The Control of Liquidity and the Radcliffe Committee

In the March 1960 issue of this review, A. Gambino gave an interesting account of factors determining the levels of bank liquidity, money and quasi-money in Italy. ("The Control of Liquidity in Italy"). However, in his opening remarks, Prof. Gambino linked his comments with the Radcliffe Committee's view that "it is the liquidity of the economy rather than the supply of money that the authorities should seek to affect by their use of monetary measures". Unfortunately the author's reference to the Radcliffe Committee's conclusion is not quite appropriate, and it implies a rather misleading picture of the Committee's thesis. The concept of liquidity used by the Committee is not the same as that explored by Prof. Gambino in the remainder of his article.

Gambino's starting-point is that the liquidity of the public does not consist wholly of money, in the sense of coin, bank notes and demand deposits. It also includes quasi-money, "understood as an asset capable of being rapidly changed into money without appreciable loss" (1). He views liquidity as a stock or supply of assets, and offers fairly precise measures of the liquidity available to both the public and the banking system in Italy.

The Radcliffe Committee also took account of both money and quasi-money in their survey of liquidity. This, however, was not the point of major difference between their approach and the traditional one, and their concept of liquidity included certain other elements that fall outside the scope of Gambino's article. Although (as the Committee's critics have emphasized) they did not define liquidity very precisely, it is fairly clear that they used the term to refer to a state or condition, not to a definite body of assets. They gave particular attention to "the ease or difficulty encountered by spenders in their efforts to raise money", and treated this as an important constituent of liquidity (2). Moreover, when they did turn their attention to liquid assets they were concerned not only with the assets of the public and the banking system, but also with a wide range of other financial institutions that they regarded as an integral part of the monetary system.

(1) *Banca Nazionale del Lavoro Quarterly Review*, March 1960, p. 3.

(2) *Report of the Committee on the Working of the Monetary System*, Cmnd. 827, paragraph 389.

The contrast between Gambino's approach (as expressed in his article) and the Committee's can be expressed in another way, in terms of what they were attempting to do. Gambino was attempting to measure the monetary situation at a given time, and to measure the impact of central banking policy, the behaviour of the banks and other forces on that situation. The Committee were interested less in monetary phenomena themselves than in the monetary determinants of spending in the economy, and the ways in which the authorities might be able to influence spending through monetary policy (3). The term "liquidity" as used by the Committee was not a precise theoretical concept. It was rather a short-hand summary of the monetary conditions (or, more broadly, the financial conditions) that influence spending.

In so far as there was a novel element in the Committee's thinking about these matters, it did not lie in the inclusion of quasi-money as an important determinant of spending. It lay in a stress on access to borrowed funds and to the capital market, and a relative neglect of changes in interest rates and changes in the supply of money (or quasi-money) as decisive factors in the situation. In their concluding remarks on monetary policy, the Committee did give a certain weight to interest-rates, but not as a deterrent to borrowing. They acknowledged that the volume of money and of quasi-money was an element in liquidity, but they discussed it much less fully than the ability to borrow, which they appeared to regard as the really decisive element and as the element at which policy must strike (4).

The Committee arrived at this conclusion by asking what are the sources of funds available to the person or corporation who wants to spend (5). (This notion of "the sources of funds", which has a recognized place in accountancy and in the analysis of company accounts, is perhaps the best short summary of what the Committee meant by liquidity). No doubt cash in hand must be included among these, as well as assets that can be "rapidly turned into money without appreciable loss", and expected flows of income. The Committee duly noted

(3) *Ibid.* ,paragraphs 382-383.

(4) *Ibid.*, paragraph 397.

(5) *Ibid.*, paragraph 316.

these, but they were more impressed by the various sources of borrowed funds (including the capital market) that are available, in the economy. They were impressed, too, by the extent to which one source of borrowed funds can be substituted for another, so that if bank credit is unavailable a frustrated borrower may be able to obtain credit in other ways, e.g. by long-term borrowing on mortgage from an insurance company, by the issue of securities, or on hire-purchase. They argued that a loan that does not add to the supply of money gives just as great a stimulus to spending as does a loan made by a bank.

A large part of the Committee's report was therefore taken up firstly with a description of the activities of the complete range of financial institutions in Britain, and secondly with a discussion of the methods that might be used to influence the institutions' ability and willingness to lend. This discussion included detailed comments on the control of bank liquidity and bank lending, but the Committee stated very firmly that they gave special attention to the banks not because banks create money but because "they are the biggest lenders at the shortest (most liquid) end of the range of credit markets" (6). The Committee considered it hardly less important to influence the behaviour of other institutions that might serve as alternative suppliers of credit. For technical reasons they concluded that in normal circumstances debt management, and in times of emergency a set of direct controls, would be the most effective measures for the purpose. The tendency of their argument was to allow central banking policy a relatively minor role in monetary policy and the monetary situation as a whole.

It should now be clear that the subject-matter of Gambino's article is very different from the "liquidity" that the Radcliffe Committee regarded as the proper concern of the monetary authorities. For Prof. Gambino liquidity is a stock of assets, but for the Committee it was also access to a flow of funds from a variety of sources. A possible link between the two is the influence of the size of this particular stock of assets on the lending policies of financial institutions other than the banks. As it happened, the Committee devoted little or no space to this question. They assumed that willingness to lend varies mainly with changes in the values of certain of the capital assets held by the institutions, and that capital values are determined especially by

(6) *Ibid.*, paragraph 504, cf. paragraph 395.

interest rates (7). Their view of the relationship between interest rates, capital assets and lending policies was based on their study of the recent behaviour and the balance-sheet structure of the complex of British financial institutions. This point, while it is obvious enough, serves as a warning that it may be dangerous to attempt to use the conclusions or recommendations of the Committee as a guide to policy or even to analysis in other countries.

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(7) *Ibid.*, paragraph 393.