

# The Operation of Australian Central Bank Controls

by

J. S. G. WILSON

## I.

A fully-fledged central bank is a comparatively recent innovation in Australia, though an institution performing certain of the accepted central bank functions has indeed existed for over twenty years. The Commonwealth Bank of Australia was first set up under an Act of 1911, but initially it was nothing more than a government-owned trading bank, which after 1913 held the Federal Government's accounts and which also carried on a savings bank business. It is true that there were some among its wellwishers who hoped that it might become a «bank of issue and reserve» but there was no specific provision for this in its original constitution. During World War I, as a result of being both the Government's banker and the agent of Commonwealth Treasury in loan matters, the Bank grew in stature and influence and had already begun its evolution towards central banking status. However, apart from the largely abortive attempt of 1924 to convert it into a central institution on the Bank of England model, matters rested there until 1929, when depression conditions obliged the Commonwealth Bank, almost against its will, to take charge of both the credit situation and the exchange rate. Nevertheless, and even in these circumstances, relations between the Commonwealth Bank and the privately-owned trading banks were such as to preclude anything more than the most tentative guidance in matters of credit policy and interest rates. Undoubtedly, the investigations of a Royal Commission, which reported in 1937, helped to clear the air, but nothing material was done, prior to the outbreak of World War II, to implement its recommendations. There was, in short, much opposition to the concept of a central institut-

ion strong enough to impose a monetary policy other than that favoured by the banking community as a whole. If the Commonwealth Bank was to fulfil its responsibilities as a central bank, some addition to its powers was essential.

The advent of World War II considerably hastened its development towards this goal. During the first two years of war, the emphasis continued to be on central bank leadership and trading bank co-operation, but as the inflationary dangers became more real, Government opinion came to favour «a thorough scheme to curb unnecessary monetary expansion». After much discussion, and not without some threat of compulsion, a «voluntary agreement» to accept Commonwealth Bank controls was extracted from the trading banks. However, before this agreement could be implemented, the Government was defeated and the succeeding Labour Government decided to gazette the Wartime Banking Control Regulations of November, 1941. These required the trading banks *inter alia* to comply with the advance policy laid down by the Commonwealth Bank from time to time; to secure the prior consent of the Commonwealth Bank before acquiring securities for investment purposes; and to lodge such part of their «surplus investible funds» as the Commonwealth Bank might direct in Special Accounts held with the Bank. A nominal rate of interest was paid on these deposits, and withdrawals might only be made at the discretion of the central bank. Interest rates were likewise controlled, but under the Economic Organization Regulations. All these provisions were incorporated, substantially unchanged, in the banking legislation of 1945 and thus formed the basis of the central bank controls in operation today.

## II.

Briefly, the banking legislation of 1945 (1) had three main purposes:

(i) to regularise the relations of the Commonwealth Bank with the government of the day;

(ii) to continue and extend its trading activities; and

(iii) to strengthen it as a central bank.

Thus, specific provision was now made in the new *Commonwealth Bank Act* for possible differences of opinion between the Government and the Bank on questions of policy, such that the Government assumed ultimate responsibility for policy and, in the event of a disagreement which could not be resolved by discussion, the Bank was obliged to give effect to the Government's policy. Under an amending Act of 1951, however, the Commonwealth Treasurer was obliged on such occasions of disagreement to bring the relevant papers to the notice of each House of Parliament. At the same time, the Commonwealth Bank Board, which had been abolished in favour of an «Advisory Council» in 1945, was reinstated as a means of assisting the Governor in the management of the Bank. The new Board consists of ten members with the Bank Governor as Chairman and the Deputy Governor as Deputy Chairman. The Secretary to the Treasury is a member but of the seven others at least five must not be officers of the Bank nor of the Commonwealth Public Service. In the result, several members of the former Advisory Council were reappointed and, of the non-official members chief emphasis was placed on representatives of the primary industries. The manufacturing industries were directly represented by only one member and the trade unions not at all.

In view of the broader purposes of the 1945 legislation, the proposal to expand the Commonwealth Bank's commercial activities in active competition with the trading banks (previously the competition had been passive) may appear somewhat surprising. The Commonwealth Savings Bank, the Rural Credits

(1) There were, in fact, two cognate measures — the *Commonwealth Bank Act* 1945 and the *Banking Act* 1945.

Department, and the Mortgage Bank Department (set up in 1943) were all continued in existence and additional provision was made to provide finance to assist in the development of small industries through an Industrial Finance Department, together with arrangements for housing loans on *crédit foncier* terms. It is indeed unusual for a central bank to engage in large-scale trading activities, but there are two aspects of this decision which deserve to be borne in mind. First, the Commonwealth Bank was the creation of a Labour (*i.e.*, Socialist) Government, which had thought to break a private banking monopoly by setting up a Government-owned trading bank and the Labour Government of 1945 undoubtedly shared that tradition. Hence, under the new legislation, it was laid down that the Commonwealth Bank, through its general banking division, «shall not refuse to conduct banking business for any person, by reason only of the fact that to conduct that business would have the effect of taking away business from another bank». Second, and apart from important advantages in staffing the trading and central bank sections of the Bank, it has sometimes been argued in Australia (*e.g.*, by the Royal Commission, which reported in 1937) that Commonwealth Bank competition with the trading banks is a useful supplement to its central banking powers. One might think that latterly (with the considerable extension of powers which took place in 1941) this argument would have lost much of its force, but chief emphasis seems to be placed now on the possibility of direct credit expansion through the Bank's trading departments in times of recession. In the event of a clash between its trading interests and central bank responsibilities, the Bank would presumably be bound to place national considerations above those of immediate profit. Indeed, there are already signs that this philosophy is gaining strength within the Bank itself. It may yet be maintained that this is not an easy task the Bank has set itself, since it would seem that a central bank must lose something in objectivity when it is a question of deciding advance policy for one or other of its own trading departments. In theory, it may be argued that the system should work as well

here as outside, but, in practice, it rarely does. For the rest, the Bank would maintain the view that the fields in which it has expanded its activities most — industrial finance and housing loans — are those which were previously catered for somewhat inadequately and that the case for an expansion of these facilities was therefore strong. Whatever the arguments, there can be little doubt that the provision of additional facilities during a period of inflationary strain (such as that which has obtained during the postwar period) appears to operate against the damping process which has been the purpose of central bank controls. In addition, the trading banks naturally resent what they regard as the privileged competitive position of the trading sections of the Commonwealth Bank and, in particular, the fact that the special account procedure (referred to below) is not applied by the Bank to its own trading departments. It is this which militates against the wholehearted co-operation of the trading banks in implementing central bank credit policy. That so much has nevertheless been achieved says much for the good sense of both sides. It cannot be wholly ascribed to the existence of powers of compulsion, since no central banking system can survive on that basis alone.

The most effective arguments put forward by the Labour Government in 1945 to support the view that the Commonwealth Bank should be permanently strengthened as a central bank, while at the same time serving as an instrument of Government financial policy, were drawn from the history of the Bank during the years of depression during the 'thirties. The Commonwealth Treasurer in introducing his legislation recalled that «the necessities of the economic situation in Australia (in 1929-33) produced a central bank. But it did not fully measure up to its responsibilities», and he quoted the Royal Commission's opinion that certain extensions of the powers and functions of the Bank were required to enable it to carry out those responsibilities. The first step was to embody in the *Commonwealth Bank Act* a formal recognition of the Commonwealth Bank as central bank. Previously, it had come to act as such in fact, but had not been granted the status by law. However, this

alone would scarcely have constituted a material change. Permanent powers to control credit conditions, which were the essence of the matter, were therefore incorporated in a cognate measure — the *Banking Act 1945* — the primary objective of which was to continue in operation the wartime controls over the trading banks. In addition, there were a number of general provisions requiring banking institutions to be licensed, permitting the Commonwealth Bank to obtain information regarding the financial stability of a trading bank, and giving the central bank powers of investigation and active control of the affairs of a trading bank at its discretion. It is, however, with the operation of the credit controls that we are more particularly concerned.

### III.

Nowadays, the regulation of the volume of credit in order to assist in the damping of business fluctuations is a generally recognised function of any central bank and the case for it scarcely needs to be argued. Where differences of opinion and of practice arise is in the field of technique. In other words, how — given its particular environment — can a central bank most effectively control the availability of trading bank cash, which is the basis of bank lending? Australia developed her own technique of immobilizing increases in trading bank cash reserves during the war years and it was now proposed to continue this control (under the terms of the *Banking Act 1945*), so that the wartime accumulation of bank funds could not be used as the basis of an inflationary postwar expansion of trading bank advances and investments.

Under the Act, the Commonwealth Bank was now empowered to require each trading bank to lodge in Special Account such sums as the central bank might consider to be necessary in the light of current credit conditions. However, as an upper limit, the Commonwealth Bank might not require the lodgment of an amount, which would cause the balance in a bank's Special Account to exceed the amounts transferred from its wartime Special Account plus any increase in that bank's assets

following the commencement of the appropriate provisions of the *Banking Act 1945*. Withdrawals from these special accounts might be permitted, though possibly subject to conditions, and, in point of fact, substantial withdrawals have already been allowed under these provisions (e.g., during the latter part of 1947, again in mid-1949, and end-1951 to early 1952) «to meet the liquidity requirements of the banks». Interest is paid to each bank semi-annually on the daily balance of its Special Account at a rate not exceeding 17/6d. per cent per annum (2), to be determined from time to time by the Commonwealth Bank, with the approval of the Federal Treasurer.

After the war, it was realised that the re-establishment and expansion of peacetime industry would require some increase in bank advances, which had fallen from 91.7 per cent (as a ratio to total deposits) in June, 1939 to 35.7 per cent in June, 1945 and that it would be necessary to leave sufficient liquid funds with the banking system for the purpose. Accordingly, for the three years to July, 1948, only about 45 per cent of the increase in trading bank assets was, in fact, called to Special Account and by June, 1948 the advance-deposit ratio had climbed to 48.7 per cent. At the same time, the ratio of special accounts to deposits was reduced slightly from 41.5 per cent to 40.9 per cent, though this relative stability was perfectly consistent with the rise in the advance-deposit ratio, provided there were compensating changes elsewhere in the balance sheet position of the banks. We must therefore look to the other main asset item — holdings of Government securities. At the end of the war, the banks held quite substantial amounts of Government securities — as a ratio to deposits, Treasury bills stood at 8 per cent and other Public Securities at 17.9 per cent in June, 1945 — a large part of which had been bought during the war years at a time when advances were falling. By limiting the releases it was prepared to make from Special Account, the central bank could force the trading banks to meet a large part of their increased demand for liquid resources by selling Government securities and, as advances

began to increase rapidly after 1945, this was insisted upon. The Treasury bill ratio was reduced to 1.4 per cent by June 1949, though it subsequently recovered to 2.7 per cent in 1951, while the ratio of other Public Securities, which had reached a peak of 19.6 per cent in June, 1946 had fallen to 7.5 per cent by 1951.

But the rate of growth of advances of the different banks was very uneven and, even by mid-1947 (when the overall ratio of other Public Securities was still 12.4 per cent), the security holdings of certain banks had already been reduced to a low level. This development was followed by requests to the central bank for releases from their special accounts. However, the central bank took the view that any further relaxation to enable the banks to continue a rapid expansion of advances would have defeated the purpose for which the special account procedure had been instituted. This tightening up was reflected both in a fall in the advance-deposit ratio to 41.1 per cent in June, 1951 and a rise in the special accounts ratio to 46.0 per cent in the same month, though increases in the liquid resources of the community as a whole (the result of high wool prices) and the consciously conservative policy of two of the leading banks (the Bank of New South Wales and the Commercial Banking Company of Sydney) would also have been partly responsible.

At the same time, it was appreciated that to have forced these banks into a situation in which they could not have met the new requirements of their customers would have been too drastic. It was also recognised that credit controls must be administered with reasonable flexibility. It was realised, first, that «current demands on a bank for advances are frequently the result of decisions made many months earlier, so that a change in policy takes a considerable period to become fully effective»; and, second, that «a rigid limitation of funds may involve the refusal of legitimate finance for an eminently desirable purpose». Instead of permitting further releases from special account (upon which the trading banks were allowed ½ per cent per annum), flexibility was provided by granting to the banks in question short period central bank loans

(2) That is, 7/8 per cent.

at a rate of  $3\frac{1}{2}$  per cent per annum, which placed these banks on the same footing as those which were still able to sell Government securities, though these new arrangements were primarily designed to discourage any tendency for the banks to rely on this source of finance. The intention was merely to provide a breathing space, such that these banks could continue to meet the essential requirements of their customers while adjustments in their advance policy were being effected. It was emphasised that central bank loans were intended as a strictly temporary source of finance for the sole purpose of providing «an essential element of flexibility» but that it would be «normal policy to provide for the growing requirements of the economy for finance by releases from special account on a scale sufficient to support an appropriate level of bank investments», and the banks would be expected to adjust their operations over a period to conform with this general level. For the formulation of this policy, the central bank (in conjunction with the Commonwealth Treasury) was, of course, fully responsible, but it has become the practice to consult with the trading banks before making major policy changes, and co-operation appears to have been close even when the trading banks have disagreed with the details of the control.

Latterly, the Commonwealth Bank seems to have adopted the so-called SACT ratio (*i.e.*, the combined total of Special Accounts, Cash, and Treasury bills as a ratio to deposits) as a rough working rule in determining what proportion of the increase in deposits should be called to Special Account. There is some evidence to suggest that this ratio was gradually raised to about 50 per cent, at which figure the Bank has sought stability for the system as a whole. In the result, some part of the increase in trading bank deposits has been left free. However, the ratio has, on occasion, been allowed to vary as between banks (in the event of their having special commitments) and the chief complaint has related to the uncertainty of Commonwealth Bank action. It is understood that this is now being overcome by means of conferences with the trading banks.

Another continuation of wartime powers

under the 1945 legislation related to the direction of lending. Where the Commonwealth Bank is satisfied that it is necessary or expedient to do so in the public interest, it may determine the policy to be followed by the trading banks in relation to advances and the Commonwealth Bank may give directions, with which each bank must comply, as to the classes of purposes for which trading bank advances may or may not be made. However, the Commonwealth Bank may not «make any determination or give any direction with respect to an advance made, or proposed to be made, to any particular person». This control over the direction of lending was regarded not only as an essential continuing power in the postwar transition period but also the means of checking an unbalanced expansion of credit resulting in sectional inflation and distortions in the structure of production. Supplementing this power to control the direction in which credit was granted, the Commonwealth Bank was also required to control other forms of trading bank investment. Thus, except with the consent in writing of the Commonwealth Bank, a trading bank may not purchase or subscribe to securities of the Commonwealth or of a State, the securities of any local governing body in Australia, or securities listed on the stock exchange.

In accordance with these responsibilities (and again following the precedents of the war years), the Commonwealth Bank has issued to the trading banks from time to time «policy directions relating to advances in various classes and for various purposes». These advices have been reviewed on frequent occasions, in the light of current economic conditions and the experiences of the banks in carrying out the policy required. In general terms, this has been «designed to ensure that bank finance available was used for the most important purposes and that advance policy did not add unnecessarily to the existing inflationary pressure on resources. In particular, it emphasised that long-term capital for development and new enterprises should be obtained as far as practicable from outside the banking system, that the inflation of capital values should not be encouraged by lending on optimistic valuat-

ions, that current expenditure beyond current income should not be facilitated, and that primary producers should be encouraged to take advantage of their currently high incomes to increase their equities in their properties by the reduction of their overdrafts and other debts». Within this broad framework, credit policy has been made increasingly selective in an attempt to curb the rising inflationary pressure.

In May, 1949, and again in November, 1950, when advance policy was under review, changes were only made after detailed consultation with the trading banks. The central bank continued to be «solely and fully responsible for the content of this policy», but it was felt that «such consultation can ensure that the wide contacts and detailed experience of trading banks play their appropriate part in the formulation of policy in relation to the distribution of credit». In addition, the central bank decided, though not without some hesitation, to make its advance policy public. «The Bank is anxious that its policy in matters of such concern to the community should be widely known and understood. There is, however, a danger that publication may lead to undue importance being attached to changes and thus militate against flexibility in a policy which must be sensitively adjusted to changing economic conditions». One can appreciate the reasons for this hesitancy, yet it would seem that by taking the public into its confidence a central bank stands to gain more than it could lose and this experiment in publicity is to be commended.

On the question of interest rates, it was the Government's view that their control would be just as important in the postwar period as during the war years and that a low rate of interest would encourage the maintenance of a high level of economic activity and employment. For this reason, the Commonwealth Bank was empowered, subject to the Treasurer's approval, to make regulations to control rates of interest payable to or by banks, or to or by persons in the course of any banking business carried on by them, or rates of discount chargeable by banks or by other persons in the course of any banking business carried on by them. Regulations may also be

made providing that no interest is to be paid on demand deposits (except savings bank deposits and then only up to a certain specified amount).

Initially, however, the wartime control arrangements were continued and maximum rates of interest were fixed by the Commonwealth Bank under the Economic Organization Regulations (under which the first Order had been made in March, 1942), presumably because these could be applied to a wider range of rates than regulations under the Banking Act 1945. During the war years, there had been a persistent downward pressure on interest rates. This policy was continued postwar and they reached their lowest level in December, 1946, when the trading banks' overdraft rate was reduced to  $4\frac{1}{2}$  per cent and rates on fixed deposits were similarly lowered to levels which varied from  $\frac{1}{2}$  per cent for those with a maturity of 6 months to  $1\frac{1}{2}$  per cent for 24 months, though for amounts in excess of £A 10,000 the latter rate was reduced to 1 per cent per annum, the rate also applicable to 12 months deposits. Savings bank rates were fixed at 2 to  $2\frac{1}{4}$  per cent for the first £A 500, with 1 to  $1\frac{1}{4}$  per cent on the remainder of a deposit up to £A 1,000. There has been no postwar increase as yet in Australian trading bank overdraft or deposit rates, but there has been something of a break in the cheap money policy elsewhere in the interest rate structure. For example, at its meeting in August, 1951, the Australian Loan Council (which is a body consisting of representatives of the Commonwealth and State Governments, and of the Commonwealth Bank, with responsibility for co-ordinating governmental borrowing requirements) decided to raise the interest rate on new Government loans from  $3\frac{1}{8}$  per cent to  $3\frac{3}{4}$  per cent. This was followed by an announcement by the Federal Treasurer that as from September, 1951 the maximum rate at which loans might be made to semi-governmental and local authorities would be raised from  $3\frac{1}{2}$  per cent for State Government-guaranteed loans and  $3\frac{5}{8}$  per cent for non-guaranteed loans to an over-all  $4\frac{1}{8}$  per cent. The maximum rate on loans raised by building societies guaranteed by State Governments

was increased at the same time from 3 7/8 per cent to 4 1/2 per cent. Whether these changes constitute the first steps in a general move towards dearer money, it is difficult to say, but they may at least be read as a partial confession by the Government that its low rate policy has only served to accentuate the existing inflationary pressures and that stronger measures are now needed.

#### IV.

In addition to credit controls, it is necessary to consider the present legislative arrangements for the mobilisation of overseas funds. The Royal Commission on Banking had felt it to be desirable that the Commonwealth Bank be provided with sufficient overseas funds not merely to provide for the debt service of Australian Governments in respect of loans raised abroad but also to assist the central bank in the performance of its necessary functions. That was in 1937. Before their recommendations could be acted upon, however, the proximity of war necessitated the imposition of exchange control. The Government hoped that after the postwar « transition period » was over this control would no longer be necessary, but because overseas resources may not always be sufficient to meet normal exchange requirements it nevertheless provided in the *Banking Act 1945* for the future use of exchange control in the event of an emergency. Under more normal conditions, it was anticipated that less stringent arrangements would suffice and the Act therefore also empowered the Commonwealth Bank to buy whatever proportion it might need of any foreign currency which the trading banks accumulated abroad as a result of their Australian business after the commencement of the Act. In exercising this right, however, the Commonwealth Bank would be required to take the same proportion from each bank and to make allowance for any blocked balances which the banks might hold. The price at which transactions in sterling were to be effected was to be a matter for agreement between the Commonwealth Bank and the trading banks or, in default of agreement, as

determined in an action for compensation. Special provisions ensured that the trading banks would have sufficient foreign currency available to meet all their normal business requirements. The gold provisions in the Act were similar to those which were operated during the war years. Thus, the consent of the Commonwealth Bank might be required for the taking or sending of gold out of Australia and any person who has gold in his possession or under his control might be required to deliver it to the Commonwealth Bank or to some other prescribed authority such as a Mint. Naturally, provision was made for the use of gold for professional or trade purposes. The Commonwealth Bank was to pay for gold delivered to it at a price fixed and published by itself, though the seller could (if dissatisfied) have the price determined in an action for compensation against the Commonwealth Bank. Since these provisions might not be required as a permanent feature of central bank control, they might be brought into operation (or suspended) wholly or in part by proclamation. However, so far during the postwar period, exchange control has had to be continued and it has been operated along the lines developed during the war, with such changes in emphasis as have been dictated from time to time by the current position of sterling (to which the Australian pound is linked).

#### V.

It will be apparent that under the 1945 legislation, the Commonwealth Bank has been given a wide range of powers to control the supply and distribution of bank credit in Australia, together with the related foreign exchange position, though the high level of liquidity inherited from the war years and the subsequent import of inflationary influences from abroad (as a result of high export prices) has necessarily qualified the completeness of the control to date. Furthermore, the maintenance of cheap money during the early postwar period must have accentuated the impact of inflation, despite the tightness of the controls operated by the central bank.

It would be unfair, however, to leave

matters there and it is advisable to discuss in addition the reactions of the trading banks themselves to the form of credit control adopted. The feeling amongst trading bankers in Australia is that the powers accorded the central bank in 1945 were too wide. This nervousness was undoubtedly accentuated by the unsuccessful attempt to nationalise the private trading banks in 1947 and which was only finally scotched — on constitutional grounds — in 1949. Trading bankers have also been extremely critical of the *operation* of credit control during the postwar years. Not all of these criticisms have perhaps been entirely fair, but at least they should be brought to the reader's attention. For example, trading bankers have argued that the fault lies with the emphasis on compulsion, which has hindered the development of « classical » central bank techniques. They allow that Australian conditions impose severe limitations upon the use of such techniques and that, despite the marked growth in the magnitude and quality of the bond market in recent years, open market operations on the scale that would be required to prevent a secondary credit expansion based on a substantial initial change in cash reserves would be impracticable. The more open-minded of them would agree that the central bank should be equipped with reserve compulsive powers, but even so they doubt whether these should be exercised at any time on the basis of a month by month control. They claim that there is a danger that the existing controls will tend to promote rigidity, particularly as the several banks differ widely in the structure of their business and their policies of development. More specifically, the tendency to confuse « monetary » with « profit » control is deprecated. This is said to introduce an element of uncertainty and to militate against smooth operation. There may well be something in this view, yet it could still be argued that sometimes the most effective way of implementing particular types of action is to exert an influence on profits. In any case, the Commonwealth Bank has not been concerned merely to hold profits within a ceiling. There have been times when it has facilitated adjustments in the distribution of trading bank

earning assets in order to prevent profits from falling. In other words, a floor has also been implicit in its policy. Again, the control over trading bank investment in Government securities is regarded as both unnecessary and unwise, since it hinders the natural development of the market and impairs the banks' second line reserve of liquid assets. The trading banks also doubt whether qualitative control through advance directives can be operated effectively in practice. Quite apart from the difficulty of defining the purpose of an advance, it is objected that decisions of this kind are taken outside the market and that the costs of misjudgment may be heavy. The criticism is not apparently of the need for guidance of a general character, but the reduction of directives to « formal » and detailed terms.

However, it may be that too much importance has been attached to this charge of « over-formalisation ». It could be argued that an advance policy stated in more general terms would fail to provide any true guidance at all and there is something to be said for specific guidance in chosen matters. Nor should it be forgotten that the interpretation of policy is very largely the responsibility of the trading banks themselves. They may, of course, ask the Commonwealth Bank for advice and, in certain cases, must, but the degree of compulsion is not unduly burdensome. Indeed, co-operation in implementing a general policy comes nearer the aim of the central bank. There is, nevertheless, one consequence of the control over advances which genuinely worries the trading bankers. During the course of the postwar inflation, the central bank has requested the adoption of an increasingly selective advance policy. In particular, it felt that finance for capital expenditure and permanent non-fluctuating working requirements should be obtained from outside the banking system. Trading bankers have argued that, if this policy is persisted in for any length of time, it will seriously weaken central bank control, besides encouraging greater credit instability in time of recession. The trend towards split borrowing by business firms from banks, other financial institutions, and private persons is already noticeable and, in this way,

the insurance companies, for example, have increased their business loans considerably. In a certain sense, they have become «bankers». Yet they are not subject to central bank control (3). Naturally, the trading banker resents this loss of business, especially when he feels that little has been gained in any overall sense.

## VI.

What, on a balance of considerations, should our final judgment be? It must be recognised that banking today is an activity so vital to the welfare of the community that, in the view of many writers, effective control is not possible without wide powers. Moreover, it has been argued that in Australia the method of control adopted is eminently suited to local conditions, since the narrowness of the security market (despite its expansion since 1939) and the relative immaturity of financial institutions do not permit the effective use of the more sophisticated methods of credit control worked out for the more mature economies and banking systems of the United Kingdom and the United States. Thus, open market operations have been little used in Australia as a means of influencing the cash base (the primary purpose of such activity in this instance has been the conditioning of Government security prices) and there is no mechanism, such as the London Money Market, through the delicate operation of which it is possible to implement changes in the structure of interest rates. In these circumstances, central bank leadership was likely to be slow and difficult and the forces of tradition less persuasive than powers of compulsion. Furthermore, the vulnerability of Australia as an open economy may now be safeguarded to a certain extent by appropriate central bank action. Australian prosperity has always been dependent on conditions overseas and it was hoped to overcome some of the disadvantages of this position by resorting to

central bank measures designed to cushion Australia's domestic economy against the impact of external shocks.

Postwar experience would suggest, however, that much has yet to be learnt before it will be possible to control adequately the types of inflationary pressure which have affected the Australian economy in recent years. It is true that some of the most powerful factors have been very largely outside domestic control. Until the recent check in wool prices, export incomes had risen progressively. Recurrent rumours that the Australian pound was about to be revalued prompted importers to delay payments and overseas buyers of Australian exports either to pay in advance or to transfer funds to Australia in anticipation of early purchases. In addition, there was the movement of a certain amount of «hot money» to Australia as a pure speculation. Further, there has been a heavy capital inflow since the end of World War II for permanent investment in Australian industry. All this has meant considerable additions to Australia's overseas funds and a consequent appreciable net increase in the liquid assets and deposits of the banking system. This presented the central bank with a formidable problem, complicated still more by the Government's insistence on an ambitious policy of immigration and development. Without the operation of credit control, the situation must have been much worse. Nevertheless, Australian experience has served to underline the limitations of credit policy in an open economy and must qualify considerably the faith placed in the 1945 legislation. So much for the control of inflation. With recent falls in wool prices and an extravagant expenditure of overseas earnings, Australia's sterling balances have slumped heavily and tighter credit conditions may soon obtain, but the handling of such a situation is unlikely to prove as difficult, since the Commonwealth Bank seems to be quite well armed to deal with the perils of deflation. Yet the coming months may well provide the Bank with its first opportunity to test the efficacy of the resources available to fight recession. Again, one must expect that the results will be qualified by the operation of external factors.

(3) They have been subject to the Capital Issues Control, though this may appear to have less permanence than controls operated by the central bank. The Capital Issues Control has already been discontinued once since the war and had to be reimposed.