenser of emergency funds to meet seasonal and other temporary requirements of member banks, though it was not long before the concept was enlarged to the formulation of national credit policy to moderate the trade cycle.

Twelve Federal Reserve Banks were established and placed under the supervision of a central Federal Reserve Board. The capitals of the Federal Reserve Banks are subscribed by the member banks, which are the former National and State banks which chose to be members. Each Federal Reserve bank is expected to act as banker's bank for the member banks and carry on all central banking functions. The Federal Reserve Board was located not in New York, the most important financial centre of the country, but in Washington, the political capital.

After the first world war there took place some functional and structural changes in U.S. banking system. There was a rapid growth of industrial banking activities and decline in bank liquidity. Real estate loans also rose rapidly. Banks showed a tendency to hold larger and larger

proportions of industrial securities and less and less of U.S. Government securities. For the purpose of investment, the banks organised 'Security affiliates' as subsidiary companies through which industrial lending was done. The incidence of the post-war depression changing demands for developing industry and trade and the growth of time deposits during the period encouraged the banks.

The reduction in reserve requirements by the Federal Reserve System released a considerable amount of reserves. These funds together with a heavy gold inflow exerted tremendous pressure for credit expansion and price inflation. The second reduction of reserve requirement came in 1917, and the banks carried enormous excess reserves. The growth of savings and time deposits added to the problem. The banks tried to lend through the security affiliates and to the stock exchange for speculation in securities. Prices of securities rose higher and higher. Following a boom in 1929, there came the depression in 1933. Security prices fell and bank loans could not be called back. A general run on the banks forced them to close down and declare a nation-wide bank holiday from March 6 to 9, both days inclusive. Thus the inevitable result of excessive speculation and mixed banking came.

The American Banking Act of 1933 and Drive against Mixed banking :- Officially called the Banking Act of 1933 and popularly known as the Glass-Steagall Act, its objectives were "to provide for the safer and more effective use of the assets of banks, to regulate inter-bank control, to prevent the undue diversion of funds into speculative operations and for othere purposes." The Act brought about the following changes:

(a) Restriction on use of Federal Reserve credit for speculation :- It provided that any bank using credit for speculative purposes would be deprived of from credit facilities by the F. R. Board being informed by the F. R. Bank of the area.

(b) Separation of investment from commercial banking :-- It required complete separation of the distinctive functions of investment and commercial banking. Member banks were compelled to sever connection with their security affiliates, and to give up underwriting and sale of industrial securities. Interlocking directorates betweeen banks and security organisations was declared illegal except with special permission of the F. R. Board.

(c) Insurance of Bank deposits :— It provided for both temporary and permanent insurance plan. The failing banks revealed that overwhelming majority of them lost all their savings. The plan for a deposit insurance scheme was prepared

(d) No interest to be paid on demand deposits :— Member banks were prohibited from paying interest on demand deposits ; the F. R. Board was also empowered to regulate the interest rate.

(e) Provision for branch banking and change in capital requirements :— Under certain capital requirements National banks were authorised to engage in branch banking.

(f) Admission of National Savings and Morris Plan banks into the F. R. System was allowed.

(g) Open Market Operation and the Federal Open Market Committee :— The F. R. Banks were prohibited from carrying on open market operations except regulated by the F. R. Board. The purpose of the Board was to co-ordinate the operations throughout the country. The policy of the Board was to encourage purchase of securities for accommodating commerce and industry and focilitate control of credit.

The Act of 1935 :— This act provided further that the required reserves could not be reduced below the legal level at which they stood when the Act was passed and they could not be raised to more than twice the level.

It was calculated that this provision would give the Board an instrument which could easily and effectively be used to eliminate a large part of the excess reserves. It represented an extensi of the power of altering the reserve requi ments. But the provision was criticised on vari grounds—

(a) That sharp and sudden increase reserve requirements could easily provoke credit panic and result in extremely exten liquidations of bank credit.

(b) Reserve positions of no two ban were the same and that a uniform increase reserve requirements would affect different ba unevenly.

(c) For banks with no more than legally required reserves before the new requi ment went into effect, the consequences mi be serious.

Basic changes were also introduced in Federal Reserve Act defining rules and regulati to be observed by the member banks in lendi for different purposes. Eligible papers were d ned as "notes drafts and bills of exchange short maturities issued or drawn for agricultu industrial or commercial purposes. "The Board Governors was given increased control over discount rates of the F. R. Banks by additi to the requirement that such rates must b established every fourteen days or oftener, deemed necessary by the Board. The restrictio

on real estate loans was relaxed.

During this period, the American banking system faced the problem of excess reserves. Two causes were ascribed to this large accumulation of reserves. (a) Open market operations of the F. R. Banks effected with the purpose of expanding bank credit gave the member banks funds which they first used in repaying their indebtedness to the F.R. Banks and allowed the remainder to accumulate in their accounts as excess reserve balances

(b) The reduction in the gold content in the dollar in 1934 increased the country's monetary gold stock by 69 per cent and started an unprecedented gold flow into U. S. A. for two weeks before the announcement by the Board of Governors of its 50 per cent increase in reserve requirements for member banks. The inflow of gold was mostly on private accounts and the process was as follows: Individuals or firms would ship gold to a bank in U. S. A. and receive a deposit credit for the dollar value of the shipment. The gold would be handed over to the Treasury and the member bank would receive a cheque on its F. R. Bank for the value. So at a time when the member banks were almost out of debt, this inflow of gold resulted in swelling of the excess reserves of the member banks which rose to $3,000 milli

On the basis of these excess reserves th banks could easily increase their demand an time deposits. So the plan for sterilisation o gold was accepted. The plan, adopted in 19 was a plan to prevent such newly acquired go from functioning as basis for credit creati Whenever the Treasury would deem it desirab it would sell additional public debt obligati the proceeds of which will be used for the pu chase of gold and redemption of outstandi obligations. In other words it amounted to perm tting new gold received by a bank to increa the bank's deposits by the amount received b compelling the gold to be swapped by the Tre sury department for its equivalent interest-bea ing government debt. Thus the newly acqui gold increased the bank's deposits without incre asing the bank's reserves.

Though the Acts of 1933 and 1935 tried to prevent the undue diversion of funds into speculative operations, it did not clearly say whe 'enough' speculative bank credit became 'too much'. It had to be determined by the mem bers of the Board of Governors, which was given enough power to control the credit policy so as to accommodate maximum facility for trade and commerce

The Stock Market Regulation Act imposed heavy margin requirements on brokers' sale of securities in order to prevent the flow of bank credit into security sales. The Board was authorised to vary the margin requirements within prescribed limits. Initially this limit was fixed at as high as 45 per cent.

The Federal Deposit Insurance Corporation :— The Banking Act of 1933 provided for insurance of bank deposits in all Federal Reserve member banks as well as such non-member State banks as wished to participate in the plan and were able to present evidence establishing their solvency. The necessity for such insurance or guarantee arrangements was felt due to the frequent bank failures resulting in large losses to innumerable depositors.

The Banking Act of 1933 provided for a temporary deposit insurance plan to be in effect from January 1, 1934 to July 1, 1934. On the latter date it was to be succeeded by a permanent plan administered by Federal Deposit Insurance Corporation to be formed for the purpose. Deposits of the participating banks were to be fully guaranteed up to $2,500 for each depositor. The guarantee fund was to be raised by assessments on all participating banks to the extent of ½ of 1 per cent of their insured deposits. Members of the temporary scheme remained liable to a further levy of an equal amount and no more. It was estimated that by guaranteeing up to \$ 2,500 for each depositor, about 97 per cent of the depositors were fully protected.

Management of the F. D. I. C. was vested in a Board of three directors. The Comptroller of Currency was one of them, and the other two were to be appointed by the President. The Corporation was to have a capital of between \$ 450 million, and \$500 million of which 1/3rd would be paid up and the remainder to be called at any time. The capital was to be subscribed as follows: \$ 150 million by the U. S. Treasury; \$ 139 million by the Federal Reserve Banks; subscriptions by all participating banks to the extent of $\frac{1}{2}$ of 1 per cent of their total deposits.

The F. D. I. C., as distinguished from the temporary scheme, was to guarantee repayment in full of all deposits up to \$10,000 in amount and a minimum of \$10,000 in larger deposits. In addition to this, 75 per cent of the amount of a deposit exceeding \$10,000 but not exceeding \$50,000 and 50 per cent of the balance of any deposit over 50,000 in amount, were to be guaranteed. If the assets of the corporation were inadequate for meeting all the claims

arising out of the guaranteed deposits, the participating banks remained liable to pay an unlimited number of assessments of $\frac{1}{4}$ of 1 per cent of their total deposits.

While the temporary plan was characterised as a laudable attempt to stabilise the banking situation at the cost of an assessment not burdensome to the banks, there was loud opposition to the permanent scheme, and consequently, the life of the temporary plan was extended for another year.

The Banking Act of 1935 made the following important amendments in the plan.

(1) It provided that the temporary insurance funds should be consolidated into a permanent insurance fund and that the F.D.I.C. should operate from August 23 as a permanent plan.

(2) The insured banks instead of subscribing to the stock of the F.D.I.C. and of remaining liable to unlimited future levies should pay an annual assessment of 1/12 of 1 per cent of their total deposits (as distinguished from insured deposits).

(3) The maximum amount of the insured deposit of any depositor was reduced to \$5,000.

(4) The condition of membership to the plan was relaxed, it being limited to all banks

with average deposit of 1 million dollars or more.

(5) The Secretary was authorised to purchase any obligation of the F.D.I.C., and for this purpose was permitted to use the proceeds of the sale of securities.

The F.D.I.C. was criticised on several grounds. It was said that it penalised the strong banks by requiring of them the same contributions that it required of the weak banks. It violates the principle that premium should vary with risk. If the depositors were as safe in one bank as in another by reason of the insurance, they were most likely to go to the most liberal banks encouraging them to be even more liberal. This would mean slackness and absence of competition among the banks in granting loans. The careful banker would lose to the careless banker. It was also argued that a good and efficient banking system did not repuire any guarantee from the government, and that insurance of bank deposit is never a substitute for sound banking. The contribution by the insured banks meant a perennial cost to them without any material return.

The actual experience of several states also indicated that insurance of deposits reduces the vigilance of the depositors, and permits unsound bankers to practise risky banking without the

risk of frightening away their customers. The Corporation itself in its first annual report stated : "By the very fact that the Corporation offers security to depositors the force of local pressure for pursuing sound banking practices tend to be diminished. The natural tendency under deposit insurance would be downwards from even the distressingly unsound methods of 1929 rather than upward ;

Because of the Corporation guarantees many banks that were insolvent in effect were allowed to reopen after the bank holiday, and there was tremendous pressure on the authorities to admit these banks to the insurance scheme. It appears that the banking business is a business in nerves and the very fact that deposits are insured to the full extent is enough to inspire confidence in the minds of the depositors and prevent bank failure. In the absence of this confidence, every banker is always a bankrupt, for, it invests the major part of the deposits and keeps only a small part in cash ; and in case of a sudden run, no bank can meet.

The Corporation possesses wide powers relating to inspection of, and direction to, banks ; liquidation and action against them ; expulsion from the Corporation and direct mergers and amalgamations, as it desired. These powers are necessary in order to standardise efficiency and risk in the banks. In the absence of such powers no insurance scheme can work successfully. The F. D. I. C. has been functioning very successfully since its inception.

Assessment at the fixed rate of 1/12 of 1 per cent gave the F. D. I. C. an income of $904 million during the years 1935 to 1948. Investments and other income raised its total income to $ 1,148 million; and it incurred expenses of $ 83 million only during the period. With the inclusion of more and more banks and increase in, deposits, its annual assessment rose to more than S150 million a year, while its expenses amounted to not more than $5 million annually. In 1940 there was already some discussion about appropriation of the reserves which then amounted to S500 million. After the war,. in 1947 the U. S. Congress, at the suggestion of the F. D. I. C. enacted a law prohibiting further accumulation of reserves of the F. D. I. C., until the capital funds of S150 million subscribed by the Treasury and S139 million subscribed by the Federal Reserve Banks were repaid. The Corporation repaid the above capital of S289 million in 1948 and after the repayment, its reserves stood at S1,065.9 million. Investment of the amount yielded an

income much more than the annual expenses of the Corporation.

In 1949 Senator Maybank introduced a bill which provided for the repayment of the assessments paid by the banks in excess of the requirements of the Corporation. The annual expenses were to be charged against the annual collections and the balance to be refunded to the banks. It also provided for increasing the maximum limit of cover from $5,000 to $10,000.

The success of the F.D.I.C. is proved not only by its financial solvency but also by the conspicuous reduction in bank mortality. We have already observed that bank failures were frequent in America during the pre-F.D.I.C. period. Thus between 1921 and 1928, 5,214 banks failed. 659 banks failed in 1929, 1 350 banks in 1930 and 2,293 banks in 1932. On the other hand, since its establishment in 1934, up to 1959, it had to pay S343,000,000 to 1,400,000 depositors in 439 failing banks. This is really creditable.

The success of the F.D.I.C. should also be judged from the coverage it extends to banks. In 1934, 87 per cent of all the banks and in 1936, 43 per cent of all the deposits were insured. By 1958, the insurance fund amounted to $ 1965 millon and 57 per cent of al[l] the deposits of the country were insured. As re[g]ards the number of banks, as early as 1948, 9[?] per cent of all commercial banks were insured.

Structure of the U.S Banking System–The U.S. banking system possesses certain distinctive features. Large number of small unit banks, the limited growth of branch banking, the existence of an institution for insuring bank deposits, the decentralised system of central banking, advanced techniques of credit control, and the departmental store method of commercial banking are some of its interesting features. In the words of prof. Sayers (American banking system,p 1), "There is no nation-wide system of few great branch banks centred on a single pivot like the Bank of England. Instead there are some 14,000 commercial banks, the great majority of which have no branch office. Such branch banking as exists is on a very restricted scale, about half the branch offices being located in the same town as their respective head offices. In contrast to the single central banking institution which Britain and most other countries have there is a peculiar structure of twelve Federal Reserve Banks, though these are for the most important purposes now closely knit together by a central Board which, however,

its not in N w york, the main financial centre, but in washington, the political capital. The laws governing the operations of these banks are not confined to numerous elaborate Acts of the Federal Congress but have to be sought also among the legislative output of the forty-eight States." In 1951, there were 14,132 unit banks throughout the country with about 5,264 branches in all, the total number of bank offices amounting to 19,396.

Although unit banks predominate in U.S.A., there are three types of multiple office banking namely, branch banking, group banking, and chain banking. Of late several States are encouraging branch banking ·by passing laws allowing opening of branches by banks.

In States that do not allow branch banking, chain banking has developed.

Chain banking is a type of multiple office banking through which the operations or policies of a number of independently incorporated banks are controlled by one or more individuals through common ownership of stocks or interlocking of directorates. A chain generally includes five or less banks situated mostly in agricultural areas. There are about 115 chains at present.

Group banking is another form of multiple office banking in which independently incorporated banks are directly or indirectly controlled by a 'holding company'. At the end of 1950 there were 28 such groups controlling 367 banks with 1,019 branches spread over 26 states. The fear of monopoly has led to discouragement of group banking in recent years.

Banks are also linked together by the correspondent system "whereby surplus funds flow from the little county banks to large town banks and so ultimately to Chicago and New York, while, exceptionally, accommodation loans by town correspondents provide movement in the opposite direction".

The causes of this peculiar growth are partly historical and partly economic. The rapid growth of the country necessitating quick formation of banks, the settlement in the country by successive waves of immigrants from different parts of Europe, the dual control of the State and Federal legislatures over banks etc., are some of the economic causes. The horrible experience of the banking crises, the general American antipathy towards monopoly resulting in the so-called 'anti-money-trust' feeling, and the experience of early bank failures may be regarded as historical causes.

As the combined result of all these factors we find the predominance of unit banks in the country. In 1951, there were about 14,132 unit banks with 5,264 branches throughout the country. This figure again is the result of a considerable number of amalgamations and absorptions effected mainly to economise cost, extend branches, expand business, gain in prestige and avoid failure and prevent another 'bank holiday'. Thus in 1922 there were about 30,000 unit banks, the number falling to 26,000 in 1929, and to about 20,000 in 1933 after the 'bank holiday'. Since then amalgamations and absorptions have reduced the number to its present figure. Majority of the unit banks are small in size and situated in places with small population. The number of people served by a bank is about 8,000. The deposits of these banks range from $1 million to $5 million. They are incorporated under the Federal and different State laws.

Those chartered under the Federal law are called National banks, while those under State laws are called State banks. All are also known as member banks in relation to the Federal Reserve system.

American commercial banks render almost the same services as the English jointstock banks do. But the separation of 'commercial' from 'investment' banking appears to be only partial in U.S.A. The principal types of business are: "the lending and investing of money obtained through the receipt of demand and time deposits, keeping valuables in 'safe deposit', acting in various fiduciary capacities, and rendering subsidsary services to customers. The National banks are authorised "to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin and bullion ; by loaning money on personal security". They can purchase 'investment securities' for their own accounts, but are not authorised to underwrite issues of securities, except government securities, and invest in capital stock of companies. State banks carry on the same functions as those of the National banks.

"Broadly speaking, commercial banks serve as a depositary of the country's liquid resources, provide a mechanism for the prompt transfer and clearance of money claims, and furnish direct credit accommodation to various classes of borrowers through the deposit account mechanism. The credit activities of commercial banks not only serve the working capital requirements

of business and agriculture, but also now extend to the financing of fixed capital needs and real estate. However, banks are not allowed to acquire ownership in equities in business concerns, either for income or control, nor are they allowed to undertake the open market flotation of corporate securities. It is in this sense that 'commercial banking' has been separated from 'investment banking' "(Beckhart, p840.)

Some of the big commercial banks carry on foreign exchange business and have opened branches and correspondent relationships in foreign countries. They also hold investments in International banking institutions. The Federal Reserve Act authorises a member bank having a capital and surplus of $ 1,000,000 to establish branches in foreign counries.

Besides receiving money in Demand deposits and Time deposits from private individuals, business firms, Government agencies and from other banks, the main business consist of loans and investments. They make wide variety of loans such as, commercial, industrial and agricultural loans ; loans to brokers and dealers in securities ; real estate loans ; loans to other banks ; loans to individuals for various consumption purposes ; and term loans. Commercial and industrial loans form the largest of the loans.

Bank credit is granted in the form of advances against securities or discounts of promissory notes. The amount of overdraft is small. The borrower's account is generally credited with the amount of the promissory note or discount proceeds of the customer's paper, and he is allowed to draw against the credit balance. This is to be distinguished from the overdraft method where the amounts drawn are debited to the customer's account. Often the banks promise 'lines of credit' up to stipulated amounts without accepting any liability for failure.

As in other countries, the rates of interest vary with the size and credit worthiness of the borrower. The rate also varies slightly from region to region owing to slow mobility of funds.

Term Loans — Term loans are 'business' loans with an original maturity of more than one year, made for the purpose of financing intermediate capital needs of a borrower, and requiring periodic repayment of principal. These loans are granted for more than one year and usually up to five years either without security or against the security of bonds and stocks, machinery and epuipment, or even real estate. They are to be periodically repaid

in instalments, not necessarily equal, out of the anticipated income of the borrower.

These loans are granted for various purposes such as, to purchase machinery and equipment, to redeem debentures, to replace short-term credit, to avoid duties of capital issues, to redeem mortgages and to help simplifying dealings with a single bank rather than many.

Term loans form about one-third of the total loans of member banks. The bigger banks generally grant more of such loans than the smaller ones, which, however, are developing this business rapidly in recent years. Although large business concerns take the bulk of term-loans, the overwhelming majority of such loans are granted to small business concerns by banks of moderate size, and are for moderate amounts. Term loans are often syndicated, that is, shared by a number of banks or by banks and insurance companies.

Various factors have contributed towards the popularity of term loans. The traditional short term loans have failed to satisfy the needs of business in the era of mass production. The steady growth of insurance companies and other non-banking financial intermediaries providing long term credits compelled the commercial banks to enter the field for fear of losing business.

The establishment of different credit—reporting institutions has lessened the risk of long-term lending considerably. The anticipated income and instalment repayment system has increased the liquidity in such loans. The success of the F. D.I.C. has also contributed to the banks' dependability on such loans. Speaking on this point Mr.K.C. Mitter rightly observes: The term loans as are granted in U. S. A. have several useful features in regard to the maintenace of desired liquidity by banks. The instalment repayment of these loans, which is strictly enforced, provides fcr pericdic cash inflows not unlike the results of spaced series of short term loans. Modest holding of term loans therefore do not interfere with adequate liquidity protection provided the bank's portfolio contains short term open market securities and properly staggered short term loans with some additional margin to provide for planned conversion of assets into cash, with a view to meeting seasonal and other predictable requirments and unexpected drains of moderate size. Secondly, in most cases of short term loans, the borrower expects them to be renewed from year to year and unexpected withdrawal of the facility might affect the business adversely. And in the event of emergency the withdrawal of the facility by

number of banks might precipitate a liquidity crisis. The instalment of term loan is geared carefully to the anticipated income of the brrower, his needs, business prospects etc. and he is assured that there will be no call to accelerate payment as long as he adheres to the terms and conditions of the loan. In order to achieve the desired end, long term planning is necessary on the part of both the borrower and the bank, which contributes in some measure to the economic stability. Direct and intimate relationship continues between the borrower and the banker throughout the period of loan so that the banker is able to take prompt action in safeguarding his interests if new and unforeseen circumstances which affect the borrower's performance are encountered." (Banker vol. VII. No. 2. pp 89—90.)

'Industrial loans' are granted by the banks to business enterprises. They are repayable in fixed instalments. Generally secured by assets of the borrower and repayable within one to five years, they are usually granted for purchase of equipment and expansion and to serve as working capital. Credit worthiness and repayment capacity of the borrower are closely scrutinised.

Loans are also granted for construction

of buildings, purchase and preparation of buil-ding sites, purchase of houses already built, and for modernisation and repair of buildings. Construction loans are generally secured by mortgages of the land or building machinery, and are for short term. Some of these loans are guaranteed by the Vaterans Association or the Federal Housing Association.

Farm credit is also granted by commer-cial banks to a limited extent. Both short term and long term mortgage loans are granted to farmers generally in small amounts for meeting production and living expenses and purchase of equipments and livestock. These loans are guaranteed by the Commodity Credit Corpora-tion, an institution wholly owned by the Government.

Commercial banks situated in the finan-cial centres also grant a wide variety of secu-rity loans to brokers and dealers in securities and for carrying securities. "Brokers and dea-lers borrow from banks in order to finance their customers' purchases of securities, their own positions in securities, their purchasing and carrying of new security issues pending sale to investors, and the delivery or clearance of secu-rities traded." Brokers generally borrow for financing their customers in buying securities

on margin when the demands made by custo-mers for credit exceed their capital funds. As the dealers are required to make daily full cash payment for their purchases, they borrow in the form of 'day loans' payable on the same day, and secured by a lien on the securities.

Thus the bulk of the loans to brokers and dealers are demand or call loans, and in making such loans the banks are regulated by the Securities Exchange Act, 1934, which pres-cribed 'margin requirements; that is, the diffe-rence between the market value and loan value, in loans against securities, for the purpose of purchasing or carrying listed stocks. The margin requirements are varied from time to time by the F. R. Board which can even dec-lare 'no loan value' to prevent such loans.

Bank loans are often secured by ware-house receipts showing deposit of the commo-dities in a public warehouse. Field warehouses have been established where the farmer can deposit their harvests and obtain bank loans against receipts. Such loans are also granted against deposit receipts of industrial products.

Banks also grant loans against assignments of 'accounts receivable' to the borrowers. Only a certain percentage of the accounts receivable assigned to the banker is granted as loan.

Proper audit and investigation precedes granting of such loans.

Investments :— About 40 per cent of the investments is in Government, municipal and commercial marketable securities. The Federal Reserve Act authorised banks to accept bills drawn upon them, and made such accepted bills, called 'bankers acceptances', eligible for purchase by the Federal Reserve Banks. These 'bankers acceptances' have been very popular in U. S. A. like its London counterpart. Purchase of shares or stock is forbidden. A regulation of the Comptroller of Currency says that all securities purchased must be in the form of bonds, notes, and/or debentures. About one-fifth of the securities are Government securities; the rest first class commercial papers, bankers' acceptances, and others. As regards the deposits, about three-fourth of them are demand, and one-fourth time deposits of various periods of notice. No interest is allowed to be paid on demand deposits, and rates on time deposits are limited by law. Savings deposits also earn interest. The deposits are insured with the Federal Deposit Insurance Corporation under its rules.

Statutory Cash Reserves :- Legal reserve requirements have been provided for commercial

banks in the country. Member banks' reserve requirements are fixed by the Federal Reserve Board; and the requirements of non-member banks are fixed by the respective State Governments. Member banks must keep their entire reserves in the form of balances with the Federal Reserve Bank of the district. Neither vault cash nor balances with other banks will be counted. Requirements in different State laws vary from State to State. As we have already seen, the reserve requirements for member banks can be varied by the Federal Reserve Board of Governors. Distinction is made between time and demand deposits on the one hand and Reserve City, City and County banks on the other, for the purpose of reserve requirement.

The Specialised Credit Systems :— Specialised Credit Systems have been established in U. S. A. for providing different lines of credit. The following are important among them. The Farm Credit System is under the supervision of the Farm Credit Administration. The twelve Federal Land Banks; the twelve Production Credit Corporations; the twelve Federal Intermediate Credit Banks; the thirteen Banks for Co-operatives; and the Farm Loan and Production Credit Associations come under the system. These institutions grant or guarantee agricultural loans.

The Housing Credit System:— The Housing and Home Finance Agency includes the Home Loan Bank System; the Veterans' Administration; the Federal National Mortgage Association; and the Public Housing Administration. All these institutions either grant or guarantee loans for construction of houses and lands and equipments for the purpose.

The Clearing Houses :— In 1951 there were about 233 city clearing houses and 300 regional clearing associations throughout the country. Clearing houses are private associations formed for clearing and collection of cheques. Of late they have assumed a number of other functions such as, keeping informed of the condition of each of its members, issuing certificates to members in periods of crisis in exchange for promissory notes and other obligations, standardisation of banking practices, and solution of common banking problems. The regional clearing associations do not clear cheques but try for solution of their common banking problems and improvement of banking practices.

1913 Act recommendation of national commission.

Central Banking In The U. S. A.,

The Federal Reserve System— We have already seen that the Federal Reserve Act, instead of establishing a single central bank, provided for twelve Federal Reserve Banks in twelve districts into which the country was divided for the purpose. These F. R. Banks are central banks owned by the member banks and they form an intergrated central banking system. At the centre of the system, in Washington, is the Board of Governors with powers over the entire system. There is also the Federal Open Market Committee and the Federal Advisory Council. Under the twelve Federal Reserve Banks fall the Member Banks in the respective districts. The system is not directly under the Government Treasury or any other Government department but forms a separate agency of the Federal Government; and it reports directly to the Federal Congress.

We have already referred to the fuuctions and powers of the Board of Governors while discussing the different Acts. The Board of Governors is Composed of seven full-time members appointed by the President of the United States generally for a fourteen year term. Prof. Sayers divides the functions of the Board of Governors into three classes.

1. Regulation of central banking activities of the Federal Reserve Banks ;
2. General supervision of government of the Federal Reserve Banks
3. Regulation of certain financial transactions in the country ;

Powers relating to central banking operations—It has the final authority over the discount rate and other interest rates applicable to direct transactions between the Reserve Banks and the member banks. Its approval is necessary to any proposal of a F. R. Bank for changing discount rate. It can also direct a F. R. Bank to initiate changes in the discount rate. It can prescribe maximum limits of interest deposits. It prescribes and varies the legal reserve requirements for member banks. It also supervises the foreign exchange business of the F. R. Banks,

Supervision of government—It appoints one-third, including the chairman, of the directors of the Reserve Bank, and has to approve the appointment of officers to the F. R. Banks. It supervises the Reserve Bank's examination of the member banks.

Regulation of financial transactions It has to fix the margin requirements in loans against securities, as we have already seen. It also regulates hire-purchase transactions.

While the Federal Open Market Committee; consisting of seven members, has mandatory power to direct any F. R. Bank to engage in specified open market operations, Federal Advisory Council is without any executive functions, and advises the Board of Governors on the views of the member banks. Besides the above three bodies, the U. S. Treasury has the power to vary the price of gold ; alter the foreign exchanges and the currency basis of all Federal Reserve operations.

The Federal Reserve Banks :— Each F.R. Bank has nine directors of which the Chairman, Vice-chairman and one member are appointed by the Board of Governors of the System. The other members are elected. The main business of the Federal Reserve Banks are : to act as bankers' bank, rediscount eligible papers brought by the member banks, and to make advances to them and hold their legal reserves. A F.R. Bank purchases securities and provides clearing facili ties for its member banks. It issues notes and is required to hold a reserve of 25 per cent against its notes and deposit liabilities in the form of gold certificates issued by the U.S. Treasury in exchange for gold. It operates under the general supervision of the F.R. Board.

Member banks include all National banks and such State banks as have chosen to be members. While there are a large number of non-member banks, the member banks control more than 80 per cent of the country's deposits. A member bank is required to purchase shares of the F.R. Bank of the district equal to 6 per cent of its 'capital and surplus' and can vote in election of directors. It is under the control of the F.R. Bank.

The Federal Reserve Policy :— The objectives of the Federal Reserve Act are: "to establish Federal Reserve Banks to furnish an elastic currency, to afford means of rediscounting commercial paper, and to establish a more effective supervision of banking." In the words of Goldenweiser, 'the system was viewed originally as a provider of elastic currency and a dispenser of emergency funds to meet seasonal and other temporary requirements of member banks. It is for these ends that its operations are directed.

It was at first believed that change in monetary requirements would arise out of change in the volume of actual commercial

1961— O.M.O.

transactions which again would bring about appropriate change in the amount of commercial papers brought by the member banks for rediscount with the F.R. Banks and would automatically change the amount of Reserve Bank credit in the desired direction. Thus the regulation of discounting operation in commercial paper was regarded as most important. But in the beginning partly because of liquidity of the banks and partly as a matter of tradition the volume of rediscounting was very small, and the System thought it desirable to raise the reserve requirement and control the inflow of gold.

During the first world war, in trying to finance the Government, the F.R. banks sold bonds to the public and raised loans for the Goverment. After the war the prevailing inflationary situation had to be controlled in face of the desirability of keeping the interest rate low for the public debt. Interest rate was not raised, but the banks were asked to restrict credit for selected purposes. This selective credit control failed to control inflation and by 1919 the necessity of raising the discount rate was apparent. The desirability of maintaining the discount rate above the market rate was also felt. In May 1922 the Board of Governors appointed the Open Market Operations Committee to co-ordinate open market operations of the F. R. Banks and to see 'that the time, manner, character and volume of open market investments purchased by F.R. Banks be governed with primary regard to the accommodation of commerce and business and to the effect of such purchases or sales on the general credit situation.' Thus the two weapons were integrated for exercising restraint at times when business and speculative activity become excessive, and relax when depression approached.

From 1928 the security prices began to rise due to excessive speculation financed by bank credit. To stop the trend the System announced that it would deny rediscounting facilities to banks granting speculatve credit except as allowed by the F. R. System. This system of 'direct pressure' did not improve matters much and the discount rate was raised from 5 to 6 per cent at the same time the Bank's buying rate for bankers' acceptences was reduced from 5 1/4 to 5 1/8 per cent. This somewhat improved the situation. The great depression having passed, in 1933 the Act was passed. It empowered the System to prevent use of bank credit for the speculative carrying on of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance

of sound credit conditions.' The Securities Exchange Act of 1934 was passed empowering the Board to regulate margin requirements for purchasing and carrying on of securities or in selling them. This selective method of credit control had to be applied in order to curb speculative activities in the stock exchange while business in other fields was not to be disturded. In order to help liquidity of the banks in times of need, the eligibility control was somewhat relaxed by the 1935 Act which provided that "any Federal Reserve Bank may make advances to any member bank on its time or demand notes·······which are secured to the satisfaction of such Federal Reserve Bank. Though the provision applied only to advances, it was a fundamental one as this made all sound assets of member banks a potential basis of advances by the F. R. Banks. It also made it clear that granting of advances formed a part of the F. R. Policy. The Act of 1935 also gave the Board exclusive power over reserve requirements, mainly for enabling it to deal with the question of excess reserves. In 1936 and 1937 the Board raised the reserve requirement but pointed ont that "it was not the intention to reverse the policy of monetary ease which has been pursued by the System since the beginning of the depression. Rather it was an adjustment to a changed reserve situation brought about through the cxraodinary inflow of gold from abroad. While there was no evidence of actual excessive expansion in bank loans, the excess reserves provided the basis for such an expansion and it was considered far better to sterilise a part of the superfluous reserves while they were still unused than to permit a credit structure to be erected upon them and then to withdraw the foundation of the structure. At the time of taking action to increase reserve requirements the board announced that the Federal Reserve System proposed to continue its policy of exerting its influence towards the maintenance of easy money conditions for the encouragement of full economic recovery. Analysis indicated that reserves were not only large but well distributed so that all but a relatively small number of member banks were in a position to meet the increased requirements either by utilising their excess reserve balances with the Reserve Banks or by drawing upon their excess balances with correspondent banks."

When as a result of raising reserve requirements some banks wanted to sell Government securities for replenishing their reserves

the F. R. System announced that "with a view to (1) exerting its influence toward orderly conditions in the money market and (2) to facilitate the orderly adjustment of member banks to the increased reserve requirements effective May 1, 1937, the Open Market Committee of the Federal Reserve System is prepared to make open market purchases of the U. S. Govt. securities for the account of F. R. Banks in such amounts and at such times as may be desirable." In 1939 there was again some shift in emphasis, in use of open market operations, from their influence on member bank reserves to their direct influence on conditions in the capital market. It was decided that no useful purpose would be served by continuing to replace maturing bills for which there was a strong demand in the market. This did not reflect any change in monetary policy.

During the Second World War the System tried to maintain orderly conditions in the market for U S. Government securities and announced that "it stood ready to make advances on Government securities to member and non-member banks at par and at discount rate". This steadied the market for Government securities.

The increased war production and efforts

expanded the incomes of the population crea-
ting inflationary condition demanding restraint.
In Sept. 1941, the Board raised reserve require-
ments to the maximum permitted by law. Con-
sumer instalment credit was also regulated.
The interest rate policy became less effective
for, in financing the war, the utmost impor-
nce was devoted to the interest payable on
public debt. The need for minimising the
bank credit was considered more profitable for
keeping the interest rate low, and making the
war loan drives successful.

The treasury raised about 383 billion
dollars during the war years out of which
230 billion was by borrowing. Of this amount
about 194 billion came from the banking
system against Government securities. In the
process of discounting Federal Reserve holdings
of Government securities increased by 22 billion
dollars and indebtedness of member banks
declined by 5 billion dollars.

As a result of this war finance, serious
inflationary condition prevailed and rise in
prices could be halted by direct controls over
demand, supplies, and prices of goods and
services. Government's policy of debt redemp-
tion, however, lowered cash balances of mem-
ber banks thus checking further rise in prices

and further fall in long term interest rates.

The superabundance of money resulting from wartime growth and changing relation to national production had to be controlled without disturbing the security prices and the financial operations of the economy. The traditional weapons of credit control proved hardly sufficient for the purpose. Credit had to be made available for post-war production without making it more costly. In inflationary situation the long term interest rate has a tendency to decline unless it is checked by rise in demand for investments. Under the circumstances a flexible interest rate policy allowing some variation in the spread between, and levels of short-and long-term rates would alone help control the expansion of credit and prevent downward movement of the long-term interest rate. Substantial difference between the two again could not be expected to continue for long. The efficacy of tne flexible interest rate policy was thus limited. Consequently selective credit controls had to be tried.

During 1945, the Board made considerable use of regulation of margin requirements. To prevent inflationary effects on security prices the margin requirements were raised and held at 100 per cent and consequently dealings had to consumer credit shall be made available, such as the down payment required on instalment sales or financing and the length permissible for instalmet contracts. To provide for such regulation, by legislation which will contemplate the timely tightening and timely easing of such terms, will assist the overall program of stabilising the national economy at a high level of production and employment.

B sides the controls over stock market credit and over consumer credit, the Federal Reserve System introduced regulation of real estate credit and guaranteed certain types of bank loans against loss by the lender. First introduced to encourage war production loans, it has been used in the post-war years with success.

All the selective instruments permit their application in particular sectors where alone inflation and deflation are present. They can also be used to supplement the traditional weapons of credit control.

Federal Reserve Policy in Recent Years – In the middle of 1948, a mild inflationary policy was pursued as a corrective to the recessionary trend then prevailing. After the outbreak of the Korean war, inflationary pressure was experienced and money supply rose by 6. 3 per cent. In August 1949, a reversal of the liberal monetary policy was decided

V.R.R. in 1941 raised maximum
V.R.R. in 1951 — from 22, 18, 12 to 24, 20, 14.
VRR. in 1960 - from 16½ to 17½

upon and the discount rate of the Federal Reserve Banks was raised from 1 1/2 per cent to 1 3/4 per cent. Banks and other lending institutions were requested to restrict their lending and investment activities. Consumer credit was again regulated with mortgage credit for house building. These measures failed to stop expansion of bank credit to the desired degree. In December 1950 the following measures were announced : Effective in stages from 11 January 1951, reserve requirements on demand deposits were raised from 22, 18 and 12 per cent for Central Reserve City, Reserve City and County banks to 24, 20 and 14 per cent respectively, and on time deposits from 5 to 6 per cent for all member banks. Margin requirements for lending against purchase or sale of listed stocks by banks and brokers were raised from 50 to 75 per cent. Control of real estate credit was further tightened.

There was divergence of views between the Treasury and the Federal Reserve Board. The latter considered that to meet a situation of mounting inflation a rise in interst rate was necessary, while the former insisted on keeping the rate stable. The difference became apparent when in August 1950 the Treasury started refunding operations at the old rate while the

V.R.R. in 1913 — 18—15—12
1917 —

Board raised the discount rate from 1 1/2 to 1 3/4 per cent. To make the refunding operations successful, the Federal Reserve Banks bought the maturing issues and sold short dated ones at discount for firming up the interest rate structure. To help orderly condition of Government securities market the F.R. Banks made substantial purchases of Govt. securities. But the long term interest rate rose from 2.20 to 2.39 per cent during 1950. With the application of selective methods, there took place some ease in the monetary situation. To restrict credit further, the discount rate was raised from 1 3/4 per cent to 2 per cent in 1953. During the later half of the year, however, the inflationary pressure appeared to have receded and to ease the situation the F.R. Banks carried on open market purchases and reduced reserve requirements. The reserve positions of banks improved and some began to accumulate excess reserves.

In April 1954 the discount rate was lowered to 1 3/4 per cent, seeing the adjustment of the economy. It also made substantial purchases of securities and lowered the minimum buying rate for bankers acceptances by $\frac{1}{4}$ per cent to 1 3/4 per cent. To narrow down the spread between the discount rate and the short term money rates, the discount rate was further reduced to

$1\frac{1}{2}$ per cent. It also carried on open market operations. Towards the end of 1954 there took place an unprecedented boom in the stock market and the F. R. Authorities changed their policy from that of "active ease" to one of "less active ease." To discourage speculation, margin requirements on listed securities loans were raised from 50 to 60 per cent, effective from January 1955. During 1956 bank credit expanded by 9 per cent and cost of living index rose by 2 per cent. In 1957 there came a recession in the U. S. economy which, however, proved to be short-lived and revival came in 1958. During the recessionary phase the F. R. System found it necessary to supply additional reserves to the banks, but with the revival there was renewed concern about inflation and its restraint and monetary and credit policies accordingly adapted to meet the needs of the changed situation. As a result the index of wholesale prices remained stable throguhout the year.

During 1959, the policy of credit restraint was continued, but bank credit expanded by 14 per cent and the discount rate was raised to 3 per cent to check potential inflationary pressure. In May the discount rate was further raised to $3\frac{1}{2}$ per cent when the pace of business activity was quickening and bank credit was undergoing a rapid rise. It was raised to 4 per cent in September.

In 1960 the U.S.A. faced a recessionary tendency and a continued balance of payments deficit and the monetary policy was changed to one of ease. This led to interest rate differential resulting in large scale movement of short-term capital from the U.S,A. to Western Europe, specially to West Germany. The U.S. balance of payments showed an overall deficit. The authorities therefore faced the confronting objectives of correcting a domestic business recession on the one hand and a continued balance of payments deficit on the other. Its decision to follow the policy of ease resulted in the impact of the deficit in balance of payments being absorbed by its gold reserves which fast dwindled. The discount rate was lowered from 4 to $3\frac{1}{2}$ per cent in June, and further to 3 per cent in August. Effective July 28, the margin requirements were also reduced from 90 to 70 per cent. The reserve requirements were also relaxed from $17\frac{1}{2}$ per cent to $16\frac{1}{2}$ per cent in December for demand deposits of the Central Reserve City banks. In February 1961. the System carried on open market operations with a view to prevent further fall in short term rates and thus curb the flight of U.S. dollars to foreign countries.

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THE END.

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