Credit Control in the Netherlands

by

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As is known, Holland's banking system consists of: (a) the *Bank of issue,* the Netherlands Bank, since 1948 a state-owned corporation; (b) *deposit banks* (limited companies operating in the field of short term loans to business and investments in the money market); (c) *cooperative agricultural banks* (united in two important groups, accepting sight and savings deposits and supplying both short and longer term credit, investing the remainder of their assets partly in the money market, partly in the capital market); (d) *institutional investors* (savings banks, mortgage banks, life insurance companies, pension funds, and the large semi-Government Netherlands Reconstruction Bank) which operate in the capital market and also supply important long term loans to industry and housing.

Relations between the Netherlands Bank and the banking system.

Before the war the Netherlands Bank, then a private bank of issue, exercised indirect control on the monetary situation in the orthodox way, *i.e.* by its position as lender of last resort through discount policy, open market operations, and « moral suasion ». The Bank had no legal ascendancy over the banking system.

Since the thirties — during which critical period no banking crisis occurred in the Netherlands — regular contact between the Central Bank and the banking system became closer. In 1933 the larger banks agreed to supply quarterly statements of their balance sheets to the Netherlands Bank.

A) In 1945 the relations between the Netherlands Bank and the banking system entered a new phase, as in the course of the money purge the Bank was charged with *temporary* credit control. This control was concentrated on *qualitative lines until the end of 1950, when qualitative restrictions were dropped and replaced by more effective quantitative ones.* To these controls the deposit banks and the agricultural banks, the so-called « money-creating institutions », only have been subjected. The institutional investors have not been interfered with, and until recently they have been encouraged to extend more direct loans to business.

In 1945 the granting of bank advances was licensed under the following provisions:

(a) no advances were allowed if the prospective borrower owned readily marketable securities;

(b) stock exchange advances and loans for speculative purposes or for consumption were prohibited;

(c) short term advances for trade and production were allowed without special license up to fls. 50,000 per debtor;

(d) advances of fls. 50,000 and over were subject to approval by the Netherlands Bank; approval was to be witheld in the case of advances for investment in equipment;

(e) banks were requested to restrict credit for unessential purposes.

The qualitative credit restrictions of 1945 have had some psychological effect, but in practice the Netherlands Bank has hardly ever refused approval for advances the banks were prepared to grant (for reasons to which we shall return). The restrictions therefore were not stringent, with the exception perhaps of the ban on stock exchange credit.

B) The system of control was extended and improved in 1946, when a Gentlemen's Agreement was stipulated between the Netherlands Bank and the *more important banks*, under which:

(a) banks agreed to supply the Netherlands Bank with all particulars it needs for supervising the banking system (and to permit the relative necessary investigations), as well as with monthly statements of their situation and annual balance sheets and profit and loss-accounts;

(b) banks undertook to inform the Netherlands Bank of credits opened of fls. 1,000,00 (1) or exceeding 5% of their capital (2);

(c) the Netherlands Bank was authorized to contact individual banks should it notice developments it deems undesirable.

This Agreement still exists and is working smoothly. Personal contact is easy as most large banks are situated within walking distance of the office of the Netherlands Bank. It should be remarked that the *smallest* banks have not signed the Agreement; their quantitative importance is not large, but from the point of view of quality some of them are much weaker than the banks which joined the Agreement.

C) In 1948 the shares of the Netherlands Bank were vested in the Government (3), and its charter was reconstructed upon more ambitious lines.

The tasks of the Bank are outlined in art. 9 of its charter (Bank Act, 1948), quoted in the footnote (4), where « supervision over the credit system » is emphasized (par. 3 and 4).

Lastly, in conformity with par. 4 of said article, a bill of a full-fledged banking legislation was submitted to Parliament, containing both control on individual banks for the protection of depositors and various kinds of general monetary controls for coordinating the credit policy of the banks with the monetary and financial policy of the Government. In practice, however, up to now everything has remained as it was; the further legislation anticipated for detailed supervision of the banking system has yet to be approved, and emergency decrees, as provided for cases of undesirable developments harming either the soundness of banking system or the interests of the customers of individual banks (see footnote 4, par. 4), have not been found necessary.

Broadly speaking the monetary influence of the Netherlands Bank is mainly restricted to the money market. The capital market is hardly interfered with, with the exception of a mild control over the issue of shares and bonds (5). Of course the debt policy of the

(1) Fls. 1,000,000=abt. US $ 263,160 and abt. Lst. 94,000.

(2) At first sight this may seem unnecessary as under the 1945 arrangements advances of fls. 50,000 and over were already subject to the approval of the Netherlands Bank. But in practice it worked out differently. The Gentlemen's Agreement of 1946 is a permanent agreement between banks and the Netherlands Bank (in its quality of Central Bank) enabling the Bank to secure information about the position and policy of each individual bank. The 1945 regulations were temporary and would lose their validity with the liquidation of the Money Purge. Furthermore, credits over fls. 50,000 were subject to permits of a special office of the Netherlands Bank (in its capacity as agent for the Government); and bankers prefer keeping the proper function of the Central Bank and the functions of the Government Agent well separated from each other.

(3) The Bank remains a limited company, managed by a Governing Board under the supervision of a Board of Commissioners and a Royal Commissioner and a Bank Council. The members of the Governing Board are appointed for seven years. The Finance Minister is authorized to issue such directions to the Governing Board as he deems necessary in order to coordinate the monetary and financial policy of Government and Bank. If the Governing Board should object to follow these directions the Crown will decide whether they have to be followed, and if the Crown confirms the directions, its decision is to be published together with the objections raised by the Governing Board. If then the Governors still refuse to comply they can be removed from office.

(4) *Article 9*:

1. It shall be the appointed task of the Bank to regulate the value of the Netherlands monetary unit in such a way as is deemed most conducive to the welfare of the country, and therewith to stabilize that value as far as possible.

2. The Bank shall provide for the monetary circulation in the Netherlands as far as this circulation consists of bank notes, it shall facilitate the use of bank money in the Netherlands and shall promote the settlement of payments to and from foreign countries.

3. The Bank shall exercise supervision over the credit system.

4. *Awaiting the passing of an act regulating the supervision over the credit system*, we reserve the right, whenever urgent circumstances do so require and after having consulted the Bank Council, to issue by decree further regulations under which the Bank shall exercise such supervision in the interests of the solvability and the liquidity of the credit institutions and in order to promote a sound credit policy. If and when such decree shall have been promulgated, a bill will be introduced as soon as possible to sanction its contents by law.

(5) Before handling issues of shares or bonds, bankers and stockbrokers are to enquire whether the Netherlands Bank has any objections. The formalities are very simple: usually a condensed balance sheet and a statement of the purpose of the issue are sufficient. Against reasonable propositions of domestic business and public authorities the Bank raises no objections; towards issues of foreign bonds a more critical attitude is taken with a view to their repercussions on the balance of payments. As the capital market has markedly tightened recently, a more restrictive attitude towards issues is not improbable, if the unfavourable state of the market is not a sufficient deterrent to intended issues.

Treasury is one of the most influential factors in the capital and money markets.

Monetary developments after the war.

In 1945 the large amount of floating domestic purchasing power accrued during the war was about halved by a Money Purge. Nevertheless, during the first post-war years spending by the general public was restricted — as is known — through physical controls, mainly consumer rationing, investment restrictions, allocations of raw materials, foreign exchange control and restricted and often bilateral foreign trade. And « suppressed » inflation coupled with cheap money (6).

When however in 1949 most of the internal physical controls were abolished and when in 1950 the restrictions on inter-European foreign trade were removed, the domestic monetary situation regained its direct importance for the problem of the heavy deficit in the balance of payments. The excessive financial liquidity of business and consumers allowed them to spend much more than their current income, and many durable goods were bought the purchase of which had been postponed in earlier years on account of lack of supply. Business availed itself of the opportunity for increased replacement of obsolescent equipment and to rebuild depleted inventories. The coincidence of Korea with inter-European liberalisation added to the buying spree.

In consequence the domestic bank balances of consumers and the business world contracted, whilst at the same time increased use was made of credit facilities granted by banks. In other words, the fact that money was not scarce enabled the domestic community to spend beyond its current income and thus enlarge the deficit on foreign payments. Indeed this deficit exceeded fls. 1,000 millions for 1950. It was covered by the available E.C.A. grants and other reserves, but a repetition of the same performance in 1951 had to be prevented. Not only would American aid be sharply reduced in 1951, but a greater part of available resources had to be reserved for rearmament; and so spending by the private sector of the economy had to be curbed.

Tables I and II show the expansion of credit in 1950 and the contraction of the money circulation. As can be seen, « cash » and other « liquid assets » of the commercial banks shrank by 697 millions during 1950 (—17.7%; from 3939 to 3248 millions of guilders), while « credits to clients » rose by 197 millions (+18.8%; from 1050 to 1247 millions of guilders). On the other hand « cash » and other « liquid assets » of agricultural credit banks shrank in the same year by 223 millions (—30.1%; from 747 to 518 millions of guilders), while « credits to clients » and securities rose, as a whole, by 253 millions (+21.2%; from 1194 to 1447 millions of guilders).

Taken together, the Tables roughly explain how the deficit on the balance of payments was reflected in the domestic monetary situation.

(6) The Treasury maintained its low interest policy in the post-war years when there was not much competing demand by business for loans and advances, as long as the physical volume of business remained below the pre-war level. The Treasury borrowed at 3-3¼ percent for long term bonds and also financed to a large extent with 1 year Treasury notes at 1½ percent and some 3 and 5 year bonds at slightly higher rates. These short term Treasury securities were sold on tap, mostly to the banking system.

The *official discount rate* for bills remained at 2½ percent until September 1950.

TABLE I

EXTRACT FROM COMBINED FIGURES
OF 42 (COMMERCIAL) BANKS
(in millions of guilders, as for December 31st)

	1946	1947	1948	1949	1950
Cash, balances with Netherlands Bank, etc. . .	223	231	207	222	214
Netherlands Treasury Paper	3,357	3,785	3,517	3,596	2,933
Other short term Government Paper	84	111	170	121	101
Cash and Treasury, etc. .	3,664	4,127	3,894	3,939	3,248
Advances, loans, bills, etc.	700	799	870	1,050	1,247
Total	4,364	4,926	4,764	4,989	4,495
Credit balances in guilders	3,575	4,018	3,866	3,858	3,382

TABLE II

EXTRACT FROM COMBINED FIGURES OF AGRICULTURAL CREDIT BANKS

(in millions of guilders, as for December 31st)

	1949	1950
Cash, balances with Netherlands Bank, etc.	41	42
Netherlands Treasury Paper	452	238
Other Government Paper	65	73
Deposits with Treasury	183	165
Cash and Treasury etc.	741	518
Securities	395	453
Advances, loans, bills, etc.	799	994
Assets in guilders	1,935	1,965
Savings deposits	1,538	1,547
Current account deposits	293	275
Credit balances in guilders	1,831	1,822

A very interesting complete explanation of domestic money creation and cancellation during 1950 is to be found in the 1950 *Report* of the Netherlands Bank (7).

Given the existing liquidity of the banking system, there was no actual check on credit expansion; at the end of 1950, about 60% of total assets of all commercial and agricultural banks consisted of cash and practically liquid assets, mainly short term Treasury securities.

Under these circumstances, in the fall of 1950 the Netherlands Bank decided on measures to curb a possible further outburst of credit. The Bank pointed out that a reasonable credit-expansion was warranted by the increase of production, but that such expansion would have to be orderly and kept within bounds. On the other hand, a continuous expansion of credit with the same speed as in 1950 was not expected, as the first expansion was for a substantial part explained by rebuilding of stocks, a process that would come to an end and perhaps be reversed later on. A mild restriction of bank credit was deemed sufficient for the moment.

(7) See especially Table 25, p. 43; and also Chapter IV (pp. 63-73), where the significance of credit expansion for the balance of payments is thoroughly discussed.

Incidentally the figures of Table I show a large surplus of assets over debts for the commercial banks, indicating the strength of their capital and reserves, whilst it must be borne in mind that the agricultural banks are cooperative, and find their strength not in their capital but in their members.

Individual qualitative restrictions replaced by a more severe policy of aggregate quantitative control.

Qualitative restrictions were quietly dropped, and the emphasis was shifted to the selective influence of a rise in interest rates and to a complex system of legal « ratios ». The fundamental weakness of qualitative restrictions appears to be that at unduly low interest rates there may be an excessive demand for advances, each of which is above reproach as to quality; in this case qualitative selection is impossible and does not produce the required curb on credit.

The only remaining official qualitative restriction was the ban on stock exchange advances; restrictions on consumer credit, advances for investment in equipment and mortgage credit being superfluous as banks in the Netherlands have always refrained from such « doubtful » bank advances. This point we would like to stress; if a banking system traditionally restricts itself to short term advances for financing stocks and debtors (working capital) there is no practical scope for effective qualitative control.

As there was no scope for qualitative selection there was no room for credit-rationing either; any fair system of rationing assumes a standard of priorities which the Bank was unable to provide. The only remaining solution was chosen by the Netherlands Bank; an induced rise of interest rates which it was hoped would check the rising demand for advances.

In fact, the restriction policy started by raising the discount rate of the Netherlands Bank from 2½ percent to 3 percent in September 1950, followed by another increase to 4 percent in April 1951 (8).

(8) In June 1951 the prevailing rates of interest were:

discount rate	4	percent
commercial bank advances (abt.)	6	»
mortgages and long term industrial advances (abt.)	4½-5	»
shares, average dividend rate (abt.)	5	»
1 year Treasury Notes	1½	»
long term Government bonds (abt.)	4	»
interest rate on bank deposits (abt.)	½	»
interest rate on time deposits (one year) (abt.)	1½	»
interest rate on savings deposits (abt.)	2½	»

Of course the discount rate was ineffective as long as banks were so liquid that they did not need to borrow from the Netherlands Bank. The figures of the Table I show that at the end of 1950 no less than 70 percent of the assets of the commercial banks consisted of liquid and near liquid assets. The large holdings of one year Treasury Notes were such as to enable banks to finance a large credit expansion simply by not reinvesting in Treasury Notes on redemption dates.

In order to make the discount policy of the Netherlands Banks effective, and to force banks to raise their rates on credits, a complex scheme was devised for more or less freezing the existing holdings of Treasury paper of the banking system.

Credit restriction mechanism effective as of January 1951.

The system chosen (9) does not imply a real rationing of credit, but it makes credit dearer and ties bank interest rates to the discount policy of the Netherlands Bank. Its essential features are: banks are compelled to hold large amounts of liquid assets, in effect mainly Treasury Notes. If banks want to expand credit they will have to borrow the additional funds from the Netherlands Bank, as their liquid assets are more or less frozen. This has the double effect that the cost of granting credit becomes higher for banks (for instead of foregoing 1½ percent interest on Treasury Notes sold, they will have to borrow money from the Central Bank at 4 or 4½ percent) and that bankers are subjected to the psychologically disagreeable experience of becoming dependent on advances from the Netherlands Bank.

A) *Commercial banks.*

The new and complicated system prescribes — as a fundamental rule — that the banks are to hold an amount of *cover* in perfectly or highly liquid or « Treasury » assets (10) equal to at least 40% of the *credit-balances* (11) in their books. If a bank does not meet this requirement it is put under detailed control by the Netherlands Bank. As a matter of fact, only small banks fall under the latter category, and the result will probably be that they will either reduce their business or sell out to larger and stronger banks (12).

This requirement, which would have had no effect upon banks in a highly liquid position (13), was supplemented with an alternative obligation. The banks not only have to observe the requirement of a *minimum cover* of 40%, but they must also comply with *at least one of the two following standards*:

1) The first is a special form of « *historical cover* ». For each bank a « *historical* » *basis* is found in the average of its actual balance-sheet figures on June 30th and December 31st, 1949. Now, against the « *basic* » amount of credit-balances (average for 1949) at least 90% of the « *basic* » amount of cover is to be held; if actual credit-balances are higher or lower than in 1949 the prescribed amount of cover is increased or decreased by 2/3 of the difference. Therefore if the deposits with a bank increase by fls. 3,000,000, fls. 2,000,000 have to be added

(9) The new regulations were issued by the Netherlands Bank under the authority contained in the emergency legislation for the 1945 money purge. The intention however is to base credit restrictions on new legislation recently drafted but not yet passed.

(10) The *Cover* consists of:
— cash and notes;
— balances with the Netherlands Bank, postal and municipal checks, domestic and foreign bankers, money lent on call (net of that taken on call);
— Netherlands Treasury Notes and Bonds (1, 3 and 5 year terms);
— short term securities of other Public Authorities.

(11) *Credit balances* are the total of:
— time and sight deposits;
— balances with other bankers (*loro* only);
— money taken on call (net of that lent on call);
— debts to overseas offices;
— other credit-balances.

(12) At the end of each month a detailed monthly statement is drawn up by each bank, being an extract of its balance sheet containing guilder-assets and liabilities and a few weeks later that statement is handed in to the Netherlands Bank.

All regulations are based upon this statement.

(13) For example, at the end of February 1951 the holdings of short term securities of the leading commercial banks amounted to 63% of their total assets.

to its cover and fls. 1,000,000 remain available for advances (14).

2) *The alternative standard is debit-accounts*: the total of debit-accounts may at most exceed by 5% the figures of September 30th, 1950. This relates to the total of: bills and promissory notes (exclusive of those grouped as cover); loans and advances (inclusive of those to participations and overseas offices).

If a bank falls short of both these standards it is required to *borrow* the amount of the *smaller of the two shortages* from the Netherlands Bank, for the duration of the month following that in which the statement has been handed in, debited to a special account. The borrowed amount is deducted from the amount of cover held. The possibility of appealing to the Central Bank for investments in excess of the prescribed limits, is excluded when the liquidity cover falls down to the minimum percentage of 40.

Thus, generally speaking, banks remain free to grant as many advances as they want, *provided* they pay the « penalty » of borrowing from the Central Bank and the amount of the cover in liquid assets is not less than 40 percent of the deposits. « Except by complying with the above mentioned rules, commercial banks can only grant credits or authorize disposals over outstanding credits after a license has been granted by the Netherlands Bank » (15).

B) *Cooperative agricultural banks.*

These banks, established on the Raiffeisen-system, are federated in two groups, each with a central bank, with which the member banks deposit their uninvested funds. The same regulations as those for commercial banks hold good for these central banks with the exception that they are exempted from the minimum requirement of 40% cover. That is, presumably, because a substantial part of their assets is invested in government bonds and fixed term loans to public authorities and the larger part of their credit-balances are savings deposits.

The member banks of both groups (the more than 1300 local cooperative agricultural banks) are subject to quite simple regulations. Their « debit-accounts » may exceed those of September 30th 1950, by 5%, or if the credit-balances on their books have risen since that date, their debit-accounts may rise by 1/3 of that increase. If their actual accounts are higher (which will generally mean that they have made more advances), they must borrow the amount of the excess from the Netherlands Bank, through the intermediary of the central bank of their system.

Developments since the introduction of the new measures and present prospects.

As already mentioned, the new measures made credit dearer, but not scarcer, as banks could borrow the necessary funds from the Netherlands Bank, ample cover being available as collateral. The increase of interest charges from about 5 to about 6 percent did not do much to deter the customers' demand for credit; and indeed interest charges do not matter much on a profitable deal since taxes on profits absorb half the net returns of the businessman.

The still increasing demand for credit — during a period of rising prices and stockpiling —was easily met by bankers, as the figures in Table III show.

As can be seen, there is not much difference between the slightly rising tendency before and after the new regulations.

(14) This facility is likely to affect the bank policy for deposit rates of interest in order to increase time accounts. At the end of 1950 firms and institutions outside the banking world held no less than 40% of the total volume of short term Treasury securities. The profit on advances enables the bank to offer an interest rate for marginal time deposits slightly higher than the 1¼% fixed for Treasury Notes. In as far as a higher interest rate succeeds in inducing non-bank holders of Treasury Notes to convert such investments into time deposits with banks, the latter can at the same time enlarge their cover and extend more advances, whilst complying with restriction regulations.

(15) *Report for the year 1950*, by the Netherlands Bank, p. 82.

Of course, in the long run, simple and definite cover ratios for banks of the same category would be preferable, but the emergency required that all banks should feel the restriction more or less immediately; therefore the restriction was based on each bank's situation in 1949. On the other hand, the new measures may be considered as transitional regulations. « As soon as the draft bill which is now being prepared, for the further regulation of the credit system, has become law, they will be given a more durable character, whereby the experiences gained during the operation of the present regulations will be taken into account » (Report by the Netherlands Bank, cit., p. 83).

Table III

EXTRACT OF FIGURES OF THE « BIG FIVE » COMMERCIAL BANKS

(in millions of guilders)

	Advances to debtors	Treasury Paper	Creditors and Depositors
1949 December 31st	609	2,786	3,544
1950 June 30th	706	2,644	3,369
1950 December 31st	798	2,322	3,249
1951 April 30th	910	2,252	3,226

Local public authorities however were hit hard. For one thing, bankers had to raise their interest charges to them previously near the discount rate of 3 percent to 5 percent and over, and even then were reluctant to renew such advances. Local public authorities again tried to cover their financial needs on the capital market, but without any success as they were tied to the interest policy of the Treasury which did not allow borrowing at more than 3½ percent, although market rates were approaching 4 percent. In consequence the Treasury was obliged to extend further advances to local authorities.

But the restriction policy announced had very important indirect results also on the capital market.

In this connection it should be remembered that the restrictions under consideration are limited to the banking sphere. The increase of bank rates made long term loans from institutional investors relatively more attractive to business. Moreover many business firms, foreseeing a gradual tightening of bank credit, hurried to obtain long term advances from institutional investors and mortgage banks. The pressure of the demand for credit was therefore shifted to the capital market.

This process by which the institutional investors took over part of the credit business of the banking system was already the main structural development in the financial system before restrictions were introduced. To some extent long term loans fill the needs of ever expanding industry better than short term bank loans. The institutional investors are gradually learning the tricks of financing business, and there is nothing to prevent them from passing from long-term to variable loans, akin to current account advances, the holding of bills and perhaps short term promissory notes (16). There is a wide field in which banks and institutional investors can compete, and in which the competition between bank rates and capital market rates decides which institutions will be applied to for advances.

In fact, the institutional investors were those who experienced the highest increased demand for credit, even before and especially after restrictions. In order to meet this demand they had to reduce their holdings of Treasury securities, and these could not be absorbed by the banking system. So, in a roundabout way, the credit demands of business were met by, and the pressure was passed on to, the Treasury.

Especially in the second quarter of 1951 the institutional investors ran out of funds available for investment. Consequently, a small Treasury funding operation at 3½ percent interest in the spring of 1951 failed, and interest rates in the capital market rose to 4 percent for gilt-edged.

The Treasury did not repeat its funding effort at a higher rate of interest, and consequently had to borrow from the Netherlands Bank. The circle is now complete; at the end, the pressure placed on the banking system reacts on the Netherlands Bank itself.

One of the aspects of the restriction scheme is that it appears like an attempt to create a dual money market: a privileged and cheap one for the Treasury and a hampered and dear one for business. But we may say that a dual-interest policy, low interest for the Treasury and high interest for business, is incompatible with stringent credit restriction, as there are too many connections between the money and the capital market. Unless, indeed, the capital market too were subjected to appropriate regulations.

In any case, in our opinion, the most valuable result of credit restriction is that it has curbed investment in durable goods. At present

(16) Life-insurance companies are subject to no other controls than the supervision of the Chamber of Insurance, which looks after the protection of the interests of policy holders. No objections would be raised against ways of investment that are commercially sound, even if they are not orthodox.

there are especially the house building program and public utilities that suffer from the shortage of money.

The new system of credit control could not fail to arouse keen reactions in banking circles.

It has been noted that credit restrictions should be aimed at non-essential credit (consumer credit, stock exchange credit) and long term credit (housing finance, mortgage credit and equipment loans). In countries where the banking system supplies these kinds of advances, a restriction of bank credit may be advisable. Whereas in the Netherlands, where the banking system confines itself rigorously to suplying working capital to firms, restrictions should not be directed on the banks, but on the long term lenders.

Of course every central bank should watch, influence, and in some cases control the creation of bank-credit. But the part bank advances are playing in the total credit mechanism should not be overrated; its importance is declining in industrialized countries. « Self-liquidating » commodity credit is a suitable object for general deposit banks, but in recent years semi-permanent industrial loans supplied by institutional investors are becoming much more important. The Netherlands Reconstruction Bank, a semi-official institution for development loans, estimated that in 1950 bank advances to industry increased by 160 million guilders whilst loans from Government and various institutional investors to industry increased by 361 million guilders. These two figures demonstrate the relative importance of short term credit and longer term credit for business expenditure. There is a fundamental contradiction in the policy of the Netherlands Bank, restricting bank credit for monetary reasons, and the Government, promoting longer term advances to promote industrial expansion.

In consequence of the low interest policy of the Government, the banks in the Netherlands were holding large amounts of Treasury paper. The recent cover regulations are more or less freezing these holdings by cover ratios up to 90% for the biggest and soundest banks. Such percentages nearly sterilise the banking system and degrade its main function to that of gathering money for the Treasury, whilst any credit expansion is mainly financed with loans from the Netherlands Bank.

Moreover the bankers feel they have not much influence on the volume of bank credit available for working capital, owing to the expanding activity of institutional investors in the field of industrial advances; and they very much dislike being singled out as the « object » for restrictions and cover-regulations, whilst the institutional investors remain entirely free to stimulate real investments through their uncontrolled loan-policy (17).

So much for the objections that might be raised against any system of restriction of *bank* credit in Holland. There are also specific objections against the system adopted at present. Its standards are not in keeping with those of a sound bank policy. All kinds of assets and liabilities of varying degrees of liquidity are lumped together, and ordinary principles of liquidity are neglected; so also is the overriding consideration of risk, and the relation between total credit engagements and a bank's capital and reserves. One should not however expect perfection in a scheme devised at short notice and primarily intended to give immediate results. No doubt it will be gradually improved as experience is obtained.

(17) Incidentally, this might promote new forms of co-operation for credit operations and affect the technique of financing. Indeed, in recent years the method of financing business through bankers' acceptances discounted with non-banking firms was seldom used, as current account advances from banks were in ample supply. If bank advances become scarcer the advantages of the bill of exchange as an instrument of business finance become more apparent, because they find a wide market outside the banking world. Therefore, in case of a further increase of the demand for credit, probably part of that demand will be satisfied by the creation of bills, accepted by bankers or acceptance houses, and their sale to institutional investors and business firms with liquid reserves. As buying bills implicates either selling Treasury securities or reducing bank balances, the monetary consequences of this move would be about the same as if the finance has been provided by an extension of bank advances.